No. 15-55809

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

JOYCE WALKER, KIM BRUCE HOWLETT, AND MURIEL SPOONER,
Plaintiffs-Appellants,

v.

LIFE INSURANCE COMPANY OF THE SOUTHWEST,
Defendant-Appellee.

On Appeal from the United States District Court for the Central District of California, No. 10-cv-09198-JVS(RNBx) (Honorable James V. Selna)

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CORPORATE DISCLOSURE STATEMENT

Defendant-Appellee Life Insurance Company of the Southwest ("LSW") states that National Life Insurance Company is the immediate parent of LSW, NLV Financial Corporation is the immediate parent company of National Life Insurance Company, and National Life Holding Company is the immediate parent company of NLV Financial Corporation. No publicly held corporation owns 10% or more of LSW's stock.

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INTRODUCTION

This case concerns two indexed universal life insurance ("IUL") policies that Life Insurance Company of the Southwest ("LSW") issued. These policies offered industry-standard features providing policyholders with some S&P 500 exposure while, among other benefits, protecting against negative returns. Plaintiffs purchased those policies and, after experiencing unrelated financial difficulties, could or would not pay further premiums and sought a "loophole" (to use their language) to get their money back. Plaintiffs' allegations that the policies are defective and were misrepresented are failed attempts to create that loophole.

After a class trial of almost three weeks, a jury returned a defense verdict on Plaintiffs' fraud claims in under three hours. The court then entered findings, holding on numerous independent grounds that Plaintiffs failed to prove a violation of California's Unfair Competition Law ("UCL"). The court found that Plaintiffs failed to prove any product defect, and several additional elements of their claims.

Of particular significance, the court found the testimony of Plaintiffs' expert, Dr. Patrick Brockett, inadmissible, not credible, irrelevant, and unpersuasive following Brockett's own admission that testimony he gave was "certainly misleading." The court also found that Brockett relied on unrepresentative samples and ignored other obvious problems, including that a policy lapses only if a policyholder chooses not to fund it.

The court's findings are robust and well-supported. Plaintiffs' appeal reveals no legal error or clear error of fact.

JURISDICTIONAL STATEMENT

Defendant agrees with Plaintiffs' statement.

STANDARD OF REVIEW

Defendant disagrees with Plaintiffs in one respect. A mixed question of fact and law arises only when "the historical facts are established; the rule of law is undisputed" and "the issue is whether the facts satisfy the legal rule." *In re Bammer*, 131 F.3d 788, 792 (9th Cir. 1997). A mixed question is generally reviewed de novo, unless it is "essentially factual" or factual questions predominate, in which case it is reviewed for clear error. *Tolbert v. Page*, 182 F.3d 677, 681-682 (9th Cir. 1999). In reviewing for clear error, this Court does not second-guess the trial court's "choice between" "permissible views of the evidence." *Anderson v. City of Bessemer City*, 470 U.S. 564, 574 (1985).

STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Should this Court affirm the judgment for LSW on the class claims where: (i) Plaintiffs failed to prove that an undisclosed defect exists; (ii) Plaintiffs failed to present class-wide evidence of omission; (iii) Plaintiffs do not appeal additional dispositive findings; (iv) the court rightly concluded that the California

Insurance Code prohibits disclosures Plaintiffs proposed; and (v) the court properly excluded certain evidence as irrelevant and a waste of time?

2. Should this Court affirm the judgment for LSW on Plaintiffs' individual claims where: (i) the finding that the allegedly omitted information was actually disclosed is not clearly erroneous (and indeed, plainly correct); (ii) Plaintiffs failed to prove that a bait-and-switch occurred; and (iii) the court properly exercised its discretion to decertify a subclass because individualized issues predominated?

3. Should this Court affirm dismissal of Plaintiffs' UCL claim asserting violation of Cal. Ins. Code §§ 10509.950 *et seq.* because the statute bars private enforcement and existing findings render any error harmless?

STATEMENT OF THE CASE

I. LSW AND ITS POLICIES

This case concerns two IUL policies, SecurePlus Provider ("Provider") and SecurePlus Paragon ("Paragon" and, collectively, "the Policies"), which LSW issued after extensive review and approval by the California Department of Insurance. ER791 12:12-18.

A. IUL Policy Features

Paragon and Provider features, which are similar to other companies' IUL policies, *id.* 14:23-15:6, include:

Flexible Premiums: The policyholder chooses the amounts and timing of premiums. ER820 24:4-8.

Cash Value: The Policies maintain cash value that policyholders can use, for example, to pay policy costs, withdraw funds, or support loans. ER791 15:8-12, 22:2-12. Cash value accumulates based on the policyholder's chosen strategy: A "fixed" strategy uses a fixed interest rate, while various "indexed" strategies accumulate interest based partially on S&P 500 performance. *Id.* 15:19-16:9. Some indexed strategies have a yearly return cap. *Id.* 16:19-24. All strategies guarantee a yearly floor of zero. *Id.* 16:25-17:7. Thus, indexed strategies are not intended to mirror market performance. *Id.* 17:8-17.[1]

Guaranteed Interest: The Policies offer guaranteed interest accumulation whereby LSW, "retrospectively on a look-back basis," credits minimum interest of 2% for Provider and 2.5% for Paragon. *Id.* 19:5-10. Retrospective calculation is industry standard. ER791 19:21-23; ER802 99:3-6.

Policy Loans: Policyholders may take policy loans. ER791 22:7-12. Taxation of loan proceeds is deferred while the policy stays in force. *Id.* 22:25-23:5. If the insured dies with the policy in force, loan proceeds are never taxed.

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[1] LSW invests in financial instruments offering returns replicating payable credits in any market conditions. ER791 17:22-18:2. Thus, LSW is indifferent to market performance—LSW does not attempt to predict the market, and does not seek to profit from a spread between policy credits and its own return. ER802 162:5-15.

ER805 151:21-152:11. These tax benefits and their limitations (common to insurance policies) are well-known. ER791 23:11-13; ER805 149:12-150:4.

Policy Costs: The Policies charge industry-standard costs, including a premium expense charge, monthly cost of insurance charge, monthly administrative charge ("MAC"), monthly policy fee, and (for Paragon) monthly percent of accumulated value charge. ER791 20:21-25. The policies define maximum costs, but LSW voluntarily charges less. *Id.* 21:4-11.[2]

Policy Termination: A policyholder may cancel a policy free-of-charge during a free-look period. *Id*. 23:16-20. Thereafter, a policyholder may elect surrender and receive the surrender value. *Id.* 23:20-24:2. A policy may lapse if a policyholder "chooses not to make premium payments sufficient to cover the charges and fees in his or her policy" and the surrender value of the policy reaches zero. *Id.* 25:1-17. "[T]he only way that [the Policies] may lapse is if a policyholder stops paying sufficient premiums to cover the charges and fees, or takes too much out of the policy in loans and withdrawals." *Id.* 25:12-15.

B. The Sales Process And Illustrations

The Policies are "sold by independent life insurance agents, who are not employees of National Life or LSW." *Id.* 26:19-20. Because LSW's goal is to "lead the insurance industry in its disclosure and explanation of all of the policies'

[2] Plaintiffs assert that the "fees are enormous," Br.13, but there is no such finding, and no evidence comparing the costs to any benchmark.

features," *id.* 28:1-5, LSW invested "substantial time and resources" in training agents to ensure they "understand any insurance policies they sell and can fully describe them to potential customers." *Id.* 12:19-13:13.

Plaintiffs' allegations centered on how agents sell the Policies, and specifically on one scenario (Current Basis B) depicted in sales illustrations. Purchasers sometimes review and discuss with their agents one or more customized sales illustrations. These illustrations are heavily-regulated and are "not meant to replace the policy contract or contain all of the details of a policy, but provide a brief summary that demonstrates the mechanics of [the Policies] with certain, specified '*what-if* scenarios.'" ER791 28:10-16 (emphasis added).

While Plaintiffs focus on only one scenario, sales illustrations included three: Guaranteed, Current Basis A, and Current Basis B.[3] The Guaranteed scenario reflects "the low end," using maximum charges and minimum guaranteed

[3] Plaintiffs wrongly assert (Br.13-14) that LSW admitted the Guaranteed values were statistically impossible, citing discussions by LSW employees about potential costs of the guarantees *to LSW*. TX221; ER811 200:1-201:1; ER735-2 166:11-168:4. While one LSW employee testified he believed there was little likelihood that LSW would have to pay Guaranteed interest, that was because the market had historically performed *better* than the guarantees. ER735-2 167:10-20; TX221. There is no evidence that any policyholder ever experienced performance less favorable than an illustrated Guaranteed scenario. ER791 21:6-11, 29:11-25.

growth. *Id*. 29:13-15.[4] Current Basis B is the highest-return scenario, reflecting accumulation at a hypothetical rate each policyholder and agent choose. *Id.* 29:15-17.[5] California law requires the inclusion of only the Guaranteed and Current Basis B scenarios, but LSW voluntarily includes a third, middle scenario (Current Basis A) "to disclose to policyholders what might happen if the stock market does not perform as well as reflected in Current Basis B." ER791 30:21-31:2; ER802 66:8-69:10.

Sales illustrations may be further customized by assuming future loans and premiums. ER791 31:9-10. By default, no loans are assumed, and the "majority of illustrations received by policyholders in this litigation did not reflect loans." *Id.* 31:10-12.

The illustrated scenarios show potential returns "net of all charges and fees…so they represent the bottom-line numbers that a policyholder would get in each of the respective scenarios." *Id.* 31:5-8. That the illustration does not always separately itemize each fee does not mean agents do not address those fees. LSW trains agents "to explain all charges and fees associated with the policies, and tells

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[4] Plaintiffs assert that the returns in the Guaranteed scenario are "false" based on their assertions about lapse probability. Br.15. But the court discredited the expert testimony upon which this assertion rests. *Infra* pp. 22-26.

[5] Plaintiffs assert that Current Basis B is "derived from the historical performance of the S&P 500." Br.9. In fact, that is the *maximum* that *can be* assumed and illustrated. ER791 30:11-18.

agents that they should generate…additional reports if their clients desire additional detail." ER791 31:20-23.[6] The first few pages of each policy contract also include detailed information about each associated charge. *Id*. 20:25-21:3.

Policyholders who receive a sales illustration with attributes identical to the policy for which they applied must sign and submit that illustration with their application. Illustrations, however, need not be used during the sale process. If a policyholder receives no sales illustration, or if the illustration differs from the issued policy, LSW provides a "batch" illustration of the issued policy, which the policyholder must then read and sign.[7]

Sales and batch illustrations are not "largely identical," as Plaintiffs assert. Br.11. The court found "[b]atch illustrations often differ from sales illustrations in important ways," including that batch illustrations do not include loans and reflect "a funding pattern that Plaintiffs' expert admitted would prevent the policies from ever lapsing." ER791 32:19-33:4.

Trial evidence showed that the sales process is highly individualized. The record contradicts any assertion (Br.7-9) that LSW's Policies were sold through

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[6] A cost report "can be easily added with one click by using a drop-down menu on the illustration software." ER791 31:17-20.

[7] A sales illustration may not match the issued policy if, for example, as was the case for Howlett, the policyholder's age changes between the illustration date and the date the policy is issued, or the issued policy has a different underwriting category.

one-size-fits-all marketing (*e.g.*, "tax free retirement"), or a single "standardized" document. The court explained:

> There were no sales scripts. Instead, the policies were sold by tens of thousands of agents who had at their disposal any of thousands of marketing pieces for use. … [E]ach sale is like a snowflake. In particular, [the Policies] offer a number of different benefits within one product, including death benefit protection, premium flexibility, cash value accumulation, income potential for retirement or any other purpose. No two customers are alike, and each consumer will have his or her own reasons and purposes for deciding to purchase a Provider or Paragon policy. LSW trains agents to explain what the indexed strategies are and how they work, so that the client understands the index crediting strategies. LSW also trains agents to work together with the client to understand the client's unique needs. During the course of any given sale, an agent will meet with the customer several times, sometimes gathering information about their needs and their financial situations, and explaining the features of the available product options. The agent also answers any questions that a customer may have about the policies they are considering. In addition to these oral communications, agents may provide any number of marketing, sales, or other written materials out of thousands that are made available to them. All told, there is a multitude of documents that can be provided to a policyholder during the sales process.

ER791 27:2-25 (citations omitted).

This individualization encompasses illustrations. They are "customized" "based on discussions between the consumer and his or her agent," each illustration different "because every policyholder is different." *Id.* 29:5-10.

II. PLAINTIFFS' PURCHASES

A. Joyce Walker

Joyce Walker applied for a Provider policy after "months educating herself," including at several "substantive," hour-long meetings with two insurance agents. ER791 33:20-25. They discussed "various features" of the policy, "including how the policy's indexing feature operated, the various charges and fees … (and the amount of some of those fees), and the existence of a zero percent annual floor." *Id.* 33:25-34:5. She also consulted others, including about charges and fees, and obtained answers to follow-up questions. *Id.* 34:6-17.

In some meetings with her agents, Walker "extensively reviewed" illustrations, including "the fact that Current Basis B and Current Basis A values were not guaranteed, the policy's guaranteed values, the possibility that the policy would lapse, and the various costs associated with the policy." *Id.* 34:19-35:3. Her agents noted (and Walker understood) that the illustration showed her policy could lapse under two of three illustrated scenarios. *Id.* 35:13-20. Her agents "made clear that her ability to take loans of any particular amount was not set in stone, and that they would need to re-assess the amount and timing of any loans" upon retirement "based upon how the stock market had actually performed." *Id.* 35:5-9.

Although Walker now claims to have relied on a sales illustration, she did not sign it, and certified on her application that she had "NOT received an illustration of the policy applied for." *Id*. 35:21-25.

When Walker's policy issued, she received a copy of it, a batch illustration, and two buyer's guides. *Id.* 36:1-5.[8] The policy cover instructed Walker to "READ [HER] POLICY CAREFULLY," and she knew she could cancel it penalty-free within ten days. *Id*. 36:5-10. Nevertheless, Walker did not read her policy, buyer's guides, or batch illustration. *Id.* 36:11-13. She did, however, sign the batch illustration, certifying that she "received a copy of this illustration and underst[ood] that any non-guaranteed elements illustrated are subject to change and could be either higher or lower" and that she "UNDERST[OOD] THAT HISTORICAL PERFORMANCE OF THE S&P 500 INDEX SHOULD NOT BE CONSIDERED A REPRESENTATION OF THE PAST OR FUTURE PERFORMANCE FOR ANY OF THE INDEXED STRATEGIES IN THE POLICY." *Id.* 36:14-22.

After one year, Walker received an annual statement itemizing each cost and showing zero interest credit due to market performance. *Id.* 37:1-8. Her agent confirmed that no interest had been credited. ER810 108:1-111:3; SER18. Walker

[8] The buyer's guides describe in plain English the retrospective guarantees and the tax consequences of lapse. TX86 at 3-6.

never indicated this contradicted her expectations, and she paid another premium. ER810 18:18-19, 111:9-112:7.

Later, Walker complained about her policy to "get back her premiums in light of her economic difficulties." ER791 38:11-12. These financial setbacks were "the real cause of her trying to get out of her policy." *Id.* 37:24-38:5. Walker's email shows she sought "a loophole that would work in [her] favor in terms of getting all [her] money back," so she could "get around the fact that [she] signed the contract." *Id.* 38:22-39:9; SER15; SER16; SER17.

B. Kim Howlett And Muriel Spooner

Spouses Howlett and Spooner were "sophisticated investors" that applied for Paragon policies after "more than a year" of meetings with their insurance agent, who provided them with voluminous written materials and answered their questions. *Id.* 39:18-40:3. They decided to "move forward" and apply for their policies before seeing an illustration. *Id.* 40:10-16; ER808 79:12-80:10; SER13.

Howlett and Spooner first saw illustrations on the same day they applied for their policies. ER791 40:1-16; SER6; SER19. Their agent explained the illustrations, underscoring that "historical performance of the stock market should not be considered a representation of the past or future performance of the policies" and that "failure to make premium payments could cause [Howlett's] and

[Spooner's] policies to lapse." ER791 40:16-24. Their agent found it "very easy" to discuss lapse risk based on the illustration. *Id.* 41:2-5.

When they applied for their policies, Howlett and Spooner knew that Current Basis B values were not guaranteed and were only best-case scenarios, that the S&P might perform poorly and was volatile, that constant returns were unlikely, "and that as a result the results may be more or less favorable." ER791 41:17-42:5. Nevertheless and despite capitalized warnings in their illustrations, they assumed "that the stock market would perform like it had in the past." *Id.* 41:11-17.

Their issued policies differed from what they had applied for. Howlett and Spooner therefore received superseding batch illustrations, along with copies of their policies and buyer's guides. *Id.* 42:20-43:22. They did not read these documents, although their agent told them to. *Id.* 43:23-44:3.

Howlett and Spooner complained about their policies after "economic difficulties" left them "unable or unwilling to make any further premium payments." *Id.* 44:4-14. They worked with an advisor to draft a complaint letter they admit "contained numerous [knowingly] false statements, 'overstatements,' and 'exaggerations,'" including falsely suggesting that their agent "'promised' or 'guaranteed' that the policies would perform in a manner consistent with Current

Basis B." *Id.* 44:11-20. Spooner surrendered her policy, and Howlett ceased premium payments, resulting in lapse. *Id.* 44:24-45:8.

III. THE LITIGATION

A. Pretrial Proceedings

Plaintiffs sued, asserting two causes of action (fraud and UCL violation) based on five claims:

- The "Volatility Claim," alleging "pure omission" of disclosure that a defect made the Policies prone to lapse or "reduced value" (*i.e.*, performance below the Current Basis B scenario) due to S&P volatility;
- The related "Tax Claim," alleging LSW failed to disclose that the purported volatility defect exposed policyholders to tax liability upon lapse;
- The "Costs Claim," alleging sales illustrations misrepresented charges and fees, as part of a "bait and switch";
- The "Guarantees Claim," alleging sales illustrations misrepresented that the minimum annual accumulation was 2% for Provider or 2.5% for Paragon, rather than 0%, as part of a "bait and switch"; and
- The "MAC Claim," alleging sales illustrations misrepresented as guaranteed an illustrated reduction in the MAC after ten years, as part of a "bait and switch."

At the pleadings stage, the court dismissed another UCL unlawfulness or unfairness claim for violation of the California statute governing illustrations, Ins. Code §§ 10509.950 *et seq.* ("the Illustration Statute"), because that statute bars private suits in favor of Insurance Commissioner enforcement. ER59 at 9-10. The

court allowed Plaintiffs, however, to pursue the same allegations under other legal theories. ER461 at 3.

On November 9, 2012, the court certified two classes. The first was a "pure omissions class," asserting the Volatility and Tax Claims and consisting of California Provider and Paragon policyholders who purchased on or after September 24, 2006. The second was an "illustrations subclass," asserting the other claims and consisting of California Provider and Paragon policyholders who purchased on or after September 24, 2006 and received an illustration at or before policy application ("the Subclass"). ER791 6:7-19.

On May 28, 2013, the court decertified the Subclass because "individualized issues of illustration receipt predominated over any common questions for the Illustrations claims." *Id.* 6:20-23. The court did so after extensive proceedings, including consideration of Plaintiffs' proposal for policyholder file review to determine who received sales illustrations. ER447.

B. Trial And Jury Verdict

Trial lasted almost three weeks. Plaintiffs centered their case on the testimony of Brockett. He asserted that the Policies were lapse prone because of "the interaction between policy design and natural S&P 500 volatility." Br.11. Brockett claimed to have constructed a Monte Carlo model comparing Current Basis B values depicted in certain sales illustrations with his own modeling of S&P

volatility, upon which he based his assertions of lapse risk and reduced policy value. ER791 50:10-14.

Brockett's theories were fatally undermined on cross-examination, when he admitted to "misleading" the jury in his testimony about lapse rates, an issue at the core of Plaintiffs' case. ER808 65:15-22. Specifically, he testified on direct that he analyzed the Policies' lapse rates during the first four policy years only. ER806 71:14-73:17. On cross-examination, however, he revealed he had actually calculated lapse rates beyond the fourth policy year, and that those critical later-year lapse rates were "much lower" than in earlier ones. ER807 10:11-15:3. On re-direct, Brockett sought to attribute his omission to the untrustworthiness of the later-year data. *Id*. 168:3-170:4. However, on re-cross, he was again forced into a contrary admission—going so far as to acknowledge that this testimony was "certainly misleading." ER808 65:21-22. The much-lower later-year lapse rates were not untrustworthy, he conceded; the data were in fact "reliable" and "based on large samples." *Id.* 62:12-65:20.

The court found that this error, as well as Brockett's repeated attempts to obfuscate it, critically "detract[ed] from the probative value of [Brockett's] opinion regarding a class-wide volatility defect" and "considerably undermine[d] [Brockett's] overall credibility." ER791 53:4-20.

LSW exposed many additional flaws in Brockett's methodology, including by showing that lapse occurs only because policyholders decide not to pay for their insurance and not because of any purported "defect." *Id*. 25:21-26:4. Therefore, the court found Brockett's testimony not credible, inadmissible in certain respects, and insufficient to prove Plaintiffs' claims, as explained below.

The jury returned a defense verdict on all fraud claims in under three hours. *Id*. 8:4-7.

C. UCL Findings

After trial, the court resolved the UCL claims for LSW. The court ruled:

- The Volatility and Tax Claims failed because Plaintiffs did not establish that LSW's conduct was likely to mislead consumers. The court found: (i) Plaintiffs failed to prove the Policies had any defect rendering them prone to lapse or "reduced value" (ER791 50:4-54:6, 54:2-6); (ii) given the individualized sales process and Plaintiffs' failure of proof, there was no class-wide evidence of omission (*id.* 49:11-13, 49:23-50:3); (iii) LSW's numerous disclosures adequately conveyed whatever risks were associated with the Policies (*id.* 60:2-6); (iv) the Illustration Statute prohibited LSW from issuing illustrations with values based on assumed S&P performance above the historical average rate in any duration, so LSW could not, and thus

had no duty to, make Plaintiffs' proposed disclosures (*id.* 57:7-22); and (v) Plaintiffs introduced no evidence of how consumers expected the Policies to perform or that the Policies fell short of any such expectations (*id.* 59:13-21)

- Plaintiffs' Costs, Guarantees, and MAC Claims failed because Plaintiffs did not prove LSW's practices were likely to mislead consumers in light of numerous disclosures in sales illustrations and otherwise. *Id.* 71:12-17.

SUMMARY OF THE ARGUMENT

I. THIS COURT SHOULD AFFIRM THE JUDGMENT FOR LSW ON PLAINTIFFS' VOLATILITY AND TAX CLAIMS

A. UCL Claim. The court correctly found that Plaintiffs failed to prove LSW was likely to mislead consumers by not disclosing the existence of an alleged "defect" rendering the Policies prone to lapse or "reduced value." This was not error, let alone clear error.

The court correctly found there was no proof of a "defect." Plaintiffs' only support, Brockett's testimony, was flawed and discredited. Moreover, even Brockett found that the "defect" did not exist across the class, because for thousands of class members volatility actually *reduced* the risk of lapse and *increased* Policy value.

Even if the "defect" existed (it does not), Plaintiffs also failed to prove any class-wide non-disclosure. The Policies were sold in an individualized, unscripted fashion involving oral conversations and a "multitude" of documents. This made it impossible for Plaintiffs to prove uniform non-disclosure.

If anything, numerous disclosures amply warned consumers of any risks associated with policy performance. For example, the information Plaintiffs demand is reflected in LSW's existing disclosures (albeit worded differently), but such semantic differences are immaterial. Plaintiffs claim this is a "mixed question," but it is essentially or entirely a question of fact, so clear-error review applies.

Plaintiffs also failed to establish how consumers expected the Policies to perform or that the Policies' performance differed from those expectations, as *Clemens v. DaimlerChrysler Corp.*, 534 F.3d 1017 (9th Cir. 2008) requires. Plaintiffs never attempted to satisfy this requirement.

The court also correctly found that LSW had no duty to make the disclosures Plaintiffs demand, because the Illustration Statute prohibits insurers from presenting illustrations based on assumed S&P performance in excess of statutory limits over any period of time. Plaintiffs concede their proposed disclosures are necessarily based upon such assumptions.

B. Evidentiary Rulings. The court acted well within its ample discretion in excluding evidence purportedly related to LSW's "intent." The evidence was irrelevant and a waste of time, as the court properly concluded upon a detailed review.

II. THIS COURT SHOULD AFFIRM THE JUDGMENT FOR LSW ON PLAINTIFFS' COSTS, GUARANTEES, AND MAC CLAIMS

A. UCL Claim. The court correctly found that Plaintiffs failed to prove LSW was likely to mislead consumers about the Policies' costs, guarantees, and reduced MAC via a purported "bait-and-switch" scheme. This was not error, let alone clear error.

LSW's reporting of costs and guarantees was not misleading, given the numerous disclosures in LSW's illustrations and elsewhere. This was a factual finding, so is reviewed for clear error (although the court's finding was correct under any standard of review).

LSW's reporting of the reduced MAC also was not misleading because LSW's illustrations never described the reduction as guaranteed. And, in any event, the unrebutted evidence is that LSW fully intends to reduce the charge in the illustrated timeframe, so nobody has been misled.

B. Class Certification. The court acted within its discretion in decertifying Plaintiffs' Subclass. A necessary element of Plaintiffs' bait-and-switch claim is classmembers' exposure to the "bait"—here, sales illustrations.

But the court properly concluded that sales illustration receipt is an individualized question that predominated over common issues, warranting decertification.

III. THIS COURT SHOULD AFFIRM THE DISMISSAL OF PLAINTIFFS' UCL CLAIMS PREDICATED ON THE ILLUSTRATION STATUTE

The Illustration Statute contemplates only administrative enforcement, and therefore bars private enforcement via the UCL pursuant to *Zhang v. Superior Ct.*, 57 Cal. 4th 364 (2013), and *Moradi-Shalal v. Fireman's Fund Ins.*, 46 Cal. 3d 287 (1988). The Illustration Statute has the same features as the underlying statute in those cases. The court's existing findings that Plaintiffs' illustrations were not misleading also dispose of the dismissed claims, in any case.

ARGUMENT

I. THIS COURT SHOULD AFFIRM THE CLASS JUDGMENT

A. Plaintiffs Failed To Prove The Class Claims

Plaintiffs' primary challenge on their Volatility and Tax Claims is that the court "avoided addressing" their "core theory." Br.51-54. The court, however, squarely rejected it. *See* ER791 49:2-10 ("Plaintiffs' trial theory revolves around the proposition that class members are not warned that the receipt of non-guaranteed Current Basis B values shown on illustrations is unlikely as a result of volatility. … Plaintiffs failed to support this theory with class-wide evidence"). The court was correct.

1. The court correctly rejected Brockett's assertion of a defect

Plaintiffs' case was premised on the non-disclosure of a supposed defect in the Policies that, due to S&P volatility, purportedly rendered them prone to lapse or "reduced value" compared to illustrated Current Basis B scenarios. The court rejected that premise as a factual matter after analyzing the only proof Plaintiffs offered—Brockett's testimony. ER791 25:21. The court found that testimony inadmissible in certain respects, not credible, and otherwise incorrect. Plaintiffs identify no reversible error.

First, the court acted well within its discretion in finding Brockett not credible because, among other things, he admitted to "misleading" the jury. This finding is due substantial deference. *See, e.g., United States v. Craighead*, 539 F.3d 1073, 1082 (9th Cir. 2008) ("Where testimony is taken, we give special deference to the district court's credibility determinations"); *AIG Ret. Servs., Inc. v. Altus Fin. S.A.*, 365 F. App'x 756, 759 (9th Cir. 2010) (affirming exclusion of expert testimony: "[t]he district court acted well within its authority when it determined that [plaintiff's] proffered evidence was inherently unreliable").

Plaintiffs try downplaying this critical trial event by asserting (in a footnote) that it concerned only "background evidence." Br.58 n.18. This is disingenuous—Brockett's misleading testimony immediately followed testimony about purported lapse risks for the named Plaintiffs, and purported to represent "actual lapse

experience to date for the class as a whole." ER806 69:5-8. Lapse rates were central to Plaintiffs' case. In particular, later-year lapses were essential to Plaintiffs' theory because only they (and not early-year lapses) would allegedly result from S&P volatility. *Id.* 161:18-25. The evidence that Brockett sought to hide and then to wrongly discredit (*i.e.*, *lower* lapse rates in later policy years) meant that Brockett presented "no reliable or valid statistical evidence to establish that [the Policies] purchased by the class are prone to lapse." ER791 53:18-21.

Second, the court properly rejected Brockett's volatility-based lapse theory because the evidence showed that lapse arises only if a policyholder chooses "not to pay for the life insurance benefits provided by the policy." *Id*. 25:21-24. Brockett admitted that if a policyholder funded the policy or chose not to take loans, he or she could ensure that the policy would not lapse. *Id*. 26:1-4. Plaintiffs proffered no example of any policyholder whose policy lapsed after paying the premiums their respective sales illustrations assumed. *Id.* 26:5-10. Plaintiffs' own experience confirms the point—only Howlett's policy lapsed, which occurred only because he stopped paying illustrated premiums (when his financial circumstances changed). *Id*. 45:2-8. Had Plaintiffs paid their premiums, their policies would have *outperformed* Current Basis B. ER808 39:2-42:25; SER29; SER30.

Third, the court properly rejected Brockett's lapse theory because his projected lapse rates unreasonably assumed that policyholders would never pay

premiums or take loans differently than illustrated, regardless of market performance. ER791 22:13-24, 69:20-70:7. In other words, while Brockett's analysis assumed S&P 500 performance *different from* that described in the Current Basis B scenario, he nevertheless assumed that policyholders would, in the face of that different market performance, nevertheless pay premiums and take loans precisely *the same as* depicted in their sales illustrations. That assumption contradicted real-world policyholder behavior, and the advice of Plaintiffs' own financial advisors. *Id*. 35:5-9.[9]

Fourth, the court properly found that Brockett's analysis, even if credited, could not be extrapolated to the class because his analysis was based on an unreasonably limited sample. *Id.* 51:20-52:2. Brockett's sample contained only sales illustrations, so it could not be "fairly representative" of the "significant percentage of policyholders who did not receive sales illustrations." *Id.* 51:14-20. Worse, Brockett's lapse-propensity calculation was based on an even smaller, less representative sub-sample of sales illustrations in which the policyholder takes out loans. *Id*. 51:20-24. Even Brockett would not testify that this sub-sample could be extrapolated to the class. *Id.*; ER806 27:4-21, 29:7-11. Yet, without that

[9] The court properly found that Brockett's analysis had "no probative value" because he lacked a benchmark. *Id*. 50:4-20. Plaintiffs complain this "missed the point" (Br.53) but without considering the Policies' comparison to competitors, Plaintiffs could not show that the Policies departed from consumers' expectations of an IUL's performance. ER791 50:18-20.

extrapolation, Brockett's testimony could not establish lapse-propensity across the class. ER791 51:14-52:2.

Plaintiffs argue, citing no supporting evidence, that *sales* illustrations could be extrapolated to *batch* illustrations (for policyholders receiving only the latter), because both were generated with "the same software and disclosures." Br.59. Common software is irrelevant. The court found that the funding pattern reflected in batch illustrations differs "in important ways" from those in sales illustrations—including, most significantly, because batch illustrations do not depict loans, and reflect premium payments that Brockett himself "admitted would prevent the policies from ever lapsing." ER791 32:19-33:4.

Plaintiffs also assert they should have been permitted to use the *sub-sample* of sales illustrations depicting loans "to demonstrate the lapse risk if the policy is used for retirement income." Br.60. But the problem remains that the particular funding patterns reflected in the sub-sample are not representative of all classmembers' funding patterns, much less all of their illustrated funding patterns. ER791 51:20-52:2. To prove "lapse risk if the policy is used for retirement income," Brockett needed at least to demonstrate that risk using a random, representative sample. He did not; the sub-sample contained only illustrations depicting a loan. *Id.*

Fifth, the court properly rejected Brockett's assertion of "reduced value"—by which he meant the possibility that policies may underperform Current Basis B—because he baselessly assumed that policyholders uniformly assigned "100% weight to the probability of getting non-guaranteed Current Basis B." *Id.* 52:11-13. There was *no* evidence of *any* classmember's expectation of achieving "Current Basis B, as compared to Current Basis A, Guaranteed values, or any other values." *Id*. 52:13-19. Absent proof that *any* policyholder (much less all classmembers uniformly) expected to achieve Current Basis B returns, the simple fact their policies may underperform Current Basis B does not mean the policy's value is "reduced."

Finally, the court properly found that Brockett's flawed analysis, even if accepted, shows that for "5%-10%" of the class, "the expected value of the policy was in fact better than what was illustrated under non-guaranteed Current Basis B—that is, S&P volatility actually increased policy value." *Id.* 51:10-13. Thus, thousands of policyholders received illustrations depicting future values that were *lower* than Brockett's Monte Carlo analysis (*i.e.*, volatility *increases* value, and *reduces* lapse potential).

Plaintiffs identify no evidence (because there is none) that would render the court's conclusions clearly erroneous.[10]

2. The court also correctly found that LSW's conduct was not likely to mislead

To prove their "pure omission" claims, Plaintiffs had to prove a class-wide omission with "a likelihood of confounding an appreciable number of reasonably prudent purchasers exercising ordinary care." ER791 60:16-21; *Clemens*, 534 F.3d at 1026 (same). The court properly found Plaintiffs failed to do so, given the highly individualized way the Policies were sold. ER791 27:2-7. Moreover, LSW's disclosures did properly warn potential purchasers of any material risks in the Policies' performance. *Id.* 60:2-6. Plaintiffs ignore most of the court's analysis, offering barely three paragraphs of argument. *See* Br.54, 57-58.

First, the court correctly found Plaintiffs did not present class-wide proof of a failure to disclose the effects of market volatility. ER791 49:11-50:3. Plaintiffs' theory was that classmembers uniformly were unaware of these alleged risks, but they based that theory solely on information presented in (and allegedly absent from) sales illustrations, ignoring the many other components of policy sales. Plaintiffs did so because they had no proof that agents uniformly failed to disclose the asserted risks. As the court correctly found, every sale was unique, with oral

[10] The Tax Claim depends upon the Volatility Claim (ER791 54:4-6), and fails for the same reasons. *See* Br.51 n.16.

conversations between agent and purchaser, including about the illustrations, as well as "a multitude of documents," such that each policyholder received different information—"like a snowflake." *Id.* 27:2-12; *see also id*. 49:16-18 (each agent decides on "best format for their sales presentations" and "policies are sold to consumers for a variety of different types of benefits"). The court was therefore entirely correct—and certainly not clearly erroneous—in finding that "Plaintiffs offered no evidence that the individualized sales methods of thousands of independent agents to policyholders with varying financial needs and plans could have resulted in the type of across-the-board non-disclosures that could support" the class claims. *Id.* 49:23-50:2.[11]

Plaintiffs wrongly accuse the court of speculating about agent disclosures. Br.57. What the court concluded was that the non-uniform sales process *inherently* defeats Plaintiffs' class-wide omission theory. ER791 49:11-50:3. The trial record supports that conclusion, and is dispositive. *See Kaldenbach v. Mutual of Omaha Life Ins.*, 178 Cal. App. 4th 830, 847-848 (2009) (despite assertion insurer "utilized uniform sales materials, training, and illustrations," proof of UCL claim requires analysis of "what materials, disclosures, representations, and explanations were

[11] Plaintiffs incorrectly assert the court committed legal error by requiring proof that LSW uniformly failed to disclose volatility risk. Br.57. That is the nature of an omission claim. *Pfizer v. Superior Ct.*, 182 Cal. App. 4th 622, 632 (2010) (if consumer received allegedly omitted information, "there is absolutely no likelihood that they were deceived").

given to any given purchaser"); *Fairbanks v. Farmers New World Life Ins.*, 197 Cal. App. 4th 544, 564 (2011) (rejecting attempt to "consider the [purportedly uniform] language of the policies without considering the information conveyed by the Farmers agents in the process of selling them"). The only case Plaintiffs cite (Br.58), *Yokoyama v. Midland National*, 594 F.3d 1087 (9th Cir. 2008), is not to the contrary. There, the plaintiffs deliberately limited their claim to omission from particular brochures. *Id*. at 1093 ("plaintiffs base their lawsuit only on what Midland did not disclose to them in its forms"). Here, by contrast, Plaintiffs tried a pure omission claim asserting that no disclosure was made "anywhere, to any applicant or policyholder." ER353 at 12.

Second, the court properly rejected Plaintiffs' omission claim because the illustration disclosures *did* warn purchasers of risks related to policy performance. The court evaluated LSW's disclosures against those Plaintiffs demanded, and found every element of Plaintiffs' proffered disclosures in LSW's warnings. ER791 60:22-64:19. Plaintiffs claim LSW failed to warn purchasers that, due to market volatility, historical performance of the S&P depicted in the illustration might not reflect actual performance. But, as the court correctly found, LSW's illustrations warned that a constant market return was unlikely and that policy performance may be worse than illustrated. *See id.* 63:23-64:1. For example, illustrations warned that "[t]he historical performance of the S&P 500 Index should

not be considered a representation of *past or future performance for any of the Indexed Strategies available in this policy*, nor is it an estimate of the returns that a policyholder can expect based on the current caps and participation rates." *Id.* 61:20-62:1 (emphasis added). And further: "This illustration assumes that the currently illustrated non-guaranteed elements *will continue unchanged for all years shown. This is not likely to* occur and actual results may be more or less favorable than those shown." *Id*. 61:9-13 (emphasis added). The court was correct that illustrations "make the repeated point that historical performance of the S&P 500 Index is not a reliable estimate of policy returns or performance," and purchasers must certify that they "understand" this point. *Id*. 62:6-16, 64:7-9.

Plaintiffs' argument, made in a single sentence (Br.54), reduces to a quibble that LSW does not state, in Plaintiffs' preferred words, "that volatility itself … has an effect on policy performance." *Id*. This semantic disagreement is immaterial. As the court properly concluded, LSW's disclosures either "addresse[d] Plaintiffs' point[s]" or were simply "another way of making" those points, and were not "likely to mislead." ER791 62:17-64:14.

Plaintiffs identify no error (let alone clear error) in the court's findings. For example, they identify no evidence that a "significant portion of the general consuming public or of targeted consumers, acting reasonably under the

circumstances, could be misled" by LSW's more general formulation. *Lavie v. Proctor & Gamble Co.*, 105 Cal. App. 4th 496, 508 (2003).

Indeed, Plaintiffs' example—from Spooner's illustration—demonstrates their argument's flaws. Contrary to Plaintiffs' assertion (Br.52), the illustration does not indicate that Spooner "would still have a cash surrender" at age 91; it depicts that *could* happen *only* under Current Basis B. ER791 29:15-17. Nor does the illustration "eliminate" or "ignore" volatility (Br.52); Current Basis B reflects what would occur under one plainly explained and "specified 'what-if' scenario[]"—a certain, constant rate of S&P growth every year. ER791 28:10-16. Spooner was "well aware" that this would not happen if, as has customarily been the case, the stock market was volatile. *Id.* 39:19-21. Her illustration dispelled any doubt, stating that it "assumes that the currently illustrated non-guaranteed elements will continue unchanged for all years shown. *This is not likely to occur* and actual results may be more or less favorable than those shown." *Id.* 61:8-14. Finally, Plaintiffs' assertion that illustrations "depict[] no risk of lapse if the scheduled premiums are paid" (Br.52) is false—Spooner knew her policy could lapse (ER791 40:22-41:2), and two of her three illustrated scenarios reflected lapse. TX4 at 14-20.

3. Plaintiffs failed to prove consumer expectations

Plaintiffs' class claims also failed because Plaintiffs did not prove consumer expectations. ER791 59:13-21. Plaintiffs were required to prove, in a "specific and particularized" way, how consumers expected the Policies to function, to establish that allegedly omitted information was "contrary to those expectations." *Id.* 58:2-19; *Daugherty v. American Honda Motor Co.*, 144 Cal. App. 4th 824, 838 (2006); *Clemens*, 534 F.3d at 1026.

Here, Plaintiffs offered no evidence establishing the "expectations of consumers regarding [the effect of] S&P performance on policy value or the risk of policy lapse sufficient to support a UCL claim." ER791 59:13-15. This is not, as Plaintiffs claim (Br.58), a matter of the court requiring survey evidence. Plaintiffs did not present *any* expectations evidence, survey or otherwise. ER791 59:15-16 (noting absence of "any survey or other evidence"). That failure properly doomed Plaintiffs' claim. *See, e.g.*, *Clemens*, 534 F.3d at 1026 (proof of UCL fraud claim requires proof of consumer expectations by class-wide evidence: "a few isolated examples of actual deception," "personal experience," "personal assumptions," and personal "expectations" of named plaintiffs are insufficient). Plaintiffs can hardly complain about the court commenting on the absence of survey evidence—Plaintiffs' own expert testified that, without a survey, he could not opine about consumer expectations. ER791 59:18-21.

B. The Court Correctly Found That California Law Prohibited LSW From Using The Illustrations Plaintiffs Demanded

The court also correctly rejected Plaintiffs' class claims because LSW had no duty to make the disclosures Plaintiffs demand, given prohibitions in the Illustration Statute. While not necessary to the decision below, this independently supports judgment for LSW.

The Illustration Statute prohibits illustrations showing non-guaranteed elements that assume future returns for *any* period of time above a cap called the "disciplined current scale." ER791 30:12-18. The statute provides:

> If the illustration shows any nonguaranteed elements, they cannot be ***based*** on a scale more favorable to the policy owner than the insurer's [disciplined current scale][12] ***at any duration***.

Ins. Code § 10509.956(a)(7) (emphasis added); *see also id.* § 10509.955(b)(5) (insurer may not "[u]se an illustration that at any policy duration depicts policy performance more favorable to the policy owner than that produced by the [disciplined current scale]"). For the Policies, the disciplined current scale is a rate "determined by the past average annual growth of the stock market index as filtered through the policy's participation rates and earnings cap." ER791 30:13-18. Thus, LSW could not state lapse probabilities based on a non-guaranteed rate

[12] The text refers to the "illustrated scale," which is a scale that can be no higher than the disciplined current scale. Ins. Code § 10509.953(g).

of return, "at any duration" (*e.g.*, any year), exceeding the past average growth of the S&P 500 as filtered through the Policies' upside and downside limitations.

Plaintiffs acknowledge that Brockett generated his lapse probabilities using Monte Carlo simulations that assume returns in some years *above* the disciplined current scale. Br.56 ("returns in excess of the maximum illustrated rate may occur"); *see also* ER820 194:6-195:13, 204:11-205:24. The Illustration Statute therefore prohibits use of those lapse probabilities.

Plaintiffs assert, with no authority, that a lapse probability is not a non-guaranteed element. Br.55. The point is irrelevant, however, because Brockett's modeling of lapse probability is contingent on assuming index performance (a "non-guaranteed element"), including at rates above the permitted scale. In any event, the definition of "non-guaranteed elements" includes "values." Ins. Code § 10509.953(m). Lapse probability (*e.g.*, "15% chance of lapse") is a "value" as that term is commonly understood. *E.g.*, *Merriam-Webster's Collegiate Dictionary* 1382 (11th ed. 2014) (defining "value" as "a numerical quantity that is assigned or is determined by calculation or measurement").[13]

[13] This likely explains why no insurer incorporates Monte Carlo results into illustrations. ER791 26:15-17.

The Society of Financial Service Professionals[14] argues that the court's construction of the Illustration Statute would violate the First Amendment, but Plaintiffs did not make that argument—either in the district court or here—so it should not be considered. *See United States v. Ortiz*, 776 F.3d 1042, 1044 n.3 (9th Cir. 2015) (appellant "waived [constitutional argument] by failing to raise it before the district court and failing to show good cause for its omission during trial in his Opening Brief"); *Swan v. Peterson*, 6 F.3d 1373, 1383 (9th Cir. 1993) ("Generally, we do not consider on appeal an issue raised only by an amicus"). Nor would the Society's First Amendment theory support liability here, because it would remain inequitable to impose UCL liability on LSW where it acted in good faith to follow a statute precluding Plaintiffs' demanded disclosure. ER791 69:6-15 (good faith finding); *Tzu Chien Chen v. Thomas & Betts Corp.*, 268 F. App'x 508, 509-510 (9th Cir. 2008) (absence of defendants' inequitable conduct "would preclude any award" under the UCL).

C. The Court Did Not Abuse Its Discretion In Excluding Evidence

Plaintiffs' only other challenge to the disposition of their class claims (and Plaintiffs' only challenge to the jury's fraud verdict for these claims) is the assertion that the court wrongly excluded certain evidence. Br.46-51. Each ruling

[14] The Society is hardly independent. Its recent past president, Richard Weber, was active in this litigation as a consulting expert for Plaintiffs. Moreover, much of the Society's brief is irrelevant because it discusses an "HVC" Monte Carlo product that has nothing to do with this case.

was correct, and well within the "considerable deference" afforded on evidentiary matters. *United States v. Hankey*, 203 F.3d 1160, 1167 (9th Cir. 2000).[15]

First, the court excluded as marginally relevant and a waste of time evidence of "persistency rates" that LSW actuaries had calculated for the Policies. ER674 at 21. A persistency rate is an *ex ante* actuarial assumption about how many policies may be in force at future times. ER514 ¶6. The rates are irrelevant to Plaintiffs' theory here, however, because they do not reflect any assessment of the impact of market volatility. Rather, LSW actuaries used persistency assumptions based on LSW's experience with policies with *no market exposure*. *Id*. ¶¶9-10. At most then, the rates reflect an actuary's irrelevant estimate that policies could terminate for reasons having nothing to do with market volatility. Plaintiffs never address this issue on appeal. *See* Br.46-48.

Plaintiffs claim they could solve a different problem (that the persistency rates were overinclusive) by trying to disaggregate lapses from surrenders in those

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[15] Plaintiffs assert incorrectly that Rule 403 does not apply in bench trials. Br.46. *See* Fed. R. Evid. 1101(b) (rules of evidence apply in "civil cases and proceedings"); *United States v. Sullivan*, 575 F. App'x 793, 794 (9th Cir. 2014) (no abuse of discretion in bench trial by excluding evidence that "would not be helpful to the court, but would cause undue delay and would waste time"); *Burlington N. R.R. v. Department of Revenue*, 23 F.3d 239, 241 (9th Cir. 1994) (similar). *United States v. Preston*, 706 F.3d 1106, 1117 (9th Cir. 2013) is not to the contrary. *Preston* criticized exclusion of evidence from a bench trial on the basis of *unfair prejudice*, the Rule 403 factor arguably germane only to juries. *See id.* at 1117.

rates. Br.48.[16] That does not render the court's evidentiary ruling an abuse of discretion, and would not change the fact that the persistency rates have nothing to do with market volatility. Further, Brockett's proposed method of disaggregating lapses was (consistent with his general lack of credibility) both misleading and incorrect, including insofar as it purported to use actual e*x post* experience to disaggregate surrenders and lapses from *ex ante* persistency assumptions. ER681 3:12-28.[17]

Second, the court was well within its discretion in excluding an email containing a comment that non-guaranteed figures appearing in an irrelevant PowerPoint slide were a "hallucination." Plaintiffs wrongly state that the email pertained to an "IUL *illustration*." Br.49. However, the author testified at deposition that he was not addressing policy illustrations (*i.e.*, a document "handed to a customer" deciding whether to buy a policy) at all, but "something very different" — numbers in a slideshow used in a particular sales presentation regarding a leveraged-benefit plan. ER703 at 3. Nor was he discussing the

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[16] The court correctly found surrenders were not part of Plaintiffs' Tax Claim. ER674 at 20 (though mentioned in Plaintiffs' complaint, surrender is "not the basis of their claims"). Surrenders are irrelevant because the reasons they occur "are speculative" and completely unrelated to volatility. *Id*. at 20-21; *see also* ER514 4:1-3 (policyholders may surrender because policies "accumulated substantial cash value"—the opposite of Plaintiffs' theory).

[17] Plaintiffs' claim that "72-75% of policyholders will not obtain the touted tax benefits" (Br.1) is based on this misleading analysis.

Policies. *Id*. The author's role at LSW before retiring had nothing to do with policy illustrations, he was unfamiliar with the illustration system, and he had no personal knowledge of the Policies. *Id.* at 4.

Finally, the court acted well within its discretion in excluding certain evidence purportedly germane to Monte Carlo simulation use. Exhibits 326, 505, 506, 507, and 548 relate to a 2013 presentation in which a third-party (Richard Weber) discussed the use of Monte Carlo simulations with life insurance. The presentation was irrelevant and a waste of time for several reasons including: (i) it occurred *after* the class period (*i.e.*, it could not possibly establish "intent" at relevant times); (ii) there was no evidence of who attended; and (iii) at most, it reflected one third-party's views about Monte Carlo simulations, not any view adopted or agreed to by anyone at LSW. *See* ER703 at 8, 12-13; ER805 5:2-8. Exhibits 62, 398, 415 and 417 were even less relevant, and more likely to waste time. They showed the use of a Monte Carlo simulation by a broker-dealer sister company of LSW to address irrelevant products. ER703 at 9-11; ER700 (exhibits involved "different entities" and "different investment vehicles").

II. THIS COURT SHOULD AFFIRM THE JUDGMENT ON THE INDIVIDUAL UCL CLAIMS

A. Plaintiffs Failed To Prove Their Claims

1. Plaintiffs' *Chern* argument is incorrect

Plaintiffs wrongly argue that the court ran afoul of *Chern v. Bank of America*, 15 Cal. 3d 866 (1976) in ruling against them on the Costs and Guarantees Claims. Br.34-38. *Chern* is no longer viable in light of California Proposition 64. Regardless, Plaintiffs' argument misapplies *Chern* and ignores dispositive findings that Plaintiffs have not challenged on appeal.

In *Chern*, a bank inaccurately informed a customer, and later set forth in a promissory note, that a loan would have a 9% "per annum" rate, while a Truth in Lending Statement signed at the same time as the note disclosed a 9.25% rate. The quoted "per annum" rate was based on a 360-day year. On appeal, the court ruled against the plaintiff on her contract and fraud claims for damages because she was not misled given the truthful disclosure. However, the court held that her claim for injunctive relief under Section 17500 of the Business and Professions Code should have survived summary judgment because, "if, as alleged," the bank routinely quoted borrowers inaccurate "per annum" interest rates based on a 360-day year and withheld truthful disclosures, such a practice would be misleading "[i]n the absence of evidence to the contrary." *Chern*, 15 Cal. 3d at 876.

As a threshold matter, *Chern* is superseded to the extent Plaintiffs read it to permit a UCL claim by a plaintiff who was told the truth prior to purchase. Twenty-eight years after *Chern*, California passed Proposition 64, which limits UCL standing to "any 'person who has suffered injury in fact and has lost money or property' as a result of unfair competition." *Kwikset Corp. v. Superior Ct.*, 51 Cal. 4th 310, 321-322 (2011) (quoting Bus. & Prof. Code § 17204, as amended by Prop. 64 (Nov. 2, 2004)). Thus, "a plaintiff 'proceeding on a claim of misrepresentation as the basis of his or her UCL action must demonstrate actual reliance on the allegedly deceptive or misleading statements.'" *Id*. at 326. In *Chern*, the plaintiff did not rely on the 9% rate because the actual rate was disclosed. *See Chern*, 15 Cal. 3d at 870. After Proposition 64, the plaintiff's claim in *Chern* would not be cognizable. *See In re Tobacco II Cases*, 46 Cal. 4th 298, 326 (2009) ("plaintiff must show that the misrepresentation was an immediate cause of the injury-producing conduct").

Regardless, *Chern* is inapt because it addressed only what could *go to trial*. Here, Plaintiffs' claims went to trial (based in part on *Chern*) even though there was and is no dispute that the policy discloses all information that Plaintiffs demand. ER59 at 11-12. After trial, based on the totality of evidence, the court

properly rejected Plaintiffs' claim. ER791 70:20-75:9. A host of findings, none of which Plaintiffs challenge, support that result.[18]

With respect to the Costs Claim, the court properly rejected Plaintiffs' creative assertion that they were misled by the words "One Policy Fee" in their illustration. *Id.* 71:12-15, 72:19-21. The court found, and Plaintiffs do not appeal, that they were all aware that there were fees—plural—when reviewing their illustrations.[19] Further, the court correctly observed that illustrated values are presented net of all charges and fees. *Id.* 72:1-5.[20] Thus, whether the illustration displays one fee or separately itemizes many fees is irrelevant; the illustration could not mislead someone into believing future values would be higher than the

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[18] *Rubio v. Capital One Bank* (Br.37) does not help Plaintiffs. The court there concluded that a complaint stated a claim against a bank under the UCL and for violating a regulation requiring clear disclosure of a credit-card APR when the bank described an APR as "fixed" and subject to change under three stated circumstances but reserved the right to change the rate for *any reason at all*. 613 F.3d 1195, 1202 (9th Cir. 2010). Here, LSW treated costs and guarantees as the Illustration Statute requires—accounting for them in illustrated values. And in *Williams v. Gerber Policies Co*. (Br.37), this Court reversed dismissal of a UCL claim where Plaintiffs had "stated a claim and could plausibly prove that a reasonable consumer would be deceived by fruit juice packaging." 552 F.3d 934, 940 (9th Cir. 2008). Here the district court also spared Plaintiffs' claims from dismissal so they could be tested on the merits.

[19] The record shows that "One Policy Fee" accurately indicates that the Policies provide numerous benefits (cash value accumulation, death benefit, etc.) under a single life insurance contract without paying multiple fees on different policies. ER809 60:2-24

[20] Presenting illustrated values net of fees made different policies easier to compare. ER791 72:1-5.

costs would allow. *Chern*, in contrast, involved depicting a lower loan rate than what was charged. 15 Cal. 3d at 876.

More generally, the record showed that a policyholder could not reasonably expect an illustration exhaustively to describe every individual policy feature. ER791 28:10-16 (illustrations "provide a brief summary" of performance under "certain, specified" scenarios, not purporting to "contain all of the details of a policy"). For this reason, the illustration refers the policyholder to the policy "for complete details." TX30 at 10.[21] This contrasts with *Chern*, in which the promissory note itself contained the deceptive loan rate. 15 Cal. 3d at 870.

With respect to the Guarantees Claim, the illustration itself disclosed the allegedly omitted information. Specifically, the illustration stated that the yearly return on a guaranteed basis *could be zero*, informing policyholders that the guaranteed minimum 2% (Provider) or 2.5% (Paragon) returns are not applied yearly. ER791 73:8-11 ("named Plaintiffs' sales illustrations disclosed that annual growth was subject to a zero percent floor. The manner and time the guaranteed returns … were more fully described in the policies themselves").

[21] All allegedly omitted information is undisputedly contained in Plaintiffs' policy forms. ER791 72:5-16.

2. Plaintiffs' argument concerning their MAC claim is incorrect

There is ample support for the court's finding that Plaintiffs failed to prove a deceptive depiction of the MAC reduction as guaranteed. The illustration repeatedly states: "INTEREST RATES, DIVIDENDS, OR VALUES THAT ARE SET FORTH IN THE ILLUSTRATION ARE NOT GUARANTEED, EXCEPT FOR THOSE ITEMS CLEARLY LABELED AS GUARANTEED." *E.g.*, TX4 at 20. This is the disclaimer Plaintiffs wrongly say does not exist. Br.39. Further, when guaranteed values are illustrated, they are labeled "guaranteed." TX4 at 14-17, 24. The column depicting reduced MAC has no such heading. *Id.* at 21-23. Plaintiffs' argument concerning use of an asterisk to connote non-guaranteed values (Br.38) is misdirection. LSW does not use an asterisk "*throughout* the illustration" (*id.*) to depict non-guaranteed values. Instead, the asterisk (and the accompanying disclosure) appear in a *particular* chart in which some values are guaranteed and others are not. *E.g.*, TX4 at 14-20. The MAC reduction is not in that chart. It appears elsewhere, in a section that does not use the asterisk.

Moreover, the court also correctly found (and Plaintiffs ignore) that LSW's practices were not deceptive because LSW fully intended to reduce the MAC, had priced it into the product design, and had programmed its systems to reduce it. *See* ER791 21:13-18.

Finally, as the court correctly found, none of the Plaintiffs kept their policies in force long enough to receive this reduction. Indeed, no policy had been in effect for ten years at the time of trial, so Plaintiffs had no evidence that LSW would ever fail to make good on the mischaracterized "guarantee" so as to make it deceptive. *Id.* 74:17-22, 75:1-6. If there was a "bait" (there wasn't), there certainly was no proof of a "switch."[22]

B. The Court Properly Decertified The Subclass

As a threshold matter, Plaintiffs' failure to prove their own individual claims renders their challenge to the Subclass decertification (Br.39-45) immaterial. A plaintiff with no viable claim "cannot represent others who may have such a claim, and her bid to serve as a class representative must fail." *Lierboe v. State Farm Mut. Auto. Ins.*, 350 F.3d 1018, 1022-1023 (9th Cir. 2003) (vacating certification, remanding with instructions to dismiss). While this Court accordingly need not reach this issue, decertifying the Subclass was well within the court's discretion and legally correct.

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[22] Plaintiffs assert that several witnesses could not discern whether the illustration depicted the reduction as guaranteed. Br.9. That only undermines their MAC Claim, which asserts that the illustration *did* depict the reduction *as a guarantee.*

1. The court properly found individualized issues of sales illustration receipt predominated

After extensive proceedings—including initially certifying the Subclass and allowing discovery—the court "decertified the Illustrations Subclass because it concluded that individualized issues of illustration receipt predominated over any common questions for the Illustrations claims." ER791 6:20-23. The court grounded its holding in the predominance requirement of Federal Rule of Civil Procedure 23(b)(3) and not, as Plaintiffs mischaracterize it (Br.39), in any implied ascertainability requirement.

Plaintiffs argue that identifying policyholders who received a sales illustration was a mere "administrative inconvenience," and that the court was *required* to address the issue "under the rubric of … manageability." *Id*. The court in fact *did* consider manageability when it evaluated predominance (ER447 at 3-5), however, as courts commonly do. *See, e.g.*, *Zinser v. Accufix Research Inst., Inc.*, 253 F.3d 1180, 1190 (9th Cir. 2001).

Regardless, Plaintiffs' argument fundamentally mischaracterizes the sales-illustration-receipt issue, and the primary way the court addressed it. Determining whether a policyholder received a sales illustration containing the allegedly deceptive statements is critical to the Subclass claims because it bears on whether each putative classmember was even exposed to the alleged wrong. Under settled precedent, this creates a predominance issue. In *Mazza v. American Honda Motor*

Co., 666 F.3d 581 (9th Cir. 2012), this Court vacated class certification of a UCL claim on predominance grounds because the question concerning whether each putative classmember had been exposed to the wrongdoing was individualized and predominated over any common questions. *Id*. at 594-596. Again in *Berger v. Home Depot USA, Inc.*, in finding predominance lacking, this Court reaffirmed that "certification of UCL claims is available only to those class members who were actually exposed to the business practices at issue." 741 F.3d 1061, 1068 (9th Cir. 2014).

Here, Plaintiffs' claim was that *sales illustrations* allegedly perpetrated a bait and switch. Under *Mazza* and *Berger*, the determination whether a putative classmember was even exposed to the so-called "bait" (*i.e.*, whether the policyholder received a sales illustration) is an individualized issue that turns on facts specific to each policyholder. The court not only acted well within its discretion in finding predominance lacking; that decision was entirely correct. *See Berger*, 741 F.3d at 1069 ("when the class action is based on alleged misrepresentations, a class certification denial will be upheld when individual evidence will be required to determine whether the representations at issue were actually made to each member of the class"); *Cabral v. Supple LLC*, 608 F. App'x 482, 483 (9th Cir. 2015) (predominance lacking where common class-wide

evidence would "not support a determination that all of the class members saw or otherwise received the misrepresentation").

Mullins v. Direct Digital, LLC (Br.42-45) is not to the contrary. *Mullins* concerns the *implied ascertainability requirement*, holding that it can be satisfied even absent a "reliable and administratively feasible mechanism for determining whether putative class members fall within the class definition." 795 F.3d 654, 662 (7th Cir. 2015). The court here, however, found Rule 23(b)(3) predominance lacking independent of any implied ascertainability requirement (ER447), exactly as *Mullins* instructs—*i.e.*, by applying Rule 23(b)(3)'s "explicit requirements." 795 F.3d at 662.[23]

Plaintiffs also wrongly assert (Br.39) that the court needed to evaluate the sales illustration receipt issue under the superiority prong. But as this Court has recognized, certification requires both predominance *and* superiority; the absence of the former obviates the need to address the latter. *Poulos v. Caesars World, Inc.*, 379 F.3d 654, 664 (9th Cir. 2004) (where predominance lacking, "we need not reach the superiority issue").

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[23] *Young v. Nationwide Mut. Ins.*, 693 F.3d 532 (6th Cir. 2012), and *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656 (7th Cir. 2004), are irrelevant. *Young* found that predominance was satisfied, based on the particular circumstances and expert testimony presented in that case. 693 F.3d at 540-541, 544-545. *Carnegie* rejected the defendants' manageability argument that "said nothing against [manageability] except that there are millions of class members." 376 F.3d at 660. Here, the dispute is not about sheer class size.

2. Plaintiffs' argument concerning file review is irrelevant

Plaintiffs' argument (Br.40-42) that manual review of policy files would be feasible is irrelevant, again because the feasibility of the inquiry does not make it a common, as opposed to individualized, one. Accordingly, the argument does nothing to call into question the court's *predominance* finding. Plaintiffs have not shown that the court wrongly considered a common issue to be individualized, incorrectly weighed individualized issues vis-à-vis common issues, or omitted a substantial factor from its predominance inquiry. *See In re Wells Fargo Home Mortg. Overtime Pay Litig.*, 571 F.3d 953, 957 (9th Cir. 2009). Instead, Plaintiffs' argument that file review could identify sales illustration receipt 72% of the time (even if true) only underscores the point that whether each putative classmember received a sales illustration is an individualized issue. ER447 at 4 n.2 (the "individualized inquiry required to [review] all files merely underscores the lack of predominance of common issues"). And under *Mazza* and *Berger*, the need for that inquiry merited substantial weight in the predominance analysis because it speaks to a critical element of the claim—exposure to the wrong.

The record does not, in any event, establish that file review could demonstrate Subclass membership 72% of the time. Br.40. Instead, it shows that a file review *would not* reliably determine which policyholders received sales illustrations because file documents are far from conclusive. Walker, for instance,

claims to have received a sales illustration, even though the signed certification in her file says she did "NOT" receive one, and she claims not to have reviewed the only signed illustration found in her file (a batch illustration). ER791 35:21-36:22. Uncovering the truth across the Subclass would require the same assessment of individualized evidence, not a mere file review. *See id.* 32:7-9 (unchallenged finding that even if file review found a sales illustration, individualized question remains whether policyholder actually *received* it).[24]

Finally, even if file review could reliably adjudicate pre-sale illustration receipt 72% of the time (it could not), that leaves 28% percent of the Subclass—over 11,000 policyholders—unaddressed.

3. The variation among sales further undermined predominance

Predominance was also lacking because policy sales were highly varied. *Supra* pp. 27-29. There are accordingly individualized issues concerning *what information each policyholder received and when.* For example, Plaintiffs claim that illustrations concealed policy costs. Yet adjudicating Plaintiffs' claims would require considering whether their agents disclosed the costs orally, as they were trained to do. *Id*. The court would have needed to consider individualized

[24] Plaintiffs question the support for the court's finding that it would need to determine hundreds of individual issues regarding Subclass membership arising out of 42,000 policy files. ER447 at 4. Yet when Plaintiffs tried to sample just 800 policy files, dozens of disputes resulted. ER420-15; ER421; ER421-5; ER436; ER438; SER444; ER447.

information about each sale, simply to determine whether the sale constituted "bait" in the first place. *See Pulaski & Middleman, LLC v. Google, Inc.*, 802 F.3d 979, 986 n.7 (9th Cir. 2015) ("predominance may not exist in a UCL case in which different members of the class were 'exposed to quite disparate information from various representatives of the defendant'"); *Berger*, 741 F.3d at 1068-1069 (similar).

III. THIS COURT SHOULD AFFIRM THE DISMISSAL OF PLAINTIFFS' UCL CLAIMS PREMISED ON THE ILLUSTRATION STATUTE

A. Plaintiffs May Not Base UCL Claims On The Illustration Statute

The court correctly held that Plaintiffs may not base UCL claims on asserted violations of the Illustration Statute because that statute bars private suits and opts instead for Insurance Commissioner enforcement. *See Zhang*, 57 Cal. 4th at 384; *Moradi-Shalal*, 46 Cal. 3d at 300, 304. The same analysis that caused the California Supreme Court to find in *Zhang* and *Moradi-Shalal* that the Unfair Insurance Practices Act ("UIPA") bars private and UCL actions applies equally to the Illustration Statute. Plaintiffs' and the Attorney General's contrary position relies largely on analysis that *Zhang* rejected and inapposite caselaw.

1. The Illustration Statute bars private suits

Where the legislature "contemplated only administrative enforcement by the Insurance Commissioner," this "absolutely bar[s]" private suits and litigants "may not rely" on that legislation "as a basis for a UCL claim." *Zhang*, 57 Cal. 4th at

384. Thus, in *Zhang*, the California Supreme Court reaffirmed prior holdings that the UIPA bars private enforcement and does not permit UCL actions.

In so doing, *Zhang* relied on *Moradi-Shalal*, which held that the UIPA was not privately enforceable because the statute's enforcement provisions contemplated "only administrative enforcement" and were not "intend[ed] to create a private civil cause of action." *Zhang*, 57 Cal. 4th at 368, 384; *Moradi-Shalal*, 46 Cal. 3d at 300, 304. The court cited in-depth analysis of the legislative history of the UIPA, the legislative history of the National Association of Insurance Commissioners ("NAIC") model act that served as the template for the UIPA, and the adverse consequences of allowing private suits to enforce the UIPA. *Moradi-Shalal*, 46 Cal. 3d at 299-304. The Supreme Court later built on *Moradi-Shalal*, holding that a "plaintiff could not plead around that limitation [on private enforcement] by relying on conduct which violates only the UIPA as the basis for a [UCL] cause of action." *Manufacturers Life Ins. v. Superior Ct.*, 10 Cal. 4th 257, 283 (1995).

The Illustration Statute does not permit a UCL action because, like the UIPA, it "does not create a private right of action and instead opts for administrative enforcement." ER478 at 4. The same analysis that (per *Zhang* and

Moradi-Shalal) yields the undisputed proposition that the UIPA precludes UCL claims also shows that the Illustration Statute does so.[25]

First, the text of the Illustration Statute incorporates the UIPA administrative enforcement provision. *See* Ins. Code § 10509.961 ("an insurer or producer that violates [the Illustration Statute] shall be subject to Section 790.06"). Thus, the Illustration Statute adopts the same enforcement regime that *Zhang* found preclusive of UCL claims. Simply put, if that statutory language precluded UCL enforcement when it appeared in the UIPA, then that same language, when used in the Illustration Statute, should not yield the same result.

Indeed, the timing of the Illustration Statute's enactment confirms the Legislature's intention to bar UCL claims by incorporating the UIPA enforcement mechanism. The Illustration Statute was enacted in 1996, one year after the California Supreme Court held that the UIPA provided for only administrative enforcement and consumers "could not plead around that limitation by relying on conduct which violates only the UIPA as the basis for a [UCL] cause of action." *Manufacturers Life*, 10 Cal. 4th at 283. The Legislature is presumed to have been

[25] Contrary to Plaintiffs' suggestion (Br.27-30, 32), the court did not hold that the absence of a private right of action alone bars a UCL claim. Rather, the Court found that, just like the UIPA, the Illustration Statute "contemplated" only "administrative enforcement" by the Insurance Commissioner. ER478 at 4.

cognizant of the statutory interpretations of the California Supreme Court. *In re Halcomb*, 21 Cal. 2d 126, 129 (1942).

The Attorney General's observation that the Illustration Statute preserves "any other penalties provided by law" is irrelevant. AG Br.26 (quoting Ins. Code § 10509.961). Under well-established law, private UCL recovery "does not constitute a penalty." *Murphy v. Kenneth Cole Prods., Inc.*, 40 Cal. 4th 1094, 1112 (2007); *see also Clark v. Superior Ct.*, 50 Cal. 4th 605, 614-615 (2010) (restitution in private UCL action "not a penalty").

Second, the legislative history of the Illustration Statute confirms, just like the UIPA, that the legislature did not contemplate UCL actions. The Legislative Analyses prepared for the Illustration Statute made no mention of private actions. Rather, the Analyses noted that a "key feature" of the statute was that it "[p]rovide[d] that violations of the bill may be enforced pursuant to specified provisions of the Unfair [Insurance] Practices Act which require a hearing before issuance of a stop order, and further requires resort to the courts through the Attorney General if the conduct does not stop." Senate Comm. on Ins., Analysis of AB 3234 (1995-1996 Reg. Sess.) as amended June 10, 1996 (App. C); Senate Rules Comm., Floor Analyses of AB 3234 (1995-1996 Reg. Sess.) as amended Aug. 19, 1996 (App. F) (same). Other Analyses described the bill as "authoriz[ing] the Insurance Commissioner to regulate illustrations presented to

life insurance consumers." Senate Comm. on Appropriations, Fiscal Summary of AB 3234 (1995-1996 Reg. Sess.) as amended July 9, 1996 (App. D); Senate Rules Comm., Floor Analyses of AB 3234 (1995-1996 Reg. Sess.) as amended July 9, 1996 (App. E). Further, when Analyses discussed the "fiscal impact" of the bill, they noted that the Department of Insurance may incur costs resulting from the statute's enactment, but did not anticipate any costs for courts. *See, e.g.*, Senate Comm. on Appropriations, Fiscal Summary of AB 3234 (1995-1996 Reg. Sess.) as amended July 9, 1996.

In *Moradi-Shalal*, the Supreme Court heavily weighed very similar legislative history, which described the UIPA as "contemplating only *administrative* enforcement by the Insurance Commissioner" and made "no mention … of a possible private civil remedy." 46 Cal. 3d at 300 (emphasis in original). *Moradi-Shalal* found "[t]he fact that neither the Legislative Analyst nor the Legislative Counsel observed that the new act created a private right of action is a strong indication the Legislature never intended to create such a right of action," and therefore barred private suit. *Id.*

Third, the legislative history of the NAIC model illustration regulation, which California adopted largely unchanged as the Illustration Statute, further confirms that the statute bars private suits. The Illustration Statute "adopt[ed] … the [NAIC] Model Regulation on Life Insurance Illustrations," Senate Comm. on

Ins., Analysis of AB 3234 (1995-1996 Reg. Sess.) as amended June 10, 1996, including incorporating the NAIC's enforcement provision nearly verbatim. In developing the model regulation, the NAIC considered at length and rejected private actions, 1993-4 NAIC Proc. 642, 651-655 (App. A), noting that "a provision creating a private cause of action was a major departure from NAIC policy" and could create a situation where "if someone did not understand an illustration and was unhappy with the results, he could hire a lawyer and make millions on this." *Id*. at 652-653. Instead, the NAIC (like California) opted only for administrative enforcement proceedings as set forth in the model equivalent of the UIPA which, as the NAIC noted, "specifically said it did not imply a private cause of action." *Id*. at 654; NAIC Model Laws, Regulations and Guidelines 582-1, § 12 (App. B).

Similarly, *Moradi-Shalal* looked to the legislative history of the NAIC model equivalent of the UIPA, finding "the NAIC [legislative history] instructive regarding the intent of the framers of the model act on which the California act was based." 46 Cal. 3d at 299. *Moradi-Shalal* emphasized that the model act did "not contain an individual right of action provision" and in fact, "one proposal which would have created such a cause of action was deleted from the draft model act." *Id*.

Fourth, the legislative history makes clear that the Illustration Statute was intended as a "comprehensive regulatory scheme to control when and in what

manner life insurers may use [illustrations] to describe the operation and benefits of life insurance policies." Senate Comm. on Ins., Analysis of AB 3234 (1995-1996 Reg. Sess.) as amended June 10, 1996. The statute specifies not only general standards for illustrations but also such detail as terminology and placement of various text. *See* Ins. Code § 10509.956(a)(1)-(9). As California courts recognize, when the Legislature enacts such a comprehensive regulatory regime, it normally intends to bar UCL actions. *Loeffler v. Target Corp.*, 58 Cal. 4th 1081, 1104, 1126-1130 (2014) (barring UCL claims as "interfer[ing] and "inconsistent" with "searching regulatory scheme"); *Charles J. Vacanti, M.D., Inc. v. State Comp. Ins. Fund*, 24 Cal. 4th 800, 810-812, 827-828 (2001) (California Workers Compensation Act, "a comprehensive statutory scheme," bars UCL claims); *Summit Tech, Inc. v. High-Line Med. Instruments Co.*, 922 F. Supp. 299, 316-317 (C.D. Cal. 1996) (California FDCA statute, a "comprehensive public health scheme[] administered by [an] expert agenc[y]," bars private UCL claim where court found "no expressed legislative intent" to the contrary).

Finally, contrary to the Attorney General's public policy discussion (AG Br.26-28), this case displays the Legislature's wisdom in avoiding private actions. Were Plaintiffs correct, courts would be left hearing challenges to the use of an asterisk rather than a zero to denote lapse (ER464-13 ¶95(i) (proposed complaint with such a claim)) or similarly technical issues. The California Supreme Court

assumes the Legislature did not intend to burden courts with UCL suits for violation of any technical requirement in a comprehensive regulatory regime. *Loeffler*, 58 Cal. 4th at 1130 (rejecting private UCL suits that "could form a huge volume of litigation" occurring "outside the system" designed "to develop that law, and without the benefit of" regulator's "expertise or its ability to conserve judicial resources by correcting error by means of administrative proceedings").[26]

2. Plaintiffs' and the Attorney General's position runs afoul of precedent

Plaintiffs and the Attorney General: (i) do not address the analysis that *Moradi-Shalal* requires;[27] (ii) largely ignore the statutory text; and (iii) disregard the Illustration Statute's legislative history.

A fundamental problem with Plaintiffs' and the Attorney General's position is that, as the court explained (ER478 at 4-5), the position parallels the concurrence in *Zhang*, relying on *Stop Youth Addiction* and *Cel-Tech* to suggest that statutory text and legislative history indicating "that the Legislature did not create a right of

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[26] The Attorney General wrongly asserts that the court's decision would immunize unfair and deceptive acts from private suit. AG Br.25-26. As in *Zhang*, a plaintiff would remain free to bring a UCL claim under the unlawful prong for violation of other statutes (or under the other UCL prongs), even if the conduct in question also violates the Illustration Statute. *See* 57 Cal. 4th at 384. Indeed, here, Plaintiffs were permitted to do just that—try their challenges to illustrations, just not as alleged violations of the Illustration Statute.

[27] Plaintiffs miss the point by arguing that *Moradi-Shalal* concerned the UIPA rather than the Illustration Statute. Br.31. The *analysis* called for by *Moradi-Shalal* shows that the Illustration Statute does not permit UCL claims.

action in the Act" is "insufficient" to preclude UCL claim. *See Zhang*, 57 Cal. 4th at 388-389. The *Zhang* concurrence argued that the UIPA features described above were insufficient to constitute an "actual[] bar," and UCL claims "predicated on violations of the [UIPA] are, in fact, permissible." *Id*. at 388. The *Zhang* majority, however, rejected the concurrence. *See id*. at 379 n.8. The same result follows for Plaintiffs' position here—for the same reasons *Zhang* re-affirmed that the UIPA bars UCL actions, the Illustration Statute does too.[28]

Plaintiffs and the Attorney General also make other errors. For instance, the Attorney General wrongly argues that "*Moradi-Shalal* "reaches no further than section 790.03(h)." AG Br.18. While *Moradi-Shalal* involved Section 790.03(h), subsequent decisions make clear that the bar on UCL actions extends to the entire UIPA. *Zhang*, 57 Cal. 4th at 384; *see also Manufacturers Life*, 10 Cal. 4th at 280, 283 (applying 790.03(c), not 790.03(h), and holding private UIPA actions are barred); *Vikco Ins. Servs. v. Ohio Indem. Co.*, 70 Cal. App. 4th 55, 64-66, 68 (1999) (UCL claim barred where enforcement provision of non-UIPA underlying statute was Section 790.06). The reason has nothing to do with 790.03(h), but flows from the separate UIPA provisions (§§ 790.05-790.09) establishing the

[28] *Rose v. Bank of Am., N.A.*, 57 Cal. 4th 390 (2013), is irrelevant. *Rose* concerned a UCL unlawfulness claim brought for violation of a federal statute that the court held "expressly permitt[ed] private actions under [consistent] state laws," like the UCL. *Id*. at 398. There is of course no such provision in the Illustration Statute.

administrative enforcement regime. *See Zhang*, 57 Cal. 4th at 372, 384; *see also Moradi-Shalal*, 46 Cal. 3d at 300, 304. The Illustration Statute adopts that same enforcement mechanism.

Plaintiffs and the Attorney General also rely on inapposite cases. *Hughes v. Progressive Direct Insurance Co.*, Br.33, is unpublished and not citable. 196 Cal. App. 4th 754 (2011), *review granted* 261 P.3d 756 (Cal. 2011), *review dismissed*, 307 P.3d 877 (Cal. 2013).[29] Regardless, *Hughes* strongly supports the court's holding. The *Hughes* plaintiff sought to base a UCL claim on violation of Insurance Code Section 758.5. 196 Cal. App. 4th at 758. The court reviewed the legislative history of Section 758.5 and noted that the legislature had considered but *rejected* an amendment that would have been essentially identical to the Illustration Statute's enforcement language. *See id.* at 768-769 ("Any person who violates this section shall be deemed to have violated [the UIPA], and shall be liable to the state for a civil penalty to be fixed by the commissioner pursuant to [the UIPA]"). The *Hughes* court placed great weight on the amendment's rejection, noting the rejected text would have signaled that the Legislature "intended simply to classify a violation of [758.5] as another unfair insurance practice with enforcement limited to those remedies set forth in the UIPA." *Id.* at 770.

[29] The Supreme Court's grant of review rendered *Hughes* unpublished. Cal. Ct. R. 8.1105(e)(1). Dismissal of review did not change that. *Id.* R. 8.528(b)(3).

Plaintiffs also rely on *Chabner*, which held that "section 17200 can form the basis for a private cause of action even if the predicate statute does not." *Chabner v. United of Omaha Life Ins.*, 225 F.3d 1042, 1048 (9th Cir. 2000). That proposition is uncontroversial, but, as this Court also noted, "[t]here are limits on the causes of action that can be maintained under section 17200" such that a "court may not allow a plaintiff to plead around an absolute bar to relief simply by recasting the cause of action as one for unfair competition." *Id*. That was the basis for the court's decision here—the Illustration Statute is best read to bar private enforcement, and Plaintiffs cannot circumvent that.[30] Consistent with *Chabner*, the court here dismissed Plaintiffs' UCL claim only insofar as it was predicated on violation of the Illustration Statute, but made clear that Plaintiffs could pursue these same theories under Insurance Code Section 330. ER461 at 3.

Stop Youth Addiction, also cited by Plaintiffs and the Attorney General, merely confirms that a UCL claim cannot proceed where "the Legislature intended to bar unfair competition causes of action based on such practices." *Stop Youth Addiction, Inc. v. Lucky Stores, Inc.*, 17 Cal. 4th 553, 565-566 (1998). There, the court found that the Legislature did not intend such a bar, because the underlying statute (Section 308 of the Penal Code) lacked almost all of the indicia of a bar that

[30] By contrast, the underlying statute in *Chabner* (Ins. Code § 10144) did not include administrative enforcement, nor did the legislative history signal the Legislature's intention to bar private suits.

are present in the Illustration Statute. *See, e.g.*, *id*. at 567 (legislative history authorized UCL suits based on Penal Code).[31]

Finally, Plaintiffs cite the unpublished decision, *Rand v. American National Insurance*, 2009 WL 2252115 (N.D. Cal. July 28, 2009), which they falsely claim "permitted UCL claims predicated on Section 10509.950," the Illustration Statute. Br.31. *Rand* is not about the Illustration Statute (Section 10509.950), but rather about a statute regulating life insurance replacement (Section 10509). 2009 WL 2252115, at *2. The replacement statute is irrelevant; it does not provide for exclusive administrative enforcement under the UIPA. *See* Ins. Code § 10509.9. Nor did *Rand* identify legislative history reflecting an intent to bar private enforcement.

B. Any Error Is Harmless Due To Existing Findings

Ultimately, this court need not weigh in on the legal issue Plaintiffs raise on appeal. Where a claim is dismissed, and subsequent findings would have defeated liability, any error is harmless. *See Karam v. City of Burbank*, 352 F.3d 1188, 1195 (9th Cir. 2003). Here, the court's correct findings also dispose of Plaintiffs' Illustration Statute-based UCL claims because, although Plaintiffs were not

[31] To the extent that Plaintiffs read *Stop Youth Addiction* to require "magic words" in statutory text to bar a UCL claim, *Zhang* rejects that reading. *See Zhang*, 57 Cal. 4th at 380 n.8 (statute that "contemplates only administrative sanctions" makes clear that Legislature "concluded that no action should lie," thus precluding a UCL suit).

permitted to base a UCL claim specifically on the Illustration Statute, the court permitted them to pursue the same theories. ER461 at 3. For instance, Plaintiffs tried to prove that illustrations were misleading with respect to non-guaranteed values, guaranteed values, policy costs, and MAC reductions. They claimed that, without such misleading illustrations, they would not have purchased their policies or would have paid less.

Those arguments resulted in extensive factual findings that dispose of the UCL claim Plaintiffs wish to resurrect. The court properly rejected the assertion that the illustrations were misleading. ER791 60:22-64:19 (non-guaranteed values not misleading); *id.* 71:12-17 (similar as to charges and guaranteed values); *id.* 74:12-16 (portrayal of MAC reductions not deceptive). The absence of deception is fatal to Plaintiffs' proposed UCL claim based on the Illustration Statute. Plaintiffs would have been required to establish that they "suffered injury in fact and … lost money or property as a result of the unfair competition." Bus. & Prof. Code § 17204. Without a misleading illustration, however, Plaintiffs' injury theory fails because the only injury they alleged was that they "relied on LSW's misrepresentations, concealment, and omissions" and "would not have purchased the policies" absent such conduct. ER464-12 64:26-65:1. Moreover, the court properly rejected the testimony of Brockett, the only witness who purported to

show that Plaintiffs would have paid less for their policies if their illustrations had differed. ER791 50:21-53:3.

Plaintiffs' allegations thus could not survive the court's findings. For instance, they claim that LSW violates the Illustration Statute's prohibition of implying that non-guaranteed values are guaranteed "by misrepresenting LSW's actual guaranteed interest rate and also by stating or implying that the [MAC] will be reduced or eliminated beginning in the eleventh year." Br.27 n.7. Plaintiffs tried these precise allegations, as individual UCL claims, and the court properly rejected them. ER791 72:12-18; 74:12-22.

CONCLUSION

This Court should affirm the judgment below.

Respectfully submitted,

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February 8, 2016

STATEMENT OF RELATED CASES

I certify that I know of no related cases pending which the court might wish to consider with the instant appeal.

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), the undersigned hereby certifies that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B)(i).

1. Exclusive of the exempted portions of the brief, as provided in Fed. R. App. P. 32(a)(7)(B), the brief contains 13,991 words.

2. The brief has been prepared in proportionally spaced typeface using Microsoft Word 2010 in 14 point Times New Roman font. As permitted by Fed. R. App. P. 32(a)(7)(B), the undersigned has relied upon the word count feature of this word processing system in preparing this certificate.

/s/ James T. Lux
JAMES T. LUX

February 8, 2016

STATUTORY ADDENDUM
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STATUTORY ADDENDUM

California Business and Professions Code § 17500

It is unlawful for any person, firm, corporation or association, or any employee thereof with intent directly or indirectly to dispose of real or personal property or to perform services, professional or otherwise, or anything of any nature whatsoever or to induce the public to enter into any obligation relating thereto, to make or disseminate or cause to be made or disseminated before the public in this state, or to make or disseminate or cause to be made or disseminated from this state before the public in any state, in any newspaper or other publication, or any advertising device, or by public outcry or proclamation, or in any other manner or means whatever, including over the Internet, any statement, concerning that real or personal property or those services, professional or otherwise, or concerning any circumstance or matter of fact connected with the proposed performance or disposition thereof, which is untrue or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue or misleading, or for any person, firm, or corporation to so make or disseminate or cause to be so made or disseminated any such statement as part of a plan or scheme with the intent not to sell that personal property or those services, professional or otherwise, so advertised at the price stated therein, or as so advertised. Any violation of the provisions of this section is a misdemeanor punishable by imprisonment in the county jail not exceeding six months, or by a fine not exceeding two thousand five hundred dollars ($2,500), or by both that imprisonment and fine.

California Insurance Code § 10509

The purpose of this article is the following:

(a) To regulate the activities of insurers and agents with respect to the replacement of existing life insurance and annuities.

(b) To protect the interests of life insurance and annuity purchasers by establishing minimum standards of conduct to be observed in replacement transactions by the following:

(1) Assuring that the purchaser receives information with which a decision can be made in his or her own best interest.

(2) Reducing the opportunity for misrepresentation and incomplete disclosures.

(3) Establishing penalties for failure to comply with the requirements of this article.

California Insurance Code § 10509.9

(a) Any agent or other person or entity engaged in the business of insurance, other than an insurer, who violates this article is liable for an administrative penalty of no less than one thousand dollars ($1,000) for the first violation.

(b) Any agent or other person or entity engaged in the business of insurance, other than an insurer, who engages in practices prohibited by this chapter a second or subsequent time or who commits a knowing violation of this article, is liable for an administrative penalty of no less than five thousand dollars ($5,000) and no more than fifty thousand dollars ($50,000) for each violation.

(c) Any insurer who violates this article is liable for an administrative penalty of ten thousand dollars ($10,000) for the first violation.

(d) Any insurer who violates this article with a frequency as to indicate a general business practice or commits a knowing violation of this article, is liable for an administrative penalty of no less than thirty thousand dollars ($30,000) and no more than three hundred thousand dollars ($300,000) for each violation.

(e) After a hearing conducted in accordance with Chapter 4.5 (commencing with Section 11400) and Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code, the commissioner may suspend or revoke the license of any person or entity that violates this article.

(f) Nothing in this section shall be deemed to affect any other authority provided by law to the commissioner.

California Rule of Court 8.528(b)(3)

(b) Dismissal of review

* * *

(3) After an order dismissing review, the Court of Appeal opinion remains unpublished unless the Supreme Court orders otherwise.

California Rule of Court 8.1105(e)(1)

(e) Changes in publication status

(1) Unless otherwise ordered under (2), an opinion is no longer considered published if the Supreme Court grants review or the rendering court grants rehearing.

Federal Rule of Evidence 1101(b)—Applicability of the Rules

(b) To Cases and Proceedings. These rules apply in:

- civil cases and proceedings, including bankruptcy, admiralty, and maritime cases;
- criminal cases and proceedings; and
- contempt proceedings, except those in which the court may act summarily.

California Penal Code § 308

(a)(1) Every person, firm, or corporation that knowingly or under circumstances in which it has knowledge, or should otherwise have grounds for knowledge, sells, gives, or in any way furnishes to another person who is under the age of 18 years any tobacco, cigarette, or cigarette papers, or blunts wraps, or any other preparation of tobacco, or any other instrument or paraphernalia that is designed for the smoking or ingestion of tobacco, products prepared from tobacco, or any controlled substance, is subject to either a criminal action for a misdemeanor or to a civil action brought by a city attorney, a county counsel, or a district attorney, punishable by a fine of two hundred dollars ($200) for the first offense, five hundred dollars ($500) for the second offense, and one thousand dollars ($1,000) for the third offense.

Notwithstanding Section 1464 or any other provision of law, 25 percent of each civil and criminal penalty collected pursuant to this subdivision shall be paid to the office of the city attorney, county counsel, or district attorney, whoever is responsible for bringing the successful action, and 25 percent of each civil and criminal penalty collected pursuant to this subdivision shall be paid to the city or county for the administration and cost of the community service work component provided in subdivision (b).

Proof that a defendant, or his or her employee or agent, demanded, was shown, and reasonably relied upon evidence of majority shall be defense to any action brought pursuant to this subdivision. Evidence of majority of a person is a facsimile of or a reasonable likeness of a document issued by a federal, state, county, or municipal government, or subdivision or agency thereof, including, but not limited to, a motor vehicle operator's license, a registration certificate issued under the federal Selective Service Act, or an identification card issued to a member of the Armed Forces.

For purposes of this section, the person liable for selling or furnishing tobacco products to minors by a tobacco vending machine shall be the person authorizing the installation or placement of the tobacco vending machine upon premises he or she manages or otherwise controls and under circumstances in which he or she has knowledge, or should otherwise have grounds for knowledge, that the tobacco vending machine will be utilized by minors.

(2) For purposes of this section, "blunt wraps" means cigar papers or cigar wrappers of all types that are designed for smoking or ingestion of tobacco products and contain less than 50 percent tobacco.

(b) Every person under the age of 18 years who purchases, receives, or possesses any tobacco, cigarette, or cigarette papers, or any other preparation of tobacco, or any other instrument or paraphernalia that is designed for the smoking of tobacco, products prepared from tobacco, or any controlled substance shall, upon conviction, be punished by a fine of seventy-five dollars ($75) or 30 hours of community service work.

(c) Every person, firm, or corporation that sells, or deals in tobacco or any preparation thereof, shall post conspicuously and keep so posted in his, her, or their place of business at each point of purchase the notice required pursuant to subdivision (b) of Section 22952 of the Business and Professions Code, and any person failing to do so shall, upon conviction, be punished by a fine of fifty dollars ($50) for the first offense, one hundred dollars ($100) for the second offense, two hundred fifty dollars ($250) for the third offense, and five hundred dollars ($500) for the fourth offense and each subsequent violation of this provision, or by imprisonment in a county jail not exceeding 30 days.

(d) For purposes of determining the liability of persons, firms, or corporations controlling franchises or business operations in multiple locations for the second and subsequent violations of this section, each individual franchise or business location shall be deemed a separate entity.

(e) It is the Legislature's intent to regulate the subject matter of this section. As a result, no city, county, or city and county shall adopt any ordinance or regulation inconsistent with this section.

APPENDIX A

Proceedings of the National Association of Insurance Commissioners, 1993, Fourth Quarter

1993 National Meeting, Honolulu, Hawaii

December 5, 1993

- December 8, 1993

1993-4 NAIC Proc. 642

LENGTH: 13712 words

TITLE: LIFE INSURANCE (A) COMMITTEE

REFERENCE: 1993 Proc. 3rd Qtr. 426, 1993 Proc. 2nd Qtr. 714

NOTE: Formulas may not appear exactly as they do in the printed version of the Proceedings.

[*642] MINUTES

The Life Insurance (A) Committee met in Coral IV of the Hilton Hawaiian Village, Honolulu, Hawaii, at 1 p.m. on Dec. 8, 1993. A quorum was present and David J. Lyons (Iowa) chaired the meeting. The following committee members or their representatives were present: John Garamendi (Calif.); Robert M. Willis (D.C.); James H. Brown (La.); Harold T. Duryee (Ohio); Kerry Barnett (Ore.); J. Robert Hunter (Texas); and Steven T. Foster (Va.).

1. Consumer Evaluation of Buyer's Guide

Commissioner David J. Lyons (Iowa) asked Mary Griffin (Consumers Union) to speak for Jim Hunt (National Insurance Consumer Organization). Ms. Griffin said that Mr. Hunt had asked her to summarize his concerns about the charge to evaluate the Life Insurance Buyer's Guide. Considering that the Buyer's Guide had not changed since 1984, Mr. Hunt did not think it was an effective or relevant tool. Ms. Griffin said that Mr. Hunt had reviewed more than 1,500 life insurance proposals over the last three years and not one of the purchasers had indicated an interest in the Buyer's Guide. He suggested a red sticker on the policy to give a warning about early surrender and the costs involved. He said the latest data he had was that 30% of the policies were dropped in two years and 40% within five years. Mr. Hunt thought that after the Life Disclosure Working Group had finished its life insurance illustrations task, it might want to consider revising the guide to include pertinent information. Commissioner Lyons said he agreed that this was an important issue and that later the Buyer's Guide could be considered for revision. Commissioner Lyons thought it was important to work on the priority issue -- that of life insurance illustrations. He suggested keeping this item as a charge to work on at the appropriate time.

2. Report of Unfunded Checking Accounts Working Group

Mary Alice Bjork (Ore.) reported that the Unfunded Checking Accounts Working Group had not expected to have a quorum at its meeting on Dec. 6 so held two conference calls prior to that time. One of the issues of concern to the working group had been whether or not guaranty funds would cover unfunded checking accounts, and she said this issue had been resolved. There still were several issues outstanding, so the group had decided it was appropriate to do a sample bulletin. A draft was attached to the working group minutes, and she said comments were to be received on this draft by Feb. 1. After that time she said the working group would hold a conference call with interested parties to

[*643] refine the draft, with expected adoption in March. Upon motion duly made and seconded, the minutes of the Unfunded Checking Accounts Working Group were adopted (Attachment One).

3. Report of Viatical Settlement Working Group

Commissioner Lyons first summarized the activity of the NAIC Executive Committee and Plenary Sessions regarding viatical settlements. He said the Plenary had adopted the Viatical Settlement Model Act. There had been significant interest and discussion in the topic, and he emphasized that the public should not see adoption of the model act as an NAIC endorsement of the concept of viatical settlements in general. Commissioner Lyons said the Life Insurance (A) Committee might receive an additional charge to investigate other alternatives such as an expanded role for accelerated benefits of life insurance policies. The group might also be expected to discuss the legal ramifications of not allowing viatical settlements at all. Commissioner Lyons next called on Roger Strauss (Iowa), chair of the working group, for a report. Mr. Strauss said the working group had begun the next task, which was development of a model regulation to implement the model act. The working group had discussed key elements to include in a regulation, and drafting would begin within the next month. He asked that the Life Insurance (A) Committee receive the report of the working group, continue the working group for the next year, and authorize the working group to proceed with the development of a regulation. Upon motion duly made and seconded, the report of the Viatical Settlement Working Group was received (Attachment Two).

4. Report of the Life Disclosure Working Group

Bob Wright (Va.), chair of the working group, reported that the working group met Nov. 15 and 16, Dec. 4, and Dec. 7, 1993, to develop a model act on life insurance illustrations, which the working group was now recommending for exposure. The group had also charged the technical resource advisors to come back with a recommendation for an understandable illustration. After discussion with the interested parties some changes had been made to the draft of the model act and Mr. Wright highlighted those changes for the audience.

It had been decided earlier not to cover annuities but after discussion the working group decided to incorporate annuities into the model act since it was an enabling statute only, and to go forward with the regulation for life insurance illustrations. After development of the life disclosure illustrations regulation, a corresponding regulation for annuities could be developed. Mr. Wright said Section 3 was changed to include broad enabling language, moving the list of issues to consider to a drafting note. He said there was significant discussion on the penalty section, Section 4, and the working group decided to leave it as it was. There had been a Section 5 in the prior draft that created a private cause of action. After extensive discussion, the working group decided to remove that provision. Mr. Wright said that more than likely there would be other changes before the model was adopted. He requested continuation of the working group and consideration of an expanded charge to encompass annuity products. Ted Becker (Texas) said the Texas Department of Insurance was particularly interested in annuity illustrations and asked if this approach was the fastest way to get at the issue. Commissioner Lyons said that much of what was learned from the development of the life illustration regulation would apply to annuities, so hopefully that regulation would move much more quickly. Mr. Wright said he did not think the working group had resources to do both areas at the same time, so agreed that the current approach was probably the quickest way to develop an annuity regulation.

Carolyn Cobb (American Council of Life Insurance -- ACLI) assured the working group that her association looked forward to assisting the working group in development of a regulation that would serve consumers, regulators and insurers. She asked the Life Insurance (A) Committee to consider exposure of the draft without the second sentence of Section 4. She said the provision was flawed on several issues: separation of powers, due process, and a lack of understanding of the term of "supportability." She said "supportable" is not a term of art, and the industry does not yet know what that term means. Commissioner Lyons said that the concept of equity did support this remedy. Ms. Cobb responded that the remedy of specific performance has existed for a long time, but it was used in the courts rather than in the insurance code. An executive administration of this type of judicial remedy had not existed. Commissioner Lyons said that there was a procedure to request a [*644] legal opinion from the NAIC staff, and he asked the industry to provide a brief to argue its position. Ms. Cobb again suggested that while this provision is being discussed it should be removed from the draft. Commissioner Lyons responded that if the sentence remained in the draft, the working group was likely to receive the information much more quickly. Mr. Wright asked that comments on that provision also be received by Feb. 1. Commissioner Robert Wilcox (Utah) expressed a concern about this provision. In an effort to

gain a powerful tool, he did not want the model to take the illustration and translate it into a guarantee. In that case, the draft should simply say that insurers could illustrate only guarantees. Commissioner Lyons asked for a motion to remove the second sentence of Section 4 of the draft. Hearing none, he said the sentence would remain in the draft. Upon a motion duly made and seconded, the report of the Life Disclosure Working Group was received (Attachment Three).

5. Report of Synthetic GIC Working Group

Reginald Berry (D.C.) reported that at the fall National Meeting in Boston a working group had been formed and given the charge to look at issues of synthetic guaranteed investment contracts (GICs). The three members of the working group had decided to approach the problem in several phases. The first phase was information gathering. Mr. Berry had a packet of information to distribute to the working group members with information about the types of synthetic GICs currently being marketed. He said the cover letter made clear that the presentation was for informational purposes only. (The cover memo and information list is Attachment Four). He asked for a charge for 1994 to have the working group continue its endeavors. Upon motion duly made and seconded, the report of the Synthetic GIC Working Group was received.

6. Report of the Life and Health Actuarial Task Force

John Montgomery (Calif.) reported that the task force had seven recommendations for the Life Insurance (A) Committee. They are:

(1) Recommend combining life Project 2j "Valuation -- Revision of the Standard Valuation Law" and accident and health Project 3d "Valuation -- Revision of Standard Valuation Law (Health Insurance Aspects)" in December 1993 into a single joint Project 1c "Valuation -- Revision of Standard Valuation Law" which would be reported to both the Accident and Health (B) Committee and the Life Insurance (A) Committee. If this recommendation is duly adopted, it is also recommended that the resulting joint project be designated a number one priority project.

(2) Recommend deletion of life Project 2l "Valuation -- Long Range Issues" from the agenda of the actuarial task force in December 1993.

(3) Recommend exposure of a new draft of the proposed "Second Standard Nonforfeiture Law for Life Insurance" in December 1993 for adoption in June 1994. This draft is dated Dec. 4, 1993.

(4) Recommend exposure of a revised draft of proposed amendments to the "Standard Nonforfeiture Law for Deferred Annuities" in December 1993 for adoption in March 1994. This draft is dated Dec. 4, 1993.

(5) Recommend deletion of life Project 4l "Special Plans -- Whole Life Policies without Cash Values or Paid-Up Benefits," from the agenda of the actuarial task force in December 1993.

(6) Recommend exposure of a revised draft of a proposed new model regulation entitled "Valuation of Life Insurance Policies -- Special Rules" in December 1993 for adoption in June 1994. This draft is dated Dec. 4, 1993.

(7) Recommend that life Project 5 "Reinsurance" be reassigned in December 1993 as a joint Project 2 "Reinsurance" to be reported to both the Accident and Health Insurance (B) Committee and the Life Insurance (A) Committee. If this recommendation is duly adopted, it is also [*645] recommended that the resulting joint project continue to be designated a number two priority project.

Mr. Montgomery said he expected a significant amount of discussion on the draft of the Second Standard Nonforfeiture Law and the Standard Nonforfeiture Law for Deferred Annuities. He suggested that the committee might want to wait until June to adopt the annuity law.

George Coleman (Prudential) said that the drafters of the Second Standard Nonforfeiture Law had changed their approach significantly from the time the model was first proposed. He said the original idea had been to address problems with universal life insurance. Now the draft goes much beyond that and regulates rates by specifying maximum charges. He suggested the draft was fundamentally flawed and questioned whether revisions to the original Standard Nonforfeiture Law were even needed. He also said little testing had been done on the formulas contained in the draft. Commissioner Lyons said that he understood there were significant concerns about the draft but said that due to time constraints the committee could not go into these at this time. He suggested holding a public hearing on the issue of

the two model drafts at the March National Meeting in Denver. Mr. Coleman said that he preferred that the drafts not be exposed at this time because the issues were not yet resolved. He said that there were major inequities to address. Upon motion duly made and seconded, the report of the Life and Health Actuarial Task Force was adopted with an amendment to propose June adoption for the annuity draft.

7. Recommendations Regarding 1994 Charges

After a review of the 1993 charges, the Life Insurance (A) Committee agreed to request charges for 1994 regarding the issue of life insurance disclosure, annuity disclosure, a regulation to implement the Viatical Settlement Model Act, and a March completion for the unfunded checking accounts issue. A new charge would be requested on synthetic GICs, and the Life Insurance Buyer's Guide should remain on the list of charges with the understanding that it would be considered after completion of the illustrations regulation.

Having no further business, the Life Insurance (A) Committee adjourned at 2:10 p.m.

David J. Lyons, Chair, Iowa; Vacant, Vice Chair; James H. Dill, Ala.; John Garamendi, Calif.; Robert M. Willis, D.C.; James H. Brown, La.; Harold T. Duryee, Ohio; Geoff Guilfoy, Ore.; Claire Korioth, Texas; Steven T. Foster, Va.

ATTACHMENT ONE

Unfunded Checking Accounts Working Group

Honolulu, Hawaii

December 6, 1993

The Unfunded Checking Accounts Working Group of the Life Insurance (A) Committee met in South Pacific I of the Hilton Hawaiian Village, Honolulu, Hawaii, at 2 p.m. on Dec. 6, 1993. Mary Alice Bjork (Ore.) chaired the meeting. The following working group members were present: Shawn Bryan (Vt.).

Mary Alice Bjork (Ore.) called the meeting to order and said that two conference calls had been held by the working group since the last NAIC meeting (Attachments One-C and One-D). She said at that time they discussed the memorandum from the National Organization of Life and Health Guaranty Associations (NOLHGA) (Attachment One-A), which addressed the concerns of the working group on the issue of guaranty fund coverage.

At the Dec. 1, 1993, conference call, the working group adopted an exposure draft of a bulletin that states could use to address the other issues regarding unfunded checking accounts (Attachment One-B). She asked that comments be sent to Carolyn Johnson (NAIC/SSO) and to each of the members of the working group by Feb. 1. She said the intent was to adopt this bulletin with whatever modifications the working group felt necessary at the spring National Meeting in Denver.

Ms. Bjork asked if there were any comments on the draft at this time. Carolyn Cobb (American Council of Life Insurance -- ACLI) said she had not, of course, had an opportunity to complete a review of the draft, but she did have some preliminary comments to make. She said retained asset accounts were an important benefit for policyholders and she appreciated the opportunity to work with the NAIC on this issue. Her first point was that the accounts were not unfunded; she said they were [*646] fully funded and accounted for as liabilities on the annual statement of the company. She said drafting a regulation was inappropriate because only a few states did not have authority already to review the agreements. She agreed that it was appropriate to disclose who was in possession of the funds but she did not think there should be a requirement to say that there was no Federal Deposit Insurance Corporation (FDIC) protection and to mention the limits on guaranty fund protection. She said the ACLI would be submitting comments by the deadline and she requested a hearing and opportunity to discuss concerns after the working group had reviewed the comments of interested parties.

Ms. Bjork clarified the intent of the working group was not to develop a regulation. Ms. Cobb said she was referring to the drafting note after the first paragraph of the bulletin. Ms. Bjork said the intent was not to develop a model regulation, but if a state did not have authority to do what the bulletin says, that state might choose to do a regulation. Ms. Cobb responded that there were other methods of getting authority to review the disclosure statements.

Shawn Bryan (Vt.) said given the fact that what the working group was proposing was in the form of a bulletin, he expected the concerns of the industry had been allayed. Ms. Bjork said that the working group would provide another opportunity to interact with interested parties before the bulletin became final. She said they would probably not have a hearing but she would consider involving interested parties in a conference call. Mr. Bryan said the issues of FDIC and guaranty fund disclosure were very important and appropriate. Because of his firm conviction, he suggested that interested parties address this issue in their comments.

Having no further business, the Unfunded Checking Accounts Working Group adjourned at 2:15 p.m.

ATTACHMENT ONE-A

National Organization of Life and Health Guaranty Associations
13873 Park Center Road, Suite 329
Herndon, VA 22071
(703) 481-5206
(703) 481-5209 (fax)

From: Anthony R. Buonaguro, Senior Vice President & General Counsel
Date: November 24, 1993
Re: Guaranty Associations Coverage of Retained Asset Accounts

ISSUE

An increasing number of life insurance companies are settling death claims through the use of what have become known generically as retained asset accounts. This option may be offered along with other more traditional options such as an annuity. We understand that the life insurance industry regards this form of settlements as the same as a lump sum payment since the beneficiary has immediate access to all or any part of the proceeds.

Specific arrangements vary, but it appears that the most common practice is for the insurer to retain the policy proceeds and credit interest, while arranging with a bank for the issuance to the beneficiary of bank drafts which allow the beneficiary to access all or any part of the funds at any time. The bank agrees to honor the draft subject to collection of the funds from the insurer. The insurer agrees to deposit the funds with the bank when it is notified that a draft has been presented. In effect, the bank serves merely as paying agent, and the insurer, as we understand it, continues to carry the beneficiary's account values as a liability for statutory accounting purposes, reported as proceeds in the process of settlement on line 10.3 in the Liabilities, Surplus and Other Funds statement.

The question is this: If the insurer becomes insolvent prior to the funds being fully paid out to the beneficiary, is the beneficiary protected by the state guaranty association?

CONCLUSION

We have concluded that funds left with the insurer under arrangements such as those described above would be protected by the guaranty association under the terms of the Life and Health Insurance Guaranty Association Model Act. We further believe that these arrangements would be subject to the same coverage limitations under the Model Act as are applicable to life policy death benefits.

RATIONALE

Section 3B(1) of the Model Act states that the Act provides coverage for "direct, non-group life, health, annuity and supplemental policies or contracts." Section 8C(1) of the Model Act requires the guaranty association to either guarantee, assume or reinsure, or cause to be guaranteed, assumed or reinsured, the "policies or contracts" of an insolvent insurer or assure payment of the "contractual obligations" of the insolvent insurer.

In the case of retained asset accounts, the continuing relationship between the insurer and the beneficiary can fairly be characterized either as the extended payment over time of the benefits under the original policy or the establishment of a

contractual relationship between the insurer and the beneficiary which is supplemental to the original policy. Under either [*647] analysis, it is clear from the language quoted above that coverage exists. A contract supplemental to a covered insurance policy continues to be protected, as the original policy was, subject to applicable statutory limits.

If viewed as payment over time of life insurance proceeds, it is clear under Section 3C(2)(a)(i) of the Model Act that the arrangement would be covered up to the same dollar amount as was the original life policy. If viewed as a supplemental contract, we believe the same conclusion would be reached. Obviously, the limitations for annuity and health insurance benefits would not apply. And the funds in the retained asset account cannot fairly be characterized as either "net cash surrender or net cash withdrawal values," since these concepts refer to values present under a life policy before it matures.

We believe that the correct analysis clearly is that the limitation for life insurance death benefits must apply. This analysis is supported by the lead-in to Section 3C(2)(a), which modifies the coverage limit for death benefits "with respect to any one life, regardless of the number of policies or contracts." If the retained assets arrangement is a supplemental contract, it is a covered "contract with respect to one life" which is not the policy itself but under which death benefits are nevertheless being held, a type of arrangement which the coverage limitation provision for death benefits contemplates.

ATTACHMENT ONE-B

Draft: 12/1/93

Sample Bulletin

TO: All Life Insurers Licensed to Write Business in [State]
FROM: [Commissioner, Director, Superintendent]
DATE: [Insert Date]
RE: Unfunded Checking Accounts

The purpose of this bulletin is to set forth the procedures this department expects to see in place in regard to the settlement of life insurance proceeds through the mechanism known by such terms as "unfunded checking accounts, "retained asset accounts," "reserve asset accounts" and "asset preservation accounts." These accounts are designed to be a temporary repository of funds while the beneficiary considers the available options. While the majority of insurers handle these accounts in an appropriate manner, the potential for misunderstanding or abuse is present. In market conduct examinations and handling of complaints these are the procedures the department will expect to find in place:

Drafting Note: If a state does not have sufficient authority to examine the disclosure forms and require their compliance with these provisions, the state should consider adopting a regulation instead, using this bulletin as an outline.

A. Disclosure

(1) The "Checkbook"

Literature describing the settlement options should clearly disclose that payment of the total proceeds is accomplished by delivery of a "checkbook," if that is the case. It should be clear to the beneficiary that one check can be written to access the entire proceeds, and that the other options are preserved until the entire balance is withdrawn. The literature should make clear that the proceeds are not in a true checking account insured by the FDIC unless such is the case. Any charges to maintain the account should be prominently disclosed.

(2) Guaranty Fund Coverage

If the proceeds exceed the statutory limit for guaranty fund coverage, the insurer should disclose the fact that only $ [insert amount] will be paid, should the insurer become insolvent. Disclosure should also include a statement that guaranty fund coverage may not include accrued interest.

(3) Tax Implications

The disclosure information should indicate that there may be tax implications, and the beneficiary should consult his or her tax advisor.

B. Interest

The funds should draw interest from the date of death at a rate comparable to that being paid for similar investments in the open market or at the statutory rate.

C. Accounting

The funds necessary to cover liabilities under these accounts shall be reported as liabilities (claims due and unpaid) on the annual statement. In the company books the obligations should be segmented from general assets.

[*648] D. Guaranty Fund Protection

As obligations of the insurer, unpaid proceeds will be subject to guaranty fund protection up to the statutory limits in the event of an insurer insolvency.

ATTACHMENT ONE-C

Unfunded Checking Accounts Working Group

Conference Call

December 1, 1993

The Unfunded Checking Accounts Working Group of the Life Insurance (A) Committee met by conference call on Dec. 1, 1993, at 10 a.m. Central time. Participating were: Mary Alice Bjork (Ore.), Chair; Beth Hill (Texas); Shawn Bryan (Vt.); and Melodie Bankers (Wash.). Carolyn Johnson (NAIC/SSO) also participated.

Mary Alice Bjork (Ore.) said the purpose of the conference call was to review the draft bulletin and vote on exposure at the winter National Meeting in Honolulu, Hawaii. Shawn Bryan (Vt.) asked the members of the working group if they had received the fax which he sent. Mr. Bryan said that Vermont still favors the development of a regulation rather than a bulletin. He said his department is still uncomfortable with respect to guaranty fund coverage. Ms. Bjork said that the letter from the National Organization of Life and Health Guaranty Funds (NOLHGA) has laid her concerns to rest in this regard. She said that she believed the guaranty fund issue had been resolved and the main issue now was disclosure. Beth Hill (Texas) said she had discussed the issue with the guaranty fund in Texas and it was of the opinion the death benefit was covered, but interest would not be paid. Melodie Bankers (Wash.) asked about the situation where the guaranty fund limits were lower than the amount in the unfunded checking account. She thought that limitations on coverage should be disclosed in that situation. The working group decided that the disclosure section of the bulletin should require disclosure of the guaranty fund limits and also the possibility that interest on the account might not be paid in the event of an insolvency.

Mr. Bryan said that he did not favor allowing any transaction charges or other charges on the unfunded checking account. He said this was another argument in favor of doing a regulation rather than a bulletin, because he did not feel a bulletin could prohibit the charges. Ms. Bjork said that in Oregon interest and other charges were not permitted. Ms. Hill said that Texas did not currently have the authority to review life products to the extent of reviewing a disclosure statement. The other members of the working group suggested that, in a state like Texas, it would be appropriate to do a regulation rather than a bulletin to give the department authority to review the disclosure statements. The members of the working group decided to add a drafting note to the bulletin to make this suggestion to states.

Mr. Bryan said that he thought it was important to make clear that the unfunded checking account was to be a temporary residence for funds. Consumers ought to be encouraged to move the funds into a more permanent arrangement as soon as they had made a financial decision.

Ms. Bjork suggested that a provision be added to disclose the fact that there may be tax implications to the beneficiary's choice and he should see his tax advisor. The working group then voted to expose the draft bulletin with the changes outlined above.

Having no further business, the conference call adjourned at 10:30 a.m.

ATTACHMENT ONE-D

Unfunded Checking Accounts Working Group

Conference Call

November 17, 1993

The Unfunded Checking Accounts Working Group of the Life Insurance (A) Committee met by conference call on Nov. 17, 1993, at 10 a.m. Participating were: Mary Alice Bjork (Ore.), Chair; Beth Hill (Texas); Shawn Bryan and Rick Barrett (Vt.); and Melodie Bankers (Wash.). Carolyn Johnson (NAIC/SSO) also participated.

Mary Alice Bjork (Ore.) said the purpose of the conference call was to determine the direction the working group wished to go. She asked if the members of the working group had received the letter from the National Organization of Life and Health Insurance Guaranty Associations -- NOLHGA which explained the position that guaranty funds would take regarding insolvent insurers with unfunded checking account obligations. The members of the working group said that they had all received the letter and were satisfied with the response. Melodie Bankers (Wash.) said she had received a letter from the Washington Guaranty Association. She had expressed concerns earlier about Washington's guaranty fund not covering some Washington policyholders and had been informed this was an error. The Guaranty Association clarified that it did intend to cover the policies. Ms. Bjork asked if the working group considered this issue to be laid to rest, and the members of the working group responded that they were satisfied that the issue was resolved.

Ms. Bankers suggested that it would be appropriate to develop a bulletin to alert companies to the proper procedures for unfunded checking accounts. Some of the difficulties that had been expressed earlier were in regard to companies that were [*649] not members of the American Council of Life Insurance (ACLI). The procedures which ACLI members used should be followed by these other companies and a bulletin would help alert them to that fact. Shawn Bryan (Vt.) endorsed that idea, suggesting that it would get everyone on to a level playing field.

The working group decided to produce a draft bulletin for exposure at the winter National Meeting in Hawaii with possible adoption at the spring National Meeting in Denver. The working group may not have a quorum at the December National Meeting so decided it would be appropriate to meet by conference call on Dec. 1, 1993, to review the draft and to vote on exposure.

Having no further business, the conference call adjourned at 10:15 a.m.

ATTACHMENT TWO

Viatical Settlement Working Group

Honolulu, Hawaii

December 6, 1993

The Viatical Settlement Working Group of the Life Insurance (A) Committee met in Iolani III & IV of the Hilton Hawaiian Village, Honolulu, Hawaii, at 11 a.m. on Dec. 6, 1993. A quorum was present and Roger Strauss (Iowa) chaired the meeting. The following working group members or their representatives were present: Reginald Berry (D.C.); Mary Alice Bjork (Ore.); Rhonda Myron (Texas); and Bob Wright (Va.).

Roger Strauss (Iowa) summarized the activity of the working group to date. He said that the NAIC Plenary had adopted the model act prepared by this working group. The next step was for the working group to develop a model regulation to implement the Viatical Settlement Model Act. He said the working group would proceed with the understanding that it might get an additional charge from the Executive Committee. He asked for comments on what should be included in a regulation, and asked Carolyn Johnson (NAIC/SSO) to take a look at the statutes and regulations of states where viatical settlement companies already are regulated, to see if there are parts that can be included in the NAIC's draft. The working group would then add provisions to fulfill the other requirements.

Ted Becker (Texas) said he thought there should be a provision included in the disclosure to alert potential viators to the fact that they should consider taking out the maximum loans on their policies. That amount might be greater than the viatical settlement. Reginald Berry (D.C.) said the authority for such a provision existed under Section 8A of the mod-

el act. Mr. Berry said that the regulation also should contain a section to implement Section 9A(1) of the act, which referred to the physician without specifying whether it was a viatical settlement company's physician or the policyholder's physician. It also did not go into any detail as far as standards for determining what happens if a dispute arises between the two physicians. This would be something that should be detailed in the regulation.

Bob Wright (Va.) said he thought the most important part of the regulation was to implement Section 10B on standards for payments. Mr. Strauss said that a verbal communication had been received from the viatical settlement industry detailing its standards and he thought this was a good starting point for the working group's discussion. Don Koch (Alaska) agreed with the importance of establishing standards for approval of viatical settlement contracts. He questioned whether the language in Section 10 was broad enough authority to allow standards for record keeping and examinations. Mr. Wright said he thought the second or third sentence of Section 5 provided broad language that gave sufficient authority. John Montgomery (Calif.) said he thought the broad authority in Section 10A would cover this provision.

Chris McDonald (Ohio United Health Services) said the most important thing from the consumer's standpoint was disclosure. She said the disclosure statements in the model act were very important and should be expanded upon in the regulation. She thought the most important thing to consumers was to note the possible loss of disability income and the tax implications of a viatical settlement. Barbara Thurston (Alaska) said making the disclosure form part of the contract would allow states to review the disclosure form during contract review.

Mr. Strauss said the timetable for the working group was for Ms. Johnson to prepare a draft of the material from other states by Feb. 1, 1994, and provide this to the members of the working group. A conference call of the working group would be held after that to review the material and fill in the gaps.

Mr. Koch asked that Alaska be added to the working group.

Having no further business, the Viatical Settlement Working Group adjourned at 11:30 a.m.

[*650] ATTACHMENT THREE

Life Disclosure Working Group

Honolulu, Hawaii

December 4, 1993

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Honolulu III of the Hilton Hawaiian Village, Honolulu, Hawaii, at 1 p.m. on Dec. 4, 1993. A quorum was present and Bob Wright (Va.) chaired the meeting. The following working group members or their representatives were present: Don Koch (Alaska); Roger Strauss (Iowa); Lester Dunlap (La.); Tony Higgins (N.C.); Noel Morgan (Ohio); and Fred Nepple (Wis.).

Bob Wright (Va.) said that the purpose of the meeting was to distribute the draft model law on life insurance illustrations and to hear comments on the task that had been assigned to the technical resource advisors at the Nov. 15 meeting. He said that the discussion of the draft of the model act would take place at the Dec. 7 meeting of the working group after the interested parties had time to review the draft. He reminded the attendees that there would also be continued opportunity for comment after the draft was exposed.

1. Illustration to be Understandable to the Applicant

George Coleman (Prudential) said that when the interested parties met with the working group in Kansas City on Nov. 15, 1993, to discuss what was expected of the technical resource advisors, initially there had been some confusion as to their task. The advisors understood they were being asked to make recommendations to simplify and clarify the illustration and the cover page. Because they were initially confused about their assignment, some had contacted individual members of the Life Disclosure Working Group and they now had a clear understanding of their task. Mr. Coleman said it was a very ambitious schedule to complete this project in January. Linda Lanam (Life of Virginia) said one of the difficulties with the assignment given to them was the variety of purchasers as well as the variety of products. Roger Strauss (Iowa) responded that regardless of who the consumer was, numbers are numbers. Ms. Lanham re-

sponded that, if the consumer was only interested in seeing the straight numbers, that was correct; but if the potential purchaser wanted to do things differently than pay the same annual premium every year, the illustration would be different for that person. Some things would be the same, she conceded, such as column headings and the basics that would be shown. Mr. Strauss said he did not think the working group would prohibit giving more than one illustration -- one with the standard straight line premiums and one with a larger or smaller initial payment or whatever variation the potential purchaser was considering. Mr. Wright said he was most concerned about a standardized format and standardized definitions. He thought it would be permissible to make some changes for very sophisticated purchasers. Tony Higgins (N.C.) said the working group had an idea of what an illustration should look like, and the task of the technical resource advisors was to prepare something that would meet the needs of the public and industry without being limited to prior experience and showing future guarantees. He said if they could come back with something usable without going to this extreme, the working group would seriously consider that product. Lester Dunlap (La.) asked the technical resource advisors to keep in mind the working group's concerns about the potential for abuse that existed and was already being shown. Mary Griffin (Consumers Union) offered to prepare a "key features document" explaining a particular type of policy. She envisioned this document as something which would give key information about a type of policy, warn about surrender charges, and alert consumers to other important features. She also agreed to provide this document in January.

James Hunt (National Insurance Consumer Organization -- NICO) said he was astonished that the working group had prepared a model to give the commissioner authority to do what he already could do under the Unfair Trade Practices Act. He said that under a similar situation in the early to mid-'70s, commissioners had used the Unfair Trade Practices Act as authority to develop and adopt a solicitation regulation. He was not finding fault with the provisions, but he questioned how many years it would be before legislatures would adopt them. Mr. Wright said that the best advice he had received was that in many states legislation was needed because the envisioned provisions go further than the legislative authority now available. He said if a commissioner felt he already had the authority, he could go forward without adoption of the model act, but from what he had been told, many did not feel they had that authority. Mr. Hunt asked that the working group consider adding a drafting note to alert commissioners to the fact that they might not need the act in order to adopt a regulation, and the working group agreed that this would be appropriate.

Mr. Hunt brought up the topic of manipulation of mortality assumptions. He said the Society of Actuaries report did not mention the "game" that is being played where the assumptions of mortality vary from what is currently being experienced. Mr. Higgins asked Mr. Hunt if he thought it was ever appropriate to vary the mortality assumptions from the current experience and Mr. Hunt responded that the commissioner should set illustration standards for mortality and he did not think they should allow improving mortality projections. Mr. Wright asked Mr. Hunt's opinion on the proposal to prepare a new illustration at any time when the assumptions changed. He asked if Mr. Hunt considered that to be a burdensome request. Mr. Hunt said it was a good idea in principle and he did not think once a year would be overly burdensome. He said almost all companies now will prepare an illustration on request so he thought the change would be modest. Scott Cipinko (National Association of Life Insurance Companies -- NALIC) said that generating the paper was not the only problem; the cost was also in postage and staff time. He also said the illustration could be quite confusing to the consumer if he was not aware of its purpose. William Fisher (Massachusetts Mutual) said he thought it was appropriate to send a letter notifying consumers that a non-guaranteed element had changed and offering an opportunity to receive a new illustration if the consumer desired.

Mr. Wright asked if there were any other questions about the project of the technical resource advisors. There were no further questions, so other issues were addressed.

[*651] 2. Actuarial Standards

Jack Turnquist (Actuarial Standards Board) said his organization had held a public hearing in March because of concern about abuses in illustrations and concerns about how non-guaranteed elements were being illustrated. The Actuarial Standards Board had considered development of standards, but he felt that it would be done in a vacuum without an understanding of what the NAIC would propose. He said there needed to be coordination of the NAIC in development of the model regulation and the Actuarial Standards Board in development of the standards. Mr. Wright asked if the Actuarial Standards Board would be willing to start drafting its standards as soon as the model regulation was developed, and Mr. Turnquist responded in the affirmative. Mr. Wright asked how long this process would take. Mr. Turnquist said he thought the Board could be finished within 12 months from the time it started drafting, allowing for a

period of exposure and comment. He said the usual timeframe was 24 months but he would ask that this project be put on a fast track.

3. Direct Writers

Mr. Wright said he had been contacted regarding another issue. Sally Cone (American Republic Insurance Company) and others had contacted him regarding the needs of direct writers. Ms. Cone said that direct writers were not currently using illustrations but she asked the working group to keep their needs under consideration so that if direct writers started to use illustrations, they would be able to meet the requirements of the model.

Having no further business, the Life Disclosure Working Group of the Life Insurance (A) Committee adjourned at 2 p.m.

The Life Disclosure Working Group of the Life Insurance (A) Committee reconvened in Coral II of the Hilton Hawaiian Village, Honolulu, Hawaii, at 8 a.m. on Dec. 7, 1993. A quorum was present and Bob Wright (Va.) chaired the meeting. The following working group members or their representatives were present: Don Koch (Alaska); John Montgomery (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Tony Higgins (N.C.); Noel Morgan (Ohio) and Fred Nepple (Wis.).

Upon motion duly made and seconded, the minutes of Nov. 15 and 16, 1993, meeting in Kansas City, Mo., were adopted (Attachment Three-B).

4. Discuss Definitions

Mr. Wright said that discussion of needed definitions would be postponed until a decision had been made on which alternative the working group's draft of a model regulation would follow. He thought it appropriate to defer discussion until that decision had been made, which would be after the technical resource advisors presented their recommendations for illustrations that would be understandable to applicants.

5. Discuss Life Insurance Illustrations Model Act

Mr. Wright suggested the meeting attendees go through the draft released on Dec. 4 section by section and offer comments for the working group to consider during the closed drafting session.

Section 1

Jack Burbidge (IDS Life) said the Nov. 15 minutes reflected the decision of the group to defer discussion of annuities. Section 1 uses the term "life insurance products" which includes annuities; he suggested changing the terminology to "life insurance policies."

Section 2

No comments were received.

Section 3

Mr. Coleman expressed concern about the list of items contained in Section 3. He said the working group had already decided all these items would not be in the regulation, and he was concerned that if the act contained a long list of possibilities, even though the model regulation was more limited, a state might choose to go off on its own. He preferred a broad authority without the detail. Mr. Strauss said he was surprised by this comment, that he had expected the industry to want an even more precise list and was surprised they would want to start with such a broad authority. Mr. Coleman responded that he preferred to see something general until the working group had decided on an approach. Ms. Griffin also said she thought the broad list sent a mixed message. Mr. Wright responded that the purpose of the working group had been to permit any of the approaches in the position paper. Because of the timing of the draft, the

working group thought it appropriate to take this approach. He expected that in the future the working group would need to go back into the model act and adjust this section.

Barbara Lautzenheiser (Lautzenheiser & Associates) suggested adding to Section 3, "for life insurance policies." John Montgomery (Calif.) asked if this meant it would be necessary to do another act and regulation for annuities. Mr. Wright responded in the affirmative.

William Regan (National Association of Life Underwriters -- NALU) expressed support for the work so far accomplished by the working group. He said his organization felt the working group was on the right course, and it was committed to helping the working group achieve its goal.

[*652] Section 4

Carolyn Cobb (American Council of Life Insurance -- ACLI) said her organization felt strongly that the Section 4 provision regarding remedies was inappropriate. Remedies were currently available in the courts and she felt that was the appropriate source. Ms. Lautzenheiser said that, as written, the model act required specific performance and that illustrations would be limited to guarantees if this requirement was retained. Mr. Fisher pointed out that Section 4 did not, in his opinion, contain adequate due process provisions. He suggested a cross reference to the Unfair Trade Practices Act or additional safeguards.

Section 5

Ms. Cobb spoke against the provision in the model providing for a private cause of action. She said ample remedies are currently available in the courts to protect policyholders and beneficiaries, and she was opposed to including a private cause of action. Mr. Cipinko agreed. He said he was concerned about the chilling affect of a private cause of action. He said if everything was required to fit the same mold such as a small tuna can, it would harm the entrepreneurial spirit evident in the small insurance companies. Reed Ashwill (National Association of Independent Life Brokerage Agencies -- NAILBA) said that if someone did not understand an illustration and was unhappy with the results, he could hire a lawyer and make millions on this. He felt sorry for insurance agents who would also be sued under this provision. Ms. Griffin spoke in favor of the private cause of action. She said it provided consumers and regulators with an additional remedy.

Section 6

No comments were received.

Section 7

No comments were received.

Mr. Wright asked if there were any more general comments that anyone in the audience wished to make. Mr. Hunt said that he, as a funded consumer representative, wanted to extend the tuna can metaphor referred to earlier. He said consumers handle tuna shopping nicely because when the tuna comes in the same size can, they can compare price and quality. Mr. Hunt went on to say that at the earlier session of the working group he had made some remarks which may not have been perceived correctly. He expressed a concern about "cheating." He said this group is dealing with something much broader and outlined the segments of the problem as he saw it:

1) Cheating and tricks. He said no one at the NAIC was aware of the practices currently being used in the marketplace. He indicated that these practices should be addressed.

2) Optimistic assumptions. He said an example of this was mortality improvement. If a company was planning to use such assumptions, there needed to be rules setting parameters or this was open-ended.

3) Conservative estimates that were too optimistic. He gave the example of a company that used interest assumptions that were being currently paid but were not likely to be paid in the future.

4) How to make illustrations more understandable to consumers. To force everyone into the same format does require a model and he thought this was the area in which the working group was planning to work.

He said the purpose of his list was to clarify the remarks he had made earlier.

Hearing no further comments, Mr. Wright adjourned the open session and after a short break called the meeting to order in Executive Session. He said it was his plan to go over the comments to the model law section by section and the working group could decide what changes it wanted to make.

Section 1

The working group reconsidered its earlier decision, made at the November meeting, not to include annuities under the model act. A decision was made to clarify the model act to include language so that only one act would be necessary to cover both life insurance and annuities. The regulation would be specific to life insurance, and if an additional charge was given to the working group later, an annuity regulation could be developed.

Section 3

Next the working group discussed at length Mr. Coleman's suggestion to modify Section 3 to use broad authorizing language instead of the list of items to be addressed. Mr. Wright summarized the three approaches suggested by members of the working group:

1) Broad language such as suggested by Mr. Coleman;

2) The list contained in the November draft;

[*653] 3) Use either the broad language or the itemized list and add a drafting note suggesting that states might feel more comfortable using the other approach.

After discussion, a decision was made to use the language suggested by Mr. Coleman in Section 3 and add as a drafting note the list of areas that might be more appropriate for use in some states and that should be addressed in the development of a regulation.

Section 4

Discussion of Section 4 focused on the sentence which gave the commissioner authority to require insurers illustrating benefits that were not supportable to pay benefits based on their illustrations. There was support from some members of the working group to significantly modify or delete this requirement because it would require commissioners to make a determination of which illustrations or practices would merit the payment of illustrated benefits. Mr. Wright pointed out that if commissioners were limited to the Unfair Trade Practices Act, they needed to show a pattern of behavior. Commissioner Robert Wilcox (Utah) said that if it was not a pattern, a mistake had been made, and he did not feel it appropriate to provide that type of penalty for a mistake. Mr. Higgins suggested adding the phrase "not supportable when presented." The working group agreed that the language should be retained at present with the addition of the language suggested by Mr. Higgins. It was also agreed that this question needed further study.

Section 5

Mr. Katz said that he was in agreement with Ms. Cobb's argument that the remedy provided under the private cause of action already existed. He said a provision creating a private cause of action was a major departure from NAIC policy. After extended discussion, the working group decided to take out the section creating a private cause of action.

Upon motion duly made and seconded, the working group voted to expose the draft with the amendments discussed (Attachment Three-A). Having no further business the Life Disclosure Working Group of the Life Insurance (A) Committee adjourned at 10 a.m.

ATTACHMENT THREE-A

LIFE INSURANCE ILLUSTRATIONS MODEL ACT

Draft: 12/07/93

Table of Contents

Section 1. Applicability and Purpose

This Act shall apply to all life insurance companies and fraternal benefit societies licensed to do business in this state and to all [producers, agents and brokers] licensed to sell life insurance or annuities. The purpose of the Act is to authorize standards which shall be followed in the illustration of life insurance products to facilitate consumer understanding of these illustrations.

Drafting Note: Insert the appropriate terminology consistent with state licensing laws.

Drafting Note: This section refers to both life insurance policies and annuity contracts. A separate regulation will be required for each.

Section 2. Prohibited Practices

No person engaged in the business of insurance shall misrepresent the benefits, advantages, conditions or terms of any life insurance policy or annuity contract through misleading or incomplete illustrations.

Section 3. Authority to Promulgate Regulations

The commissioner shall promulgate regulations that establish standards to assure that illustrations are not misleading or incomplete.

Drafting Note: Insert the title of the chief insurance regulatory official wherever the term "commissioner" appears.

Drafting Note: Some states may feel it is more appropriate to have a specific list of items to use in developing standards. If so, they could add a provision such as: "These may include but are not limited to:

[*654] A. Assumptions and methodologies;

B. Definitions;

C. Format;

D. Prohibition or limitation of projections of policy values or benefits;

E. Notification to policyowners of changes in assumptions from those provided when their policy was issued;

F. Supportability of illustrations;

G. Generic identification of the policy being illustrated; and

H. Accountability of all parties to the transaction."

The drafters recognize that some of these items are mutually exclusive and will not all be included in a regulation. The purpose of their inclusion in this list is to provide a full range of options in the development of a regulation. Any regulation written pursuant to the authority contained in this act will address issues contained in A through H above at a minimum.

Drafting Note: In a state where the commissioner already has this authority, adoption of the model act may not be necessary in order to promulgate the model regulation.

Section 4. Penalties

A violation of this Act by any person shall be subject to the penalties found in section [insert penalty section of unfair trade practices law]. In addition to any other penalty, the commissioner may require insurers who illustrate benefits that are not supportable when presented to pay benefits based on the illustration most favorable to the policyowner or beneficiary.

Section 5. Separability

If any provision of this Act or the application thereof to any person or circumstance is for any reason held to be invalid, the remainder of the Act and the application of such provision to other persons or circumstances shall not be affected thereby.

Section 6. Effective Date

This Act shall be effective [insert date].

ATTACHMENT THREE-B

Life Disclosure Working Group

Kansas City, Missouri

November 15-16, 1993

The Life Disclosure Working Group of the Life Insurance (A) Committee met at the offices of the NAIC in Kansas City, Mo., on Nov. 15 and 16, 1993. Members of the working group in attendance were Bob Wright (Va.), Chair; Don Koch (Ala.); Roger Strauss (Iowa); Lester Dunlap (La.); Noel Morgan (Ohio); and Tony Higgins (N.C.). Attending portions of the meeting by conference call were John Montgomery, Sheldon Summers and Harold Phillips (Calif.) and Fred Nepple (Wis.). Also in attendance was Carolyn Johnson (NAIC/SSO).

1. Consider Model Act on Illustrations

Chair Bob Wright (Va.) said the first order of business would be to review the initial draft of a model act on illustrations, which would be designed as an enabling statute for a comprehensive regulation. This model would be exposed at the winter National Meeting in Honolulu. The draft was intended to be broad enough to allow the working group to go in any of the directions outlined in the white paper (see NAIC Proceedings, 1993 3rd Quarter, pp. 443-446) without closing off any of the alternatives.

Don Koch (Alaska) asked if the act would be part of the Unfair Trade Practices Act. Mr. Wright asked if there was a private cause of action in the Unfair Trade Practices Act. Carolyn Johnson (NAIC/SSO) responded that the Unfair Trade Practices Act specifically said it did not imply a private cause of action. Mr. Koch said he thought it would be appropriate to include a section in the model to provide for a private cause of action. He suggested either adding language to that effect or inserting a drafting note. The working group decided to add a section authorizing a private cause of action. This would address one of the problems noted in the white paper about insufficient penalties for violations. Mr. Koch suggested a provision such as currently being considered in the draft Title Agents Model Act being prepared by another working group. Tony Higgins (N.C.) asked if this provision would limit regulatory action in any way and the group agreed that it did not.

Mr. Wright asked the working group members if they thought the regulation should address annuity illustrations also. He had been asked this question by several regulators. It was the consensus of the working group to finish the charge it had been [*655] given relative to life insurance illustrations and then decide whether to ask for a further charge regarding annuity illustrations.

The working group discussed the advisability of including definitions in the model act or the regulation. The working group decided it was more appropriate to include these in the regulation.

Discussion turned to development of a section defining the practices prohibited by this act. It was suggested that language could mirror the prohibition in the Unfair Trade Practices Act. The question was raised whether the illustrations violations were "practices" and the group agreed it would not be appropriate to require the regulator to establish practices. The language agreed upon was "define with specificity the acts and practices that would be defined as unfair." Lester Dunlap (La.) suggested adding language similar to the Unfair Trade Practices Act. Mr. Koch recommended the Alaska language giving the Director the authority to define the acts and practices as unfair and deceptive. It was agreed to add the language and make sure the penalty section made insurers subject to the Unfair Trade Practices Act penalties without having to find the violation a trade practice.

Next the working group considered the section giving authority to promulgate regulations. The intent of the working group was to make the section broad enough to cover any product developed later, but specific enough to allow development of necessary regulatory provisions. The working group considered whether it should eliminate some of the subsections from Section 3 that were mutually exclusive. Mr. Wright stated his opinion that it was good to have a wide range of alternatives so that if one did not work well, the regulators could choose another one. It was agreed to add a drafting note alerting regulators to the fact that some items were mutually exclusive, and they would not all be used.

2. Alternative Approaches in the White Paper

At this point regulators from California and Wisconsin joined the meeting by conference call and Mr. Wright requested that the group consider the four alternative approaches presented in the white paper. After lengthy discussion regarding these alternatives, the working group reached a consensus that there was strong support for Alternatives 2 and 3. These alternatives are: not permitting projections into the future; and requiring a uniform illustration or format design and uniform definition. It was agreed that Alternative 4, "develop a set of rules that provide clear disclosure" should be used in conjunction with Alternative 2 or 3. Alternative 1 from the white paper had the least support from members of the working group. Mr. Wright said that his bottom line goal was to have a proposal that consumers would understand without needing an agent to explain it.

At this point, Mr. Wright suggested that the technical resource advisors be asked to develop an illustration using Alternative 3 from the white paper. If the technical resource advisors could not develop a clear illustration using this alternative, then the working group would support Alternative 2. This was agreed to by the members of the working group.

The working group adjourned at 11:45 a.m. and reconvened at 1 p.m. for an open session. The working group was joined by interested parties.

3. Open Forum

Linda Lanam (Life of Virginia) asked how illustrations of new products would work if the working group chose the alternative that allowed only past performance to be illustrated. Mr. Wright said that if it was a new product there would be no illustration of past performance. Ms. Lanam suggested that would imply that there was a problem with the new product because it had no illustration. It was her experience that consumers wanted an illustration that would show how the product could perform. Past performance was not, in her opinion, a good focus for life insurance products. Judy Faucett (Cooper & Lybrand) said that there is a strong turnover of new products. She said that it would be fortunate if a company was able to illustrate a product for two or three years. If insurers could illustrate past performance of that type of product it would be better because some new products are just variations, however, some are really a different product.

Mr. Wright summarized the progress of the working group to this point. He said there would be a draft model act released for exposure at the Dec. 4 meeting of the working group and it was the goal of the working group to have a regulation for exposure in June. He said the act would be straightforward and broad. It would encompass all the alternatives in the white paper. Ed Jackson (Mitchell Law Firm) asked if there was a definition of illustration. Mr. Higgins responded that the group favored a broad definition such as "anything that purports to describe the policy and is used in the sales presentation." Mr. Jackson asked if this included every piece of information distributed and Mr. Wright re-

sponded that the working group was not considering advertising brochures etc. at this time. The working group was concentrating on ledger illustrations. He said the working group was interested in a cover sheet but wanted one somewhat different than that proposed by interested parties.

William Koenig (Northwestern Mutual) suggested that the parties all needed a common understanding of the terms used in their discussion. As an example he gave the term "past performance" and asked if this meant past performance of the company or of the product. He emphasized the need to define terms like past performance in a way commonly used by the industry.

Mr. Higgins brought up the topic of what the American Academy of Actuaries called "Type B usage" where consumers compared one policy with another based on the illustrations. Mr. Wright asked how this issue could be addressed. William Fisher (Massachusetts Mutual) said that it was his personal belief that any time there is a number, people will compare it with another one. He did not believe this should be the only use of illustrations, but he did not think it was inappropriate that there be some use in this manner. He spoke against using only guaranteed numbers. The result would be that life insurance would no longer be a competitive vehicle in the financial market place. Mr. Wright responded that he recognized this problem and [*656] saw also the problem of illustrating extremely complex products. It was his personal view that it would require some significant changes in how products are illustrated. The working group's concern was how to bring about a change without damage to the market place.

Ms. Faucett emphasized the need for substantial education of buyers. Using standardized experience might just set consumers up for more disillusionment because they would rely to a greater extent on the illustration. She thought the focus should be on educating consumers to reduce their reliance on projections.

Tony Spano (American Council of Life Insurance -- ACLI) said there were many different policies with different marketing methods, and that made it difficult to come up with a uniform way of presenting this material. If the working group recommendations tried to become too detailed or inflexible, he suggested that it would be impossible to comply. Mr. Higgins replied that companies had not always been good stewards of the flexibility they had in the past. Everyone must realize that there have to be some dramatic changes, otherwise there will be major damage to the industry as a whole. Mr. Spano replied that he was not advocating the status quo. William Albus (National Association of Life Underwriters -- NALU) also agreed that a major problem is misunderstanding. Mr. Higgins agreed that there was a problem with lack of education of the agents. He said that the point-of-contact people needed to be educated, because many of them believed too extensively in computer inerrancy. Mr. Morgan added that he thought there was also misuse of computer illustrations as well as misunderstanding. Mr. Albus said that agents could not change the basic assumptions. If they did so it was fraud, but they did not always have information on the assumptions on which the illustrations were based.

The group next turned to consideration of the issue of sharing information with current policyholders when the assumptions used in the illustrations changed. Mr. Koenig said he favored this absolutely. Mr. Wright asked how this should be accomplished. Ms. Lanam said that companies probably all did it differently. In her company insureds got information saying they could ask for a new illustration. She said it would be incredibly expensive to send the illustration to everyone. Mr. Koenig said he would feel an obligation to give it to anyone who asked and Mr. Wright asked what percentage of the insureds asked. Ms. Lanam said perhaps 20% of the insureds of her company asked for a revised illustration. She said this was an increase from earlier, before they wrote on the annual statement to consumers that they had the option of requesting a revised illustration. Mr. Fisher said his company's agents have been urged to go to the client if there are significant changes, especially on vanishing premiums. Agents tell the policyholders that they can get a new illustration, but if their company sent out an unsolicited one and a half million illustrations, it would do nothing but create confusion.

Mr. Strauss asked what percentage of policies are sold without the use of an illustration at time of sale. Ms. Faucett said that upper middle and upscale policies probably were 99% sold with the use of illustrations. Mr. Strauss said that many of the complaints to his department had come from the middle class. Ms. Lanam said that the regulators should not ignore the fact that consumers take advantage of a situation. If they were now dissatisfied with the policy performance, they would look for someone to make them whole.

Mr. Wright said that he thought the issue of accountability was very important. He favored the approach of requiring all parties to the sale to agree that everything was explained. Mr. Wright said that companies say agents manipulate the figures and they cannot do anything about it. Agents say that they do not get information from the company to help them understand the assumptions.

Mr. Morgan asked if insurers could put any number in the non-guaranteed column. John States (State Farm) said that the NAIC's advertising rules prohibited this from happening. He pointed out that this was a recent addition to the model so not very many states have adopted it. Mr. Fisher said that many companies show the current interest rates being paid and something somewhat below that to demonstrate the sensitivity of the interest rate. Mr. Higgins asked those present how important they thought it was to show the interest rate being paid. He said he did not think it was a good idea because it could be misleading. Mr. Fisher said in universal life it was typical to show the interest rate but that other types of policies generally did not show that in their illustration. Mr. Strauss said that he thought it was more valuable to make a statement that the company must earn X% to pay the amount shown because consumers would know if that percentage rate was commonly available in the market place.

Mr. Morgan brought up the concept of "vanishing premium." He did not think it was appropriate to include the term unless there would be no premium due; for example, in a single pay or 20-pay policy. Otherwise he said premiums do not actually "vanish," they are just paid out of accrued money. He said many of the problems he heard came from a misunderstanding that premiums really do vanish. Mr. Spano said the premium was still due, but was paid out of dividends. Mr. Morgan clarified that the consumer could opt to pay the premiums out of the dividends and if this language was included in the illustration it would be much clearer. Diane Marchesi (Transamerica) said that instead of using the term "vanishing" her company said there would be no "out of pocket" premium. She thought this prevented a misunderstanding. Mr. Fisher endorsed that approach. He said that he agreed that it would be appropriate to show the premium all the way down with an asterisk that the consumer could choose to use paid-in amounts instead of paying that amount out-of-pocket.

Mr. Morgan asked what companies did to show surrender value. He asked if they used cash value or the net amount. Ms. Faucett said that most companies showed the net cash surrender value but she was aware that a few companies put the total surrender value and then used the footnote to explain that expenses would be subtracted. Mr. Higgins asked if the insurers had any problem with requiring the net surrender value to be shown. There was no response to his question.

Mr. Wright asked the agent and company community for assistance. He said if they felt a need for illustrations in the future, he hoped they would help the working group develop a clear understandable illustration. George Coleman (Prudential) said he thought the cover page was the key concept. He said it would provide clear illustration information in an understandable [*657] fashion. He thought the illustration cover sheet designed by the technical resource advisors would go a long ways toward getting that job done. Mr. Wright said he did not think the flexibility that now exists would help achieve the goals of the working group. He said the working group would be open-minded to see what any of the technical resource advisors came up with to explain the complexity of the policy. Mr. Coleman asked what the regulators would like to see improved in an illustration cover sheet. Mr. Higgins said that the product presented just preserved the status quo and attached a cover sheet to it. Mr. Wright said the working group was looking for a new approach.

Mr. Coleman agreed that it would be possible to provide a revised cover sheet and suggestions for a simplified illustration format to the working group by the end of January. The working group will then schedule a meeting in February to discuss the proposal. Mr. Wright indicated that this was the opportunity for the interested parties to demonstrate that clear and understandable illustrations could be developed using future projections. He emphasized that if this could not be achieved and demonstrated to the working group by the end of January, the already strong support for only permitting the demonstration of past performance and elements that were guaranteed for future performance would be even stronger. Mr. Wright also indicated that the technical resource advisors should prepare illustrations that could be understood by the applicant, not requiring actuarial interpretation or explanation by an agent. Christine DelVaglio (Lautzenheiser & Associates) said that if regulators required simpler illustrations it might be easier to understand, but it would not really explain the policy. It would not give a clear picture of how the policy works. Mr. Koch suggested it was better to err on the side of understanding rather than overstatement. Ms. DelVaglio said that policies are used for different things, for example showing annuitization.

Ms. Faucett suggested that illustrations requirements and actuarial standards need to go together. She said the Illustrations Task Force of the Society of Actuaries was working with Harold Phillips in the California Department to develop definition standards. The Actuarial Standards Board is eager to work with the NAIC in developing standards, but did not want to go ahead without a clear understanding of what the regulators' requirements would be. Mr. Albus pointed out that the definitions needed to also include a "man on the street" definition, after the group had agreed on the definitions with the actuaries. Ms. Faucett said that Canada is addressing this problem also. Canada is not doing it through regulations but is setting standards for the illustrations, and if companies meet these standards they can put an informational mark on their page that says this is an approved illustration. Mr. Koch did not favor this approach because he said that it would imply that regulators had seen and approved the illustration.

The open session adjourned at 3:30 p.m.

4. Model Law Draft

The working group reconvened in closed session on Nov. 16, 1993, at 9 a.m. The suggestions made at the meeting of Nov. 15 had been incorporated into the draft, so the working group reviewed the document. Mr. Phillips suggested adding fraternal benefits societies to the first sentence of Section 1 and the group agreed. The working group decided to revise Section 2 to refer to any "person engaged in the business of insurance" rather than referring to insurers and agents. Then discussion turned to coordinating the wording of Sections 2 and 3. The working group decided to revise the language of Section 3 to delete any reference to unfair and deceptive acts and practices.

Mr. Morgan asked who the standards would affect. The working group agreed that affect would have to be prospective, that it could not affect the policies already in effect.

The group considered whether the penalties in Section 4 should be combined with the private cause of action in Section 5. The working group decided they should remain separate. Mr. Nepple asked if intent was an element of the violation to use the remedies of Section 5, and the group agreed it was not. Mr. Nepple pointed out that consumers already could sue under a theory of intentional misrepresentation, but this alternative would not include intent. Mr. Wright agreed this was a viable approach.

The working group decided to review the draft again after the changes agreed upon today were made, and discuss it further in December in Honolulu. The next steps would be to review any product of the technical resource advisors, develop an outline for a regulation and consider the definitions. Mr. Morgan offered to develop an evaluation tool to use to review the suggestions by the interested parties for a revised cover sheet and illustration page.

Having no further business, the working group adjourned at 11:30 a.m.

[*658] ATTACHMENT FOUR

Government of the District of Columbia
Department of Consumer and Regulatory Affairs
Insurance Administration
Post Office Box Number 37200
Washington, DC 20013-7200

The Honorable David Lyons
Commissioner of Insurance
State of Iowa
Lucas State Office Building
Des Moines, Iowa 40319

Re: Synthetic Guaranteed Interest Contracts

Dear Commissioner Lyons:

This letter is with reference to the Life Insurance (A) Committee charge establishing a working group to determine and evaluate the regulatory issues presented by Synthetic Guaranteed Interest Contracts (SGIC). The charge was provided during the Sept. 21, 1993, committee meeting.

In responding to this charge, the working group expanded the primary effort to include the question of whether these contracts call for the insurer to provide a financial guarantee. We took this action in response to a letter submitted by the Life and Health Actuarial Task Force and a legal memorandum submitted by the Prudential Insurance Company. At this juncture, the working group has not obtained adequate information to resolve this important issue.

To properly address these issues, the working group has agreed to first accumulate sufficient background information concerning SGICs. We believe it is critically important to first achieve a base line understanding of these innovative products before we can properly evaluate these designs within the context of existing insurance laws. It is important to note that there are several different SGIC designs.

Toward this end, the working group has accumulated background information and descriptive documents which we encourage the committee members to read. As questions arise, members should bring them to our attention so they can be incorporated into our overall efforts.

After the working group has digested this information, we will outline a specific course of action to satisfy the charge placed by the A Committee. Our next primary step is to survey states to determine whether a SGIC would be considered an insurance contract and whether it is a financial guarantee. We will also ask states to determine their regulatory position on several SGIC designs. This process will provide sufficient information to determine if specific policy language requirements are appropriate.

As you will note from the Prudential legal memorandum, the author concludes that the sale of SGICs is not engaging in the business of insurance nor is it providing of a financial guaranty under New York insurance laws. However, this evaluation is limited to Prudential's product design and an analysis based on New York laws. The New York Insurance Department, however, has not reached any determination in support of this position. Absent such a determination, we do not have a balanced response to the questions raised or the conclusions reached in the Prudential memorandum.

The working group encourages the A Committee to request a charge from the Executive Committee to continue with its work during 1994.

The working group is available to respond to your questions.

Sincerely,

Robert M. Willis, Commissioner of Insurance

(Editor's Note: The background information, descriptive documents and Prudential legal memorandum are not published in the NAIC Proceedings.)

Synthetic Guaranteed Interest Contract

Summary of Attachments

1. "A Flood of New GICs"

An article written by Laurie Goodman, Kelli Hustad Hueler and Kal P. Tourville and published in the April 1993 edition of Best's Review

[*659] 2. "Continued GIC Sales Predicted in '90s"

An article extracted from the July 19, 1993, edition of the National Underwriter written by Larry H. Mylnechuk, Executive Director of the GIC Association

3. Product News Marketing

4. A Glossary of Terms

5. A survey of GIC products

Jointly conducted by the GIC Association and the Life Insurance Marketing and Research Association (LIMRA)

6. Five (5) monograph publications written by the GIC Association. They are as follows:

"Coping with the New Investment Options for Book Value Funds"

"Separate Account GIC Alternatives"

"Evaluating GIC Product Alternatives"

"Canadian Life Insurance Companies in the United States"

"Guaranteed Interest Contracts"

7. Miscellaneous documents

8. The Prudential Insurance Companies of America legal memorandum prepared by the law firm of Debevoise and Plimpton which concludes that Synthetic GICs are not insurance products.

APPENDIX B

1 of 1 DOCUMENT

NAIC MODEL LAWS, REGULATIONS AND GUIDELINES

VOLUME IV
LIFE INSURANCE
582-1 LIFE INSURANCE ILLUSTRATIONS MODEL REGULATION

NAIC Model Laws, Regulations and Guidelines 582-1, § 12

Section 12. Penalties

In addition to any other penalties provided by the laws of this state, an insurer or producer that violates a requirement of this regulation shall be guilty of a violation of Section [cite state's unfair trade practices act].

APPENDIX C

SENATE COMMITTEE ON INSURANCE
Senator Herschel Rosenthal, Chair

Assembly Bill 3234 (Knowles) Hearing Date: July 3, 1996

As Amended:June 10, 1996
Fiscal: No

SUMMARY

AB 3234 would adopt in statute the National Association of Insurance Commissionerso Model Regulation on Life Insurance Illustrations, would repeal existing oYield Cost Indexo and oConsumer Guide to Buying Life Insuranceo regulations and replace them with a oSurrender Cost Indexo statute.

DIGEST

Existing law

1. Specifies certain acts committed by an insurer which would constitute unfair competition or unfair and deceptive practices.

2. Includes in the category described in #1 the use or issuance of illustrations or advertising of life insurance products which contain false or misleading statements, or other misrepresentations associated with the value of the policy.

3. By regulation, has implemented #2 by requiring life insurers to comply with a oyield cost indexo calculation, which provides specified disclosures to prospective purchasers of life insurance products. A oConsumer Guideo is part of this regulation.

This bill

1. Adopts a National Association of Insurance Commissioners (NAIC) Model Regulation on life insurance illustrations. The Model Regulation involves a comprehensive regulatory scheme to control when and in what manner life insurers may use oillustrationso to

describe the operation and benefits of life insurance policies. Key features of the Model Regulation include:

- a requirement that life insurers notify the Commissioner if a particular product will be sold via use of illustrations, and prohibits use of any illustration absent such notification;

- restrictions on the methodology an insurer can use to generate the values which are used to oillustrateo how the policy will perform over time;

- requirements that non-guaranteed values be clearly identified, and accompanied by a statement that the illustration includes assumptions which are unlikely to continue unchanged over time, and that actual performance may be more or less favorable than the values illustrated;

- a prohibition against use of statements to the effect that there is a ovanishing premiumo aspect to the policy;

- disclosure statements signed by both applicant and agent indicating that non-guaranteed values have been explained, and that no statements inconsistent with the values illustrated were made;

- a requirement that policyholders who have received an illustration be annually provided with information showing how the policy is performing, and informing them that they may request a free illustration which will contain updated information on the projected performance of the policy.

2. Requires life insurers to appoint an actuary to certify that any illustrations used comply with the law. The Commissioner would be empowered to object to an actuary if, after hearing, specified criteria are established.

3. Provides that violations of the bill may be enforced pursuant to specified provisions of the Unfair Practices Act which require a hearing before issuance of a stop order, and further requires resort to the courts through the Attorney General if the conduct does

not stop.

4. Adopts a oSurrender Cost Indexo which is a method designed to measure the time value of money as compared to other products. The methodology for generating the index number is set forth in the bill, but the bill also authorizes use of other methods to generate an index number if used in addition to the mandated method.

5. Repeals the existing regulations adopted by the Department of Insurance in 1994 which require use of a oYield Cost Indexo and provide for a oConsumer Guideo to the purchase of life insurance.

COMMENTS

1. Purpose of the bill. The author introduced AB 3234 at the request of the California Association of Life Underwriters (CALU) and the Association of California Life and Health Insurance Companies (ACLHIC). The sponsors believe that reform of life insurance disclosure laws is needed in order to address many of the problems which have existed over the past few years. Several large life insurers have faced nationwide scrutiny and enforcement fines due to marketing problems. Many of these abuses would be addressed by the reforms proposed by the bill. The bill is designed to address two issues: misleading oillustrations,o which can be a particularly difficult issue in an era of declining interest rates; and comparison indices. The bill addresses these two problems by adopting a new NAIC Model Regulation to control misleading use of policy illustrations, and by replacing a fairly recent DOI regulation with an alternative which has been in use for a number of years, and is in place in one form or another in 49 states.

2. Support. Pacific Mutual Life Insurance Company supports the bill because it furthers the interest in uniformity of laws, which generate cost savings for insurers, and therefore policyholders.

3. Opposition. Consumers Union (CU) and the Consumer Federation of America (CFA) oppose the bill. CU notes that Section 1 of the bill -- the NAIC oillustrationso

model -- contains some consumer benefits; however, othe repeal of the Yield Index in Section 3 takes away an important information tool that is an aid to comparison shopping for consumers.o CU urges several improvements to the oillustrationso portion of the bill -- issues which were addressed by earlier versions of the Model Regulation prior to its final adoption by the NAIC. Business columnist Jane Bryant Quinn has stated: oWhatos missing from the NAIC proposal? The big items are: disclosure of the net rate of return on your policy cash values, and disclosure of the policyos internal costs. With those, you could compare one policy with another -- which the industry definitely doesnot want.o

CFA makes no mention of the oillustrationso portion of the bill, but states that the repeal of the Yield Index (YI) regulation ois bad legislation for consumers in California.o In response to the replacement of the Yield Index by the Surrender Cost Index (SCI -- as proposed by Section 2 of the bill), CFA states that othe SCI is useless, and frequently produces misleading

results.o CFA further notes that the National Association of Life Underwriters has testified in the past that SCI is no longer useful for todayos life insurance products. The opponents argue that the index issues are exceedingly technical, and should be left for the Commissioner to address by regulation -- which the Commissioner is fully empowered by existing law to do.

4. History of abuses. Both proponents and opponents generally agree that there were abuses in the way that life insurance has been marketed in the past. Each notes cases in which very large and well known life insurers have faced disciplinary actions as a result of these abuses. Both proponents and opponents participated in efforts at NAIC, and in the United States Senate, to address these problems. The differences revolve around what precisely should be done. Generally, opponents accept that the worst of the abuses can be addressed by the Life Insurance Illustrations Model Regulation, but believe that the Model was unnecessarily watered down prior to adoption by the NAIC, and that this bill leans even further in the industryos favor. They also note that annuities

were specifically excluded from the Model, and will be separately addressed with amendments to the Model. Proponents would like to place the NAIC model oregulationo into ostatuteo in order to limit the Commissioneros discretion in this area. Similarly, Sections 2 and 3 are designed to obviate the need for the Commissioner to take administrative action.

5. Yield Cost Index. The YCI is based on an NAIC Model, and the regulation was adopted in California in 1994. It was modified last year at the industryos request to address some technical concerns with the calculations. Basically, the YCI is designed to factor out the life insurance portion of life insurance policies which have investment features, and then provide an index number which enables consumers to compare the value of the policy with other products. Proponents of the YCI note that some criticisms of its results -- such as different results for smokers and nonsmokers, or for males and females -- is irrelevant because it is not designed to compare a policy for two different people, but rather to compare different options for the same person (and in any case are attributes of the SCI as well).

Proponents suggest that one reason life insurers dislike YCI is that it suggests that certain life insurance products may not be the best buy for some consumers in some circumstances. For instance, YCI tends to highlight the fact that whole life products do not make as much sense for a person with a short-term need as for a person viewing the investment on a 20-year horizon.

Opponents of YCI argue that it is a oCalifornia-onlyo rule that increases costs to insurers, and is not more helpful to consumers than SCI. SCI, on the other hand, has been around a long time, and is in place across the country.

6. Consumer Guide. Section 3 of the bill would repeal regulations which address what have been a non-controversial aspect of the broader life insurance disclosure debate -- the NAIC Consumer Guide to purchasing life insurance. Why should this regulation be repealed by legislation?

7. Need for Legislative Action vs Rulemaking. The YCI is currently a regulation, adopted by the DOI and part of the California Code of Regulations. SCI, which the bill proposes to adopt in lieu of the YCI regulation, is in force in other states primarily via adoption of regulations years ago. CFA recommends that, since the subject of these indices is a technical, recommended NAIC oregulation,o it is best left to the administrative rulemaking process, so

that actuarial arguments can be addressed by DOI actuaries and others able to present technical input to the Commissioner. Why should the Legislature repeal complex and technical regulations which the Insurance Commissioner is empowered to modify or repeal, and replace them by statute with other rules that the Insurance Commissioner is also empowered to adopt by regulation?

PRIOR ACTIONS

Assembly Insurance	Pass 14-0
Assembly Appropriations	Pass 16-0
Assembly Floor	Pass 73-0

POSITIONS

Support

Association of California Life Insurance Companies
California Association of Life Underwriters
Pacific Mutual Life Insurance Company

Oppose

Consumer Federation of America
Consumers Union

Consultant: Mark Rakich

APPENDIX D

BILL ANALYSIS

Appropriations Committee Fiscal Summary

AB 3234 (Knowles)

Hearing Date: 8/12/96 Amended: 7/9/96
Consultant: Sedrick Mitchell Policy Vote:
Insurance 5-1

BILL SUMMARY:

AB 3234 would:

effective January 1, 1998, authorize the Insurance Commissioner to regulate illustrations presented to life insurance consumers;

pertain to all group and individual life insurance policies, and certificates, as specified;

set forth standards for the use of illustrations including disclosure notifications and actuarial certification that the new standards are met;

sunset on January 1, 2000.

Fiscal Impact (in thousands)

Major Provisions	1996-97	1997-98	1998-99	Fund
Dept. of Insurance	--	$48	$128	Insurance
Non-compliance Hearings	On average $35 - $40 per hearing			Insurance

STAFF COMMENTS: According to the Department of Insurance this measure would require additional staff totaling $48,000 in FY 97-98; $128,000 in FY 98-99; and $112,000 in FY 99-00. Staffing costs include the services of a senior life actuary, and a staff counsel. The department anticipates additional costs to conduct non-compliance hearings. According to the Department of Insuranceos Administrative Law Bureau, an average non-compliance hearing costs between $35,000 and $45,000, including transcribing and staff time.

APPENDIX E

SENATE RULES COMMITTEE AB 3234
Office of Senate Floor Analyses
1020 N Street, Suite 524
(916) 445-6614 Fax: (916) 327-4478

THIRD READING

Bill No: AB 3234
Author: Knowles (R)
Amended: 7/9/96 in Senate
Vote: 21

SENATE INSURANCE COMMITTEE: 5-1, 7/3/96
AYES: Lewis, Johnston, O'Connell, Peace, Russell
NOES: Rosenthal
NOT VOTING: Hughes, Johnson, Killea

SENATE APPROPRIATIONS COMMITTEE: 13-0, 8/13/96
AYES: Johnston, Alquist, Dills, Hughes, Kelley, Killea, Leonard, Leslie, Lewis, Mello, Mountjoy, Peace, Polanco

ASSEMBLY FLOOR: 73-0, 5/31/96

SUBJECT: Life insurance

SOURCE: California Association of Life Underwriters

DIGEST: This bill provides for the regulation of life insurance policy illustrations by the Insurance Commissioner, and would define "illustration" as a presentation or depiction that includes no-guaranteed elements of a policy of life insurance over a period of years and that is one of three specifically defined types. This bill sunsets January 1, 2000.

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CONTINUED

ANALYSIS: Existing law:

1. Specifies certain acts committed by an insurer which would constitute unfair competition or unfair and deceptive practices.

2. Includes in the category described in #1 the use or issuance of illustrations or advertising of life insurance products which contain false or misleading statements, or other misrepresentations associated with the value of the policy.

3. By regulation, has implemented #2 by requiring life insurers to comply with a "yield cost index" calculation, which provides specified disclosures to prospective purchasers of life insurance products. A "Consumer Guide" is part of this regulation.

This bill, effective January 1, 1998:

1. Adopts a National Association of Insurance Commissioners (NAIC) Model Regulation on life insurance illustrations. The Model Regulation involves a comprehensive regulatory scheme to control when and in what manner life insurers may use "illustrations" to describe the operation and benefits of life insurance policies. Key features of the Model Regulation include:

   A. A requirement that life insurers notify the Insurance Commissioner if a particular product will be sold via use of illustrations, and prohibits use of any illustration absent such notification.

   B. Restrictions on the methodology an insurer can use

to generate the values which are used to "illustrate" how the policy will perform over time.

C. Requirements that non-guaranteed values be clearly identified, and accompanied by a statement that the illustration includes assumptions which are unlikely to continue unchanged over time, and that actual performance may be more or less favorable than the values illustrated.

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CONTINUED

D. A prohibition against use of statements to the effect that there is a "vanishing premium" aspect to the policy.

E. Disclosure statements signed by both applicant and agent indicating that non-guaranteed values have been explained, and that no statements inconsistent with the values illustrated were made.

F. A requirement that policyholders who have received an illustration be annually provided with information showing how the policy is performing, and informing them that they may request a free illustration which will contain updated information on the projected performance of the policy.

2. Requires life insurers to appoint an actuary to certify that any illustrations used comply with the law. The commissioner would be empowered to object to an actuary if, after hearing, specified criteria are established.

3. Provides that violations of the bill may be enforced pursuant to specified provisions of the Unfair Practices Act which require a hearing before issuance of a stop order, and further requires resort to the courts through the Attorney General if the conduct does not stop.

4. Adopts a "Surrender Cost Index" and a "Life Insurance Act Payment Cost Index" which are designed to measure the time value of money as compared to other products. The methodology for generating the index number is set forth in the bill, but the bill also authorizes use of other methods to generate an index number if used in addition to the mandated method.

5. Repeals the existing regulations adopted by the Department of Insurance in 1994 which require use of a "Yield Cost Index" and provide for a "Consumer Guide" to the purchase of life insurance.

The bill sunsets January 1, 2000.

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CONTINUED

History of Abuses. Both proponents and opponents generally agree that there were abuses in the way that life insurance has been marketed in the past. Each notes cases in which very large and well known life insurers have faced disciplinary actions as a result of these abuses. Both proponents and opponents participated in efforts at NAIC, and in the United States Senate, to address these problems. The differences revolve around what precisely should be done. Generally, opponents accept that the worst of the abuses can be addressed by the Life Insurance Illustrations Model Regulation, but believe that the Model was unnecessarily watered down prior to adoption by the NAIC, and that this bill leans even further in the industry's favor. They also note that annuities were specifically excluded from the Model, and will be separately addressed with amendments to the Model. Proponents would like to place the NAIC model "regulation" into "statute" in order to limit the commissioner's discretion in this area. Similarly, Sections 2 and 3 are designed to obviate the need for the commissioner to take administrative action.

Yield Cost Index. The YCI is based on an NAIC Model, and the regulation was adopted in California in 1994. It was modified last year at the industry's request to address some technical concerns with the calculations. Basically, the YCI is designed to factor out the life insurance portion of life insurance policies which have investment features, and to provide an index number which enables consumers to compare the value of the policy with other products. Proponents of the YCI note that some criticisms of its results -- such as different results for smokers and nonsmokers, or for males and females -- is irrelevant because it is not designed to compare a policy for two different people, but rather to compare different options for the same person (and in any case are attributes of the SCI as well).

Proponents suggest that one reason life insurers dislike YCI is that it suggests that certain life insurance products may not be the best buy for some consumers in some circumstances. For instance, YCI tends to highlight the fact that whole life products do not make as much sense for a person with a short-term need as for a person viewing the ?4

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investment on a 20-year horizon.

Opponents of YCI argue that it is a "California-only" rule that increases costs to insurers, and is not more helpful to consumers than SCI. SCI, on the other hand, has been around a long time, and is in place across the country.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

According to the Department of Insurance, this bill would require additional staff totaling $48,000 in FY 97-98; $128,000 in FY 98-99; and $112,000 in FY 99-00. Staffing costs include the services of a senior life actuary, and a staff counsel. The department anticipates additional costs to conduct non-compliance hearings. According to the Department of Insurance's Administrative Law Bureau, an average non-compliance hearing costs between $35,000 and $45,000, including transcribing and staff time.

SUPPORT: (Verified 8/14/96)

California Association of Life Underwriters (source)
Association of California Life Insurance Companies
Pacific Mutual Life Insurance Company
Department of Insurance
Association of California Life and Health Insurance Companies

OPPOSITION: (Verified 8/14/96)

Consumer Federation of America
Consumers Union

ARGUMENTS IN SUPPORT: The California Association of Life Underwriters (CALU) and the Association of California Life and Health Insurance Companies (ACLHIC) believe that reform of life insurance disclosure laws is needed in order to address many of the problems which have existed over the past few years. Several large life insurers have faced nationwide scrutiny and enforcement fines due to marketing problems. Many of these abuses would be addressed by the reforms proposed by the bill. The bill is designed to ?5

CONTINUED

address two issues: misleading "illustrations," which can be a particularly difficult issue in an era of declining interest rates; and comparison indices. The bill addresses these two problems by adopting a new NAIC Model Regulation to control misleading use of policy illustrations, and by replacing a fairly recent DOI regulation with an alternative which has been in use for a number of years, and is in place in one form or another in 49 states.

Pacific Mutual Life Insurance Company supports the bill because it furthers the interest in uniformity of laws, which generate cost savings for insurers, and, therefore, policyholders.

ARGUMENTS IN OPPOSITION: Consumers Union (CU) notes that Section 1 of the bill, the NAIC "illustrations" model, contains some consumer benefits; however, "the repeal of the Yield Index in Section 3 takes away an important information tool that is an aid to comparison shopping for consumers." CU urges several improvements to the "illustrations" portion of the bill -- issues which were addressed by earlier versions of the Model Regulation prior to its final adoption by the NAIC. Business columnist Jane Bryant Quinn has stated: "What's missing from the NAIC proposal? The big items are: disclosure of the net rate of return on your policy cash values, and disclosure of the policy's internal costs. With those, you could compare one policy with another -- which the industry definitely doesn't want."

The Consumer Federation of America (CFA) makes no mention of the "illustrations" portion of the bill, but states that the repeal of the Yield Index (YI) regulation "is bad legislation for consumers in California." In response to the replacement of the Yield Index by the Surrender Cost Index (SCI -- as proposed by Section 2 of the bill), CFA states that "the SCI is useless, and frequently produces misleading results." CFA further notes that the National Association of Life Underwriters has testified in the past that SCI is no longer useful for today's life insurance products. The opponents argue that the index issues are exceedingly technical, and should be left for the commissioner to address by regulation -- which the

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CONTINUED

commissioner is fully empowered by existing law to do.

DLW:ctl 8/14/96 Senate Floor Analyses
SUPPORT/OPPOSITION: SEE ABOVE
**** END ****

?7

CONTINUED

APPENDIX F

SENATE RULES COMMITTEE AB 3234
Office of Senate Floor Analyses
1020 N Street, Suite 524
(916) 445-6614 Fax: (916) 327-4478

THIRD READING

Bill No: AB 3234
Author: Knowles (R)
Amended: 8/19/96 in Senate
Vote: 21

SENATE INSURANCE COMMITTEE: 5-1, 7/3/96
AYES: Lewis, Johnston, O'Connell, Peace, Russell
NOES: Rosenthal
NOT VOTING: Hughes, Johnson, Killea

SENATE APPROPRIATIONS COMMITTEE: 13-0, 8/13/96
AYES: Johnston, Alquist, Dills, Hughes, Kelley, Killea, Leonard, Leslie, Lewis, Mello, Mountjoy, Peace, Polanco

ASSEMBLY FLOOR: 73-0, 5/31/96

SUBJECT: Life insurance

SOURCE: California Association of Life Underwriters

DIGEST: This bill provides, effective July 1, 1997, for the regulation of life insurance policy illustrations by the Insurance Commissioner, and would define "illustration" as a presentation or depiction that includes no-guaranteed elements of a policy of life insurance over a period of years and that is one of three specifically defined types. The bill requires life insurers to provide prospective insured with a buyer's guide.
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CONTINUED

This bill sunsets January 1, 2000.

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CONTINUED

Senate Floor Amendments of 8/19/96:

1. Make several technical drafting changes.

2. Add a definition of "life insurance" in order to define the scope of the policy illustration law.

3. Clarify that the cost-index statute governs when specified data must be included in a policy illustration.

4. Provide enforcement authority and procedures for the Insurance Commissioner's review of policy illustrations.

5. Adopt by statute as part of the cost-indices law requirements concerning a "buyer's guide" for life insurance. The "buyer's guide" is currently part of the regulations which are superseded by the cost-indices provisions of the bill until the sunset date.

ANALYSIS: Existing law:

1. Specifies certain acts committed by an insurer which would constitute unfair competition or unfair and deceptive practices.

2. Includes in the category described in #1 the use or issuance of illustrations or advertising of life insurance products which contain false or misleading statements, or other misrepresentations associated with the value of the policy.

3. By regulation, has implemented #2 by requiring life insurers to comply with a "yield cost index" calculation, which provides specified disclosures to prospective purchasers of life insurance products. A "Consumer Guide" is part of this regulation.

This bill, effective July 1, 1997:

1. Adopts a National Association of Insurance Commissioners (NAIC) Model Regulation on life insurance illustrations. The Model Regulation involves a comprehensive

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CONTINUED

regulatory scheme to control when and in what manner life insurers may use "illustrations" to describe the operation and benefits of life insurance policies. Key features of the Model Regulation include:

A. A requirement that life insurers notify the Insurance Commissioner if a particular product will be sold via use of illustrations, and prohibits use of any illustration absent such notification.

B. Restrictions on the methodology an insurer can use to generate the values which are used to "illustrate" how the policy will perform over time.

C. Requirements that non-guaranteed values be clearly identified, and accompanied by a statement that the illustration includes assumptions which are unlikely to continue unchanged over time, and that actual performance may be more or less favorable than the values illustrated.

D. A prohibition against use of statements to the effect that there is a "vanishing premium" aspect to the policy.

E. Disclosure statements signed by both applicant and agent indicating that non-guaranteed values have been explained, and that no statements inconsistent with the values illustrated were made.

F. A requirement that policyholders who have received an illustration be annually provided with information showing how the policy is performing, and informing them that they may request a free illustration which will contain updated information on the projected performance of the policy.

2. Requires life insurers to appoint an actuary to certify that any illustrations used comply with the law. The commissioner would be empowered to object to an actuary if, after hearing, specified criteria are established.

3. Provides that violations of the bill may be enforced
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CONTINUED

pursuant to specified provisions of the Unfair Practices Act which require a hearing before issuance of a stop order, and further requires resort to the courts through the Attorney General if the conduct does not stop.

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4. Specifies that if the commissioner has reason to believe that any insurer has violated the bill, he or she may request and the insurer must file (a) an example of the annual report to the policy owner with notice of adverse change in non-guaranteed elements, and (b) an example of an illustration.

5. Adopts a "Surrender Cost Index" and a "Life Insurance

Act Payment Cost Index" which are designed to measure the time value of money as compared to other products. The methodology for generating the index number is set forth in the bill, but the bill also authorizes use of other methods to generate an index number if used in addition to the mandated method.

6. Repeals the existing regulations adopted by the Department of Insurance in 1994 which require use of a "Yield Cost Index" and provide for a "Consumer Guide" to the purchase of life insurance.

The bill sunsets January 1, 2000.

History of Abuses. Both proponents and opponents generally agree that there were abuses in the way that life insurance has been marketed in the past. Each notes cases in which very large and well known life insurers have faced disciplinary actions as a result of these abuses. Both proponents and opponents participated in efforts at NAIC, and in the United States Senate, to address these problems. The differences revolve around what precisely should be done. Generally, opponents accept that the worst of the abuses can be addressed by the Life Insurance Illustrations Model Regulation, but believe that the Model was unnecessarily watered down prior to adoption by the NAIC, and that this bill leans even further in the industry's favor. They also note that annuities were specifically excluded from the Model, and will be separately addressed with amendments to the Model. Proponents would like to place the NAIC model "regulation" into "statute" in order to limit the commissioner's discretion in this area. Similarly, Sections 2 and 3 are designed to obviate the need for the commissioner to take administrative action.

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CONTINUED

Yield Cost Index. The YCI is based on an NAIC Model, and the regulation was adopted in California in 1994. It was modified last year at the industry's request to address some technical concerns with the calculations. Basically, the YCI is designed to factor out the life insurance portion of life insurance policies which have investment features, and to provide an index number which enables consumers to compare the value of the policy with other products. Proponents of the YCI note that some criticisms of its results -- such as different results for smokers and nonsmokers, or for males and females -- is irrelevant because it is not designed to compare a policy for two different people, but rather to compare different options for the same person (and in any case are attributes of the SCI as well).

Proponents suggest that one reason life insurers dislike YCI is that it suggests that certain life insurance products may not be the best buy for some consumers in some circumstances. For instance, YCI tends to highlight the fact that whole life products do not make as much sense for a person with a short-term need as for a person viewing the investment on a 20-year horizon.

Opponents of YCI argue that it is a "California-only" rule that increases costs to insurers, and is not more helpful to consumers than SCI. SCI, on the other hand, has been around a long time, and is in place across the country.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes
Local: No

According to the Department of Insurance, this bill would require additional staff totaling $48,000 in FY 97-98; $128,000 in FY 98-99; and $112,000 in FY 99-00. Staffing costs include the services of a senior life actuary, and a staff counsel. The department anticipates additional costs to conduct non-compliance hearings. According to the Department of Insurance's Administrative Law Bureau, an average non-compliance hearing costs between $35,000 and $45,000, including transcribing and staff time.

SUPPORT: (Verified 8/20/96)

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California Association of Life Underwriters (source)
Association of California Life Insurance Companies
Pacific Mutual Life Insurance Company
Department of Insurance
Association of California Life and Health Insurance
Companies

OPPOSITION: (Verified 8/20/96)

Consumer Federation of America
Consumers Union

ARGUMENTS IN SUPPORT: The California Association of Life Underwriters (CALU) and the Association of California Life and Health Insurance Companies (ACLHIC) believe that reform of life insurance disclosure laws is needed in order to address many of the problems which have existed over the past few years. Several large life insurers have faced nationwide scrutiny and enforcement fines due to marketing problems. Many of these abuses would be addressed by the reforms proposed by the bill. The bill is designed to address two issues: misleading "illustrations," which can be a particularly difficult issue in an era of declining interest rates; and comparison indices. The bill addresses these two problems by adopting a new NAIC Model Regulation to control misleading use of policy illustrations, and by replacing a fairly recent DOI regulation with an alternative which has been in use for a number of years, and is in place in one form or another in 49 states.

Pacific Mutual Life Insurance Company supports the bill because it furthers the interest in uniformity of laws, which generate cost savings for insurers, and, therefore, policyholders.

ARGUMENTS IN OPPOSITION: Consumers Union (CU) notes that Section 1 of the bill, the NAIC "illustrations" model, contains some consumer benefits; however, "the repeal of the Yield Index in Section 3 takes away an important information tool that is an aid to comparison shopping for consumers." CU urges several improvements to the "illustrations" portion of the bill -- issues which were ?8

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addressed by earlier versions of the Model Regulation prior to its final adoption by the NAIC. Business columnist Jane Bryant Quinn has stated: "What's missing from the NAIC proposal? The big items are: disclosure of the net rate of return on your policy cash values, and disclosure of the policy's internal costs. With those, you could compare one policy with another -- which the industry definitely doesn't want."

The Consumer Federation of America (CFA) makes no mention of the "illustrations" portion of the bill, but states that the repeal of the Yield Index (YI) regulation "is bad legislation for consumers in California." In response to the replacement of the Yield Index by the Surrender Cost Index (SCI -- as proposed by Section 2 of the bill), CFA states that "the SCI is useless, and frequently produces misleading results." CFA further notes that the National Association of Life Underwriters has testified in the past that SCI is no longer useful for today's life insurance products. The opponents argue that the index issues are exceedingly technical, and should be left for the commissioner to address by regulation -- which the commissioner is fully empowered by existing law to do.

DLW:ctl 8/20/96 Senate Floor Analyses
SUPPORT/OPPOSITION: SEE ABOVE
**** END ****

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CERTIFICATE OF SERVICE

I hereby certify that on this 8th day of February, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit using the appellate CM/ECF system. Counsel for all parties to the case are registered CM/ECF users and will be served by the appellate CM/ECF system.

/s/ Andrea J. Robinson
ANDREA J. ROBINSON