SQUIRE PATTON BOGGS

State Insurance Regulation – Increased Disparagement of the Regulatory Framework and a Call for Action

State-based insurance regulation has existed for almost 200 years (187 to be exact) through a complex, but evolving and successful, regulatory framework. For most of these 200 years, states have regulated each insurance company offering products in their state, with states regulating both markets as a whole, as well as individual companies. The state regulator steps in the shoes of the consumer and also serves as the market overseer.

The state-based nature of this framework has been threatened many times over the years with federal legislation. Each time, states' rights have won the day. Today, this framework is under a more serious threat – this time from secondary regulators, such as state treasurers, and from private litigants bringing "private regulator" actions. This publication reviews the current insurance regulatory framework, discusses examples of threats to this framework and makes recommendations for addressing these threats.

Insurance Regulatory Framework

Life insurance products have been sold in the US since the mid-1700s. As early as 1831, states began to regulate insurance companies, with New York in particular requiring insurers to report to the state comptroller[1]. State insurance regulation was not always on firm footing, and it was not until 1869 that the US Supreme Court firmly placed the responsibility for the regulation of insurance on the states.[2] The following year, the National Insurance Convention was formed to address regulatory issues associated with insurance companies operating in multiple states.[3]

The National Insurance Convention is now known as the National Association of Insurance Commissioners or NAIC. The NAIC is governed by the insurance directors or commissioners from each of the 50 states, as well as the District of Columbia and several territories.[4] Since the enactment of McCarran-Ferguson in 1945, Congress has provided the federal government with some regulatory authority over insurance companies, but it has maintained the states' responsibility to oversee insurance companies operating in their jurisdictions.[5] Today, states are tightly connected in their regulatory efforts through a complex framework of laws, regulations and standards that are managed through the NAIC on a peer-to-peer basis. These laws, regulations and standards are often under review, based on market trends and state concerns. While each proposed revision to an NAIC model law or standard can spark debate among the state regulators, final changes are developed by consensus so that they can eventually be adopted on a widespread basis by the states.

Framework for Insurance Regulation

There are three primary functions of insurance regulation: (1) financial regulation to oversee solvency, (2) product standards and (3) market regulation laws.[6] In effect, insurance regulators conduct due diligence on behalf of consumers in their state to ensure that every company licensed to do business in their jurisdiction is fiscally safe and sound and is operating within the terms of such state's laws.[7] Insurance regulators do the work for their consumers, analyzing the complex finances and operations of insurers, establishing the base requirements for products, reviewing the product terms and rates before they go on the market, and determining whether or not maintains procedures to have claims are paid quickly and handled appropriately.

Solvency Regulation

Solvency regulation is the primary focus of state insurance regulation. Insurance companies must be licensed and must agree to be overseen by that state's insurance regulator in order to sell their insurance products in a given state. Because many companies operate in more than one state, financial regulation is coordinated among the state regulators through the NAIC, with the domiciliary regulator taking the lead on financial examinations and financial analysis.[8]

1 R. Carlyle Buley, *The American Life Convention 1906–1952: A Study in the History of Life Insurance* at 64 n.27 (1953). By 1849, states began to impose solvency requirements on life insurers, when New York enacted the first minimum capitalization requirements (US$100,000) and security requirements for the purpose of improving consumer confidence in state insurance markets by attempting to help stabilize companies and limit fraud.

2 *Paul v. Virginia, 75 U.S. 168* (1869). In *Paul*, a group of insurance companies attempted to invalidate state insurance regulation by seeking a federal alternative, and the group staged an unlicensed sale of insurance by an agent in Virginia that resulted in an enforcement action. Virginia's enforcement efforts were challenged in court. The group's plan failed, however, when the US Supreme Court determined, *inter alia,* that the issuance of an insurance policy was not a "transaction of commerce" governed by the US Constitution's Commerce Clause, but, rather, was the province of state governance and regulation. *Id.* at 182. *See also* H. Roger Grant, *Insurance Reform: Consumer Action in the Progressive Era* at 157, Iowa State University Press (1st ed. 1979).

3 Anne Obersteadt, et al., State of the Life Insurance Industry: Implications of Industry Trends at 7, Nat'l Ass'n Ins. Comm'rs & Ctr. for Ins. Policy & Research (2013).

4 About the NAIC, Nat'l Ass'n Ins. Comm'rs, available at http://www.naic.org/index_about.htm.

5 Obersteadt, *supra*, at 38–39, 177.

6 Gary M. Cohen, 2 *Appleman on Insurance* § 8.02[2][a] (Lib. ed. 2015); State Insurance Regulation at 2, Nat'l Ass'n Ins. Comm'rs (2011).

7 Julie Mix McPeak, 2 *Appleman on Insurance* § 9.06 (Lib. ed. 2015).

8 Framework for Insurance Holding Company Analysis at 7, Nat'l Ass'n Ins. Comm'rs (2002).

Financial statements that are filed with insurance regulators provide data mandated by regulators to address regulatory analytics, rather than to inform the general public about an insurance company's financial condition.[9] States prohibit the public dissemination of sensitive financial information in order to prevent harm to the insurance company and do not require that insurance companies make their financial statements public.[10]

Product Regulation

Life insurance product terms are heavily regulated in all states, including the form of applications and pre-purchase disclosures.[11] Many of these required life insurance policy provisions concern issues such as when coverage becomes effective, how premiums are payable, the circumstances where an insurer can deny a claim, the impact of suicide during the first two years of the policy, how a claim is made and the options that a beneficiary has when selecting a method for payment of policy proceeds.[12] Insurance codes also address information that life insurers are required to provide to prospective customers in the application for coverage or application to replace a policy.[13] Product terms and application material are not required to include, and are sometimes prohibited from including, any financial data regarding the company that is issuing the product.[14]

Market Regulation

Another key element of insurance regulation by the states is market regulation. Market regulation is generally considered to be the body of insurance regulation that does not involve financial regulation, the licensing of companies or agents, or regulation of product terms.[15] Within this area of their authority, regulators work to ensure that consumers are receiving the required product disclosures that prices being charged by insurers are in compliance with the rate filings made before the products went on the market, and that an insurer's product distribution practices are being conducted appropriately.[16]

States, through the NAIC, have developed a number of model laws prohibiting unfair trade practices, including false statements regarding a product's terms and the financial condition of a company.[17] State unfair trade practice laws are one of the few areas of insurance regulation where regulators share enforcement authority with a private right of action.[18] The private right of action is generally supported in many states to ensure that if a specific consumer has incurred a loss on a product, that consumer can recover the loss.[19]

There is nothing in these laws, however, that abrogates a state regulator's exclusive regulatory authority over insurance company solvency regulation.

Competition and Integration into an Effective Regulatory Framework

The vast majority of work by insurance regulators is done behind the scenes and is not visible to ordinary consumers. While regulators are meeting regularly with company representatives, reviewing financial disclosures or management background-check data and developing advanced accounting rules to address new products, the only public manifestation of this work is one key pronouncement – the insurer's license to do business in the state. Insurance codes are structured so that the only truly public decision that a regulator makes regarding a company's solvency is whether or not the company is licensed.

Regulators do not rank or rate companies. Regulators generally do not make announcements regarding their oversight of a particular company. These hallmarks of regulator discipline are important to ensure that each and every company is operating on equal footing. By avoiding rankings or discussion of concerns or model scenarios used in stress testing, regulators avoid creating concerns that could result in unnecessary market contagions.

Insurance regulators also must be mindful of the importance of fostering a competitive insurance market that makes quality products available to consumers at a reasonable price. Regulators understand that in order for companies to have the capacity to write new policies – the widespread availability of life insurance itself being an important public policy goal – regulators must ensure that companies are permitted to grow in a responsible manner while still managing their risks prudently. In a heavily regulated market such as insurance – where negotiation of price and product terms is limited by regulation and where a company may be licensed to sell products only after its regulator has determined it to be solvent – market competition among companies is based on the products and services that each company offers, rather than the company's value or share price.

9 *See*, e.g., NY, Ins. Code § 1322.

10 *See*, e.g., Individual Term Life Insurance Policy Standards § 3, Interstate Ins. Prod. Reg. Comm'n (2014); Individual Term Life Product Outlines, N.Y. Dep't Fin. Servs. (2015).

11 44 states also are members of a state compact, the Interstate Insurance Product Regulation Commission (IIPRC), regarding life insurance product standards. If a company utilizes the product standards established by the IIPRC, their product may be written in any IIPRC member state once approved by the IIPRC regulators. New York is not a member of the IIPRC.

12 *See*, e.g., N.Y. Ins. Law §§ 3203, 3220; Individual Term Life Insurance Policy Standards § 3, Interstate Ins. Prod. Reg. Comm'n (2014).

13 *See*, e.g., N.Y. Ins. Law § 3209; Individual Term Life Insurance Policy Standards § 3, Interstate Ins. Prod. Reg. Comm'n (2014).

14 *See*, e.g., N.Y. Ins. Law § 1322.

15 Market Conduct Regulation, Nat'l Ass'n Ins. Comm'rs available at http://www.naic.org/cipr_topics/topic_market_conduct_regulation.htm.

16 *Id.*

17 *See*, e.g., Unfair Trade Practices Act, Nat'l Ass'n Ins. Comm'rs (2004).

18 *See* Kenneth Levine, 2 *Appleman on Insurance* § 13.06 (Lib. ed. 2015).

19 *Id.*

Consumers benefit greatly from the efforts of insurance regulators. A strong insurance market is important to the success of our society. Few can protect their possessions or some of the most valuable and important assets in their lives, including homes, automobiles and businesses, without insurance, and many can prepare for the risk to their families or businesses in the event of an unexpected death or plan for retirement only by utilizing insurance. If consumers lack confidence in their insurers or the insurance market where they live, they will buy less insurance, with the inevitable consequence that uninsured losses will impose great hardship on many. Insurance regulators help to maintain consumer confidence and stability in insurance markets by monitoring insurer solvency, thus limiting failures, and by monitoring performance, such as claims payment and sales practices, to ensure that obligations to policyholders are fulfilled.

State Insurance Regulation Under Siege

Life insurance companies have a terrific track record of paying benefits. In 2016, in excess of US$76 billion in life insurance claims were paid and more than US$79 billion in annuity payments were made to consumers.[20] However, in recent years, life insurance companies and their products have come under unprecedented fire from secondary regulators and private litigants who are pressing for change in the insurance regulatory framework to drive additional revenue to fill state coffers or to create more private rights of action. Many of these claims hinge on creating chinks in the state insurance regulatory framework.

Secondary Regulator and Private Regulator Actions

By far, the largest assault on the life insurance industry and state insurance regulation in recent years was landed through widespread unclaimed life benefit examinations in 2010. These actions, brought by contingent-fee unclaimed property auditors, completely reinterpreted the terms of life insurance policies without any statutory or regulatory basis. These actions are now resulting in state treasurers and unclaimed property administrators constantly advocating to gain a *de facto* role as the primary regulator of life insurance claims – well beyond their statutory authority. As secondary regulators, these agencies seek to duplicate and undermine the authority vested in state insurance departments. Throughout the process, the secondary state regulators and their appointed auditors publicly disparaged insurance companies and, more subtly but equally aggressively, disparaged insurance regulators.

Additionally, lawsuits brought over the past several years include claims where the litigant is seeking to service as a "private regulator" in order to obtain recovery over and above their product benefits. The best examples of these actions against life insurance companies are the "shadow insurance" actions. These actions will be explored briefly below as an example, with a focus on how the insurance regulatory framework has potentially weakened actions.

Unclaimed Life Benefits Examinations

Starting in 2010, life insurance companies began to receive audit notices from Verus Financial LLC (Verus), a third party, contingent-fee auditor appointed by various state treasurers and unclaimed property administrators.[21] The unclaimed property examinations quickly turned adversarial, with immense data requests and short deadlines. For the first time ever in an unclaimed property examination, auditors were demanding delivery of entire portfolios of policy records spanning back decades. When companies could not meet the burdensome data requests or questioned their legality, the auditor immediately cited the company as "uncooperative" and, suddenly, companies were noticed with a multistate market conduct examination by state insurance regulators.

Unbeknownst to the life insurance industry, Verus was formed by two class action attorneys who had previously brought class action litigation against life insurance companies.[22] Also unknown to the insurance industry, Verus had lobbied state insurance commissioners to get them involved in market-conduct examinations. Several states were prepared to open multistate market conduct examinations once Verus made its allegations regarding noncooperation against the companies. These market conduct examinations provided Verus with almost unlimited authority to gain access to life insurance company records.

The auditor gathered several decades' worth of active and terminated life insurance and annuity records to "match" them against the Social Security Administration's Death Master File (DMF).[23] The auditor then sought to determine whether or not the policy death benefits had been paid out, regardless of whether or not the insurer had been notified of an insured's death – and, significantly, regardless of any "fuzzy" matching that lead to the identification of an actual company insured. Where the benefits had not been paid, the company had a short time to identify and pay the beneficiary or the auditor would declare the funds unclaimed and due to the states. The auditor also advised state insurance regulators that if a company had utilized the DMF in its payout book for fraud prevention purposes, but had not looked up other customers who were not in payout, then this "asymmetrical" DMF use was an unfair and deceptive practice. This logic linked the unclaimed property examinations to the coveted market conduct authority from the insurance code and allowed the unclaimed property auditor to blur the lines of authority. The door to company data was opened far wider by these allegations than ever before in an unclaimed property audit.

20 ACLI 2017 Life Insurers Fact Book at 47-48, available at www.acli.com.

21 "Life Insurers Skimp on Payouts: States" (*Wall Street Journal,* Apr. 28, 2011).

22 *Id.*

23 Such a demand for policyholder data ignores the security risk to insureds' sensitive personally identifiable information. Particularly in light of recent and ongoing security breaches that affect every state, company and cross-section of individuals, insurers must be committed to protecting the privacy, identity and security of its insureds, as well as protecting itself from any liability that would arise from the breach of such information.

Of course, life insurance companies had reason to be concerned because these allegations were not supported by either the unclaimed property codes or the insurance codes in any state.[24] Instead of circling back to consider the legal basis for the theories being advanced by Verus, the state insurance regulators pushed ahead with hearings and demands for settlement. Later, several courts confirmed these company concerns were validated.[25] However, by then, the state insurance regulators and state treasurers had embraced Verus's narrative and publicly disparaged insurers for allegedly withholding claims payments and mistreating policyholders.

Examples of this disparagement were evident throughout the process and continued at settlement. When the first settlement was announced in March 2011, the Florida State Treasurer/CFO stated publicly that:

- It is inconceivable that such large companies are unaware that their policies are cheating hardworking Floridians out of monies they've set aside to prepare for the loss of a loved one. The evidence to date reveals that the inexcusable policies and actions of life insurance companies have kept Floridians from collecting money they are rightfully owed. I believe that this settlement sends a clear message that deceptive practices will not be tolerated in our state and prevents further delay in returning these monies to the rightful owners.[26]

After the first settlement, the investigations exploded and settlements began to be announced. Often viewed as "legislation through settlement agreement," the settlement agreement terms were widely publicized and outlined an entire new regime for life insurance companies to utilize the DMF regularly (monthly or quarterly) to match it against customer records, identify and attempt to contact beneficiaries and provide them with instructions to make a claim, and pay any unclaimed benefits to the states as unclaimed property.[27] Conveniently, the settlement agreements defined the trigger for beginning to calculate a life insurance proceed as unclaimed as the date of the insured's death, rather than the statutory triggers of termination, limiting age and, in some states, knowledge.[28] This resulted in the companies being required to pay the funds to the state treasurers and unclaimed property administrators several years in advance, often with penalties and interest.[29] Notably, this expedited process resulted in limited time for the insurer to locate and pay the beneficiary before paying the states.

As settlement packages were announced, the disparagement of life insurance companies and, indirectly, insurance regulators remained heated. Each announcement by state unclaimed property administrators included negative comments by these secondary regulators, suggesting that life insurance companies did not pay claims. More startling, state treasurers and unclaimed property administrators began to assert that they would work to enforce the life insurer's claims paying efforts in the future. Examples of these disparaging statements, combined with assertions of new authority, include:

- For decades, the surviving families of policyholders have been cheated by life insurance companies…I reserve the right to use the full force of my office – including litigation – to compel insurance companies to follow the law and take care of life insurance beneficiaries.[30]
- This latest global agreement will make sure families who have been harmed by [Company's] practices are made whole and receive the life insurance benefits they are owed. These settlements make it clear that if the industry isn't willing to make the payments legally required, we will take action, including lawsuits, to compel them to do right by their customers.[31]

24 State unclaimed property laws applicable to these examinations all provided that life insurance proceeds are presumed dormant under the following circumstances: (1) if the policy or contract has matured or terminated; (2) after the obligation to pay arose under the contract (i.e., when a claim and proof of death are filed with the insurance company); or (3) if no claim is filed, after the insured reaches his or her limiting age under the mortality table on which reserve is based. *See,* e.g., Cal. Civ. Proc. Code § 1515; Fl. Stat. § 717.107; Ind. Code § 32-34-1-20; KY Rev. Stat. § 393.062; LA. Rev. Stat. § 9:154; ORC § 169.02; Tex. Ins. Code § 1109.001; Wis. Stat. § 177.07. Life insurance policy proceeds would only be eligible for reporting as unclaimed if one of the above circumstances existed, and then only after the statutory dormancy period has expired. Identifying deceased policyholders may trigger dormancy in some states, but it does not identify unclaimed property. Thus, conducting a DMF matching against any company's life insurance records would not identify any unpaid and unclaimed property, as a matter of law. Additionally, many insurance codes mandate that a life insurance policy include terms describing the requirements for how the beneficiary makes a claim upon death of the insured and the requirements for delivery of due proof of death. *See,* e.g., Fl. Stat. § 627.461; Ind. Code § 27-1-12-5; ORC § 3915.05; Tex. Ins. Code §1151.060; Wis. Stat. § 628.46. Insurance codes also contemplate a claim will be made with delivery of due proof of death. These code terms have been in place for decades in order to reduce the risk of fraud. Insurance codes do not require a life insurance policy to be payable immediately upon death.

25 *Feingold v. John Hancock Life Ins. Co.,* No. 13-2151, 2013 U.S. Dist. LEXIS 117070, at **6-8 (D. Mass. Aug. 20, 2013), aff'd., 753 F.3d 55 (1st Cir. 2014)(state insurance codes did not include any requirement for life insurance company to match life insurance policy files against the DMF); *Andrews v. Nationwide Mut. Ins. Co.,* No. 97891, 2012 WL 5289946, at ¶28 (Ohio Ct. App. Oct. 25, 2012), *appeal denied,* 135 Ohio St. 3d 1415 (2013)(neither the insurance contract nor common law imposed a duty on life insurer to search DMF periodically); *Thrivent Financial for Lutherans v. Florida Dept. of Financial Services,* 145 So. 3d 178, 181 (Fla. Dist. Ct. App. 2014) (no appeal taken)(court rejected a claim by the Florida Department of Financial Services that life insurance proceeds become due upon the date the insured dies and that dormancy period on life insurance begins to run at moment of insured's death. Court noted that, under Florida's Code, the limiting age is the alternative means by which "a contract 'not matured by actual proof of death' may be deemed matured and the proceeds due and payable," and court found that this provision would be rendered meaningless under DFS proposed claims); *Total Asset Recovery Services, LLC v. Metlife, Inc.,* 2010-CA-3719, at *4 (Fla. Ct. App. Aug. 20, 2013)(DMF matching of life insurance policy records is not indicator of whether life insurance policy proceeds are reportable as unclaimed property).

26 "Florida OIR and John Hancock Reach Settlement Agreement" (May 18, 2011) (propertycasualty360.com).

27 *See,* e.g., Global Settlement Agreement, Schedule D, available at https://www.sco.ca.gov/Files-EO/AIG_GRA_2012.pdf.

28 *See id.*, page 9, "Proceeds Escheatable By Reason of Death."

29 Mary Jo Hudson and Jill Murphey, "Life Insurance, Unclaimed Property and the Death Master File," at 12-13, ACLI White Paper (3d ed. 2016).

30 "Controller Reaches Settlement with Prudential Insurance," Press Release, CA Controller John Chiang (Jan. 13, 2012).

31 "Controller Chiang Announces Settlement with MetLife," Press Release, CA Controller John Chiang (April 23, 2012).

- Through a series of audits, my office has seen a harmful and systemic trend in the insurance industry that often robs families of life insurance benefits…[Company] has fought to keep its books closed…that is simply unacceptable and my office will hold them accountable to both the law and their customers.[32]

Through statements like these, state treasurers and unclaimed property administrators were regularly asserting authority over the life insurance company and the claims-paying process *before* property had become unclaimed. Likewise, they were taking a backhanded jab at state insurance regulators, as if those regulators had ignored an obvious legal violation.

Today, state treasurers and unclaimed property administrators continue to make disparaging public comments about life insurance companies and seem to be constantly working to pass legislation that will enable them to return to regular DMF searches through their contingent-fee examiners. For example, in 2017, Illinois Treasurer Michael Frerichs barnstormed his state, seeking legislative enactment of a new unclaimed property law and amendments to the insurance code that would allow DMF searches by his contingent-fee examiners and redefine the life insurance reporting trigger to be the insured's date of death. This campaign included statements such as:

- Most insurance companies don't pay out the policies unless people go to them and inform them of a family member's passing …. they may wait 5, 10, even 15 years until the beneficiary gets paid.[33]

He also aggressively fought the Illinois Governor's efforts to defend existing law and clarify the Treasurer's vague and misleading positions.[34] As state treasurers and unclaimed property administrators continue to advocate for updated laws to expand their ability to conduct DMF searches and race beneficiaries to the policy proceeds, it appears that these secondary regulators remain eager to intrude further into the claims process and elbow their way into the realm of state insurance regulators.

These secondary regulators do not seem to appreciate that, now that the settling companies' accelerated unclaimed benefit reports have been made, and now that DMF searching is mandated by more than half of the states and are routine for most companies, the promise of future large paydays has ended. However, their efforts always gain public attention and, to date, few regulators, industry advocates or companies have successfully challenged these disparagement and expansion efforts, only encouraging more unfair statements. Thus, the continuing use of disparagement of life insurance companies in order to advance disingenuous public and private causes does not seem to have any end in sight.

Private Regulator Actions

Aggressive private actions and attempted class actions of various sorts brought against insurance companies raise issues that have been historically restricted to insurance regulators. A good example of these cases are the "shadow insurance" cases, which include allegations that can only be labeled as "Private Regulator Actions." In these actions, many elements of the complaint that support the alleged damages are matters that, historically, are reserved to exclusive jurisdiction of insurance regulators. While to date none of these claims has been successful, the rhetoric and assertions chip away at the integrity of our existing insurance regulatory framework.

As background, on June 12, 2013, the New York Department of Financial Services issued a report titled, "Shining a Light on Shadow Insurance" (the NYDFS Captives Report).[35] The NYDFS Captives Report detailed the findings from its studies of captive reinsurance programs. The findings were de-identified and discussed the various practices of companies and other insurance departments in connection with the formation and regulatory review of captive reinsurance programs. The NYDFS Captives Report concluded by stating that "DFS is taking immediate action and making several recommendations to address the potential risks and lack of transparency surrounding shadow insurance."[36] The NYDFS Captives Report outlined recommendations for the NAIC and other insurance regulators to consider. The debate at the NAIC has since concluded with new actuarial and accreditation standards adopted.

Immediately after the NYDFS Captive Report was issued, several purported class action complaints were filed by life insurance and annuity owners against the life insurance or annuity issuers, alleging that the owners had lost "value" on their policies because the issuing insurer utilized a captive reinsurance transaction, a.k.a. "shadow insurance."[37] For example, in an action bringing RICO claims against an annuity and life insurer, plaintiffs challenged the company's calculation of its surplus, and the company's solvency, through criticizing the company's captive reinsurance program.[38] In great and painstaking detail, the plaintiffs outline the reinsurance transactions and associated accounting as if they had uncovered a treasonous spy ring. Plaintiffs' complaint devoted dozens of paragraphs to describing a "Scheme to Falsely Represent Financial Strength and Condition" with paragraph headings containing phrases such as "Defendants continue the scheme in 2009" and "Defendants continue the scheme in 2010." As the legal name of one captive was an anagram for the term "Iowa Captive," plaintiffs added to the perceived intrigue by including a pictogram with lines connecting the overlapping letters.

32 "Controller Sues Second Life Insurer for Violating Unclaimed Property Law," CA Controller John Chiang (July 17, 2013).

33 "Illinois Treasurer Frerichs Visits Riverbend, Touts Insurance Reform," June 20, 2017, available at https://www.thetelegraph.com/news/article/Illinois-Treasurer-Frerichs-visits-Riverbend-12573489.php.

34 *See,* e.g., Office of Illinois State Treasurer Press Release, November 8, 2017, "Illinois Families Win as Senate Overrides Gov. Rauner's Veto Of Life Insurance Reform Act." This press release ignores Governor Rauner's stated concerns regarding the use of contingent-fee auditors, due process and equal protection.

35 http://www.dfs.ny.gov/reportpub/shadow_insurance_report_2013.pdf.

36 *Id.* at 3.

37 See, e.g., *Jonathan Ross et al. v. AXA Equitable Life Insurance Co.,* Case No. 15-2665 (2d Cir.); *Calvin W. Yarbrough v. AXA Equitable Life Insurance Co.,* Case No. 15-3553 (2d Cir.); *Maria Del Carmen Robainas v. Metropolitan Life Insurance Co.,* Case No. 15-3504 (2d Cir.); *Mark Andrew Intoccia Sr. v. Metropolitan Life Insurance Co.,* Case No. 15-4189 (2d Cir.); *Hudson v. Athene Annuity and Life Company,* Case No. 4:16-CV-89 (S.D. Iowa);and *Ludwick v. Harbinger Group, Inc.,* 854 F.3d 400, 404 (8th Cir. 2017).

38 *Athene,* Case No. 4:16-CV-89 (S.D. Iowa).

Plaintiffs ultimately alleged that they were harmed by the captive reinsurance transactions, even though no annuity benefits had been paid or were even due. Indeed, they contended that, by virtue of these transactions, the insurance company was operating "with the same risks" as a "hedge fund without regard for the long term obligations and principles of conservancy and solvency that must govern an insurance company." While plaintiffs certainly noted regulatory guidelines issued by the NAIC, at no point did plaintiffs reference the authority, examination, oversight or coordination of state insurance regulators with respect to the company that had issued their insurance products. Instead, plaintiffs suggested that the "value" of the company somehow impacted the "value" of their products, while ignoring the insurance regulatory framework altogether.

Ultimately, the Eighth Circuit Court of Appeals affirmed the dismissal of plaintiffs' RICO claim because such claims "would interfere with state regulation of the insurance business, and the claims are barred by the McCarran-Ferguson Act."[39] *Ludwick* was then relied upon to dismiss the complaint from which the fanciful allegations quoted above were derived: "Plaintiff's case is controlled by the *Ludwick* decision. Both Iowa and Vermont regulate captive reinsurance companies and their transactions…. [The company] is domiciled in Iowa, and the Iowa Insurance Division approved the transactions at issue."[40]

In these "shadow insurance" cases, plaintiffs made no claims that their insurer had breached any of its obligations to them under their contracts or that they had received anything less than what they had bargained for. Ironically, their claims were based on expressed concerns about how their insurer was regulated – specifically, with regulatory decisions regarding how certain of their insurer's reinsurance transactions were structured. These claims were generated by a well-intended, but recklessly written report issued by an insurance regulator. They demonstrate that a mere thread of disparagement in a policy discussion can result in whole-cloth disrespect for the state insurance solvency regulation framework and the companies that the framework governs.

Discussion and Recommendations

As a former insurance regulator, I am troubled by the marked uptick in attacks on the state insurance regulatory framework through disparagement of life insurance companies and products from secondary regulators and private litigants. While the insurance regulatory framework has withstood many challenges, these efforts have an erosive effect that must be considered for the future.

The regulatory framework relies on the stability of one set of primary regulators in one system, regulators who focus on the current status of the company and who work to ensure that the company is prepared to meet its obligations in the near term and the distant future. In contrast, secondary regulators and private litigants are focused on individual issues, not on the stability of the regulatory framework, the market or policyholders generally. These continuing efforts to erode the insurance regulatory framework suggest that insurance companies will need to manage their risks to include even more *ex post, ad hoc* risks in the future, based on the outcome of secondary regulator claims or litigation.

Unfortunately, this is a result that weakens insurance markets, consumer confidence in insurance products and the insurance regulatory framework.

Is some disparagement to be expected? Absolutely and always. The insurance industry and its products can be misunderstood. However, the examples described above are systemic attacks on the current insurance regulatory framework in a manner that is unprecedented – and the accompanying narrative remains largely unchallenged. More importantly, the methods of attack are being replicated and are permeating into advocacy at the NAIC, appearing in other types of class actions against life insurance companies and creeping more frequently into public policy discussions.

The time is now for the life insurance industry to consider education and advocacy that include countering the derisive narrative. As policymakers and insurance regulators come and go, they are often focused on the "here and now" because the future is presumed to be ensured by the regulatory framework. The future is not as certain in light of this constant effort to erode confidence in the insurance regulatory framework.

The audience for these efforts would be state insurance regulators, academics, business thought leaders, the next generation of insurance industry leaders and the general public. When secondary regulator or private litigant issues arise, insurance regulators and companies usually find themselves on the defensive, with few modern-day communications weapons to rely upon to counter the usually unwarranted attack and they are left with few good options for resolution. More must be done to counter the "here and now" disparaging messages attacking the insurance regulatory framework than just ducking away.

Most of the necessary responses and communications materials to support the modern insurance regulatory framework and provide perspective on various secondary or private regulator challenges would not be direct. Instead, they must be omnipresent and woven into the fabric of discussion and advocacy regarding insurance regulation. Currently, there is a dearth of articles and authority on the modern insurance regulatory framework, its foundations and its pillars for success. The supply of readily available materials to explain insurance markets, the modern concepts and foundations of insurance, the various types of insurance and factors that limit markets or access to coverage is also quite limited and not readily accessible. Developing these tools through supporting scholarly analysis and discussion and modernizing long-range communication plans for proactively discussing the modern insurance regulatory framework are essential. Then, insurance regulators and insurance companies could pivot away from secondary and private regulators and take action more aligned to strengthening the insurance regulatory framework.

39 *Ludwick*, 854 F.3d at 406.

40 *Athene*, Case No. 4:16-CV-00089, Doc. 203 at 6, (S.D. Iowa May 11, 2017).

Preserving the modern insurance regulatory framework is essential to maintaining a safe and sound insurance market in the future. The influences of toxic disparagement, as discussed in this publication only by example, will only continue to erode the framework unless consistent and long-term education and advocacy efforts are made to neutralize and counter these influences.

Contacts

Mary Jo Hudson
Partner, Columbus
T +1 614 365 2732
E mj.hudson@squirepb.com

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations, nor should they be considered a substitute for taking legal advice.

© Squire Patton Boggs.

All Rights Reserved 2018