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Annuity Surrender Charge/MVA Disclosures Held Insufficient in California

On September 29, 2010, the U.S. District Court for the Northern District of California granted partial summary judgment against defendant American National Insurance Company (ANICO) on claims challenging the adequacy of ANICO's disclosures to senior citizens with respect to its deferred annuities, including disclosures relating to the Market Value Adjustment (MVA). *Rand v. Am. Nat'l Ins. Co.*, C 09-639 SI (N.D. Cal. Sept. 29, 2010). (Please click [here](#) for the opinion.)

Plaintiff alleged in a putative class litigation that Defendant violated California's Unfair Competition Law by failing to comply with the senior citizen disclosure obligations contained in California Insurance Code Sections 10127.13 and 10127.10. In its September 29 Order, the court granted summary judgment in favor of Plaintiff as to the claim that Defendant's failure to disclose, on the cover page, the MVA and the death-related surrender charge violated California Insurance Code Section 10127.13. The court also granted summary judgment in favor of Plaintiff as to the claim that Defendant violated the insurance code by providing an inadequate disclosure that did not list the page numbers of the policy that showed surrender charges. However, the court granted partial summary judgment in favor of Defendant as to the claim that Defendant also violated Sections 10127.13 and 10127.10 by placing the notices required by those sections on the inside of the policy jacket instead of stamping them on the front page of the policy jacket. The court rejected Defendant's argument that prior insurance department approval of the policy form precluded the court from determining whether Defendant violated the California Insurance Code.

The court first addressed Plaintiff's MVA related contention that the MVA formula contained an imbedded charge (referred to as a "bias") of 50 basis points that always reduced the withdrawal payment to the policyholder and thus operated as an additional, undisclosed surrender charge. In California, all individual life insurance policies and annuity contracts for senior citizens that contain a surrender charge period must disclose the surrender period and all associated penalties or the location of the surrender information on the cover page of the policy or on a sticker affixed to the cover page or to the policy jacket. Cal. Ins. Code § 10127.13. As an initial matter, the court agreed with Plaintiff that the California Department of Insurance's "review of the policies at issue neither establishes ANICO's compliance with the insurance code, nor precludes [the court] from determining whether ANICO violated the disclosure requirement." The court then rejected Defendant's argument that Section 10127.13 does not require disclosure of the MVA because it is a policy feature distinct from the surrender charge and thus is not a charge associated with the surrender period. The court reasoned that the statute "is not limited to those penalties that ANICO chooses to label as a surrender charge." According to the court, the statute requires disclosure of all penalties associated with the surrender period, and the MVA is such a penalty. The court's finding was based on Defendant's own witnesses' testimony that the MVA operates as a penalty and that the bias factor results in a lower policyholder value upon early surrender.

As to the Plaintiff's claim that Defendant violated the insurance code by not disclosing death-related surrender charges on the cover sheet or in the surrender charge schedule, the court agreed with the Plaintiff. The court noted that it was not mentioned on the cover sheet or in the surrender charge schedule that surrender charges applied at death and that a policyholder had to look at three different provisions on three different pages of the policy to ascertain the charges. The court also noted that "[c]ompliance with the statute is not excused simply because the required disclosures can be lengthy." As to the argument that there is no duty to disclose because the death-related charges are applied to

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beneficiaries and not policyholders, the court observed that the statute “is broadly written to include all penalties associated with the surrender period” and does not distinguish based on whom the surrender charge is assessed against.

As to the contention that Defendant violated the insurance code by placing the required notices on the inside of the policy jacket instead of outside, the court agreed with Defendant that the statute does not require the sticker to be placed on the outside of the jacket. However, the court found that the surrender notice was deficient because it referred to a “data page” for surrender charges without listing a page number. According to the court, this disclosure was inadequate because the notice does not direct policyholders to the “location of the surrender information” as required by the statute.

Although it is not yet clear whether the U.S. District Court’s decision in *Rand v. Am. Nat’l Ins. Co.* will be appealed or will be followed by other courts, insurers doing business in California may wish to examine their disclosures in light of the court’s findings. Furthermore, insurers with policies or annuities that have an MVA feature or impose surrender charges at death may wish to review their disclosures under the insurance regimes of the various jurisdictions in which they do business.



If you have any questions regarding this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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