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EXPECTFOCUS®

LEGAL ISSUES AND DEVELOPMENTS FROM CARLTON FIELDS JORDEN BURT, P.A.

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NAVIGATING THE IMPACT OF TECHNOLOGY AND REGULATIONS

CARLTON FIELDS
JORDEN BURT

EXPECTFOCUS®
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OCIE Lessons From Cybersecurity 2 Initiative

BY JOSEPHINE CICCHETTI & THADDEUS EWALD

On August 7, the SEC's Office of Compliance Inspections and Examinations (OCIE) issued a risk alert containing observations from its Cybersecurity 2 Exam Initiative. As a follow-up to the 2014 Cybersecurity 1 initiative, the Cybersecurity 2 Initiative examined the cybersecurity preparedness of 75 SEC-registered broker-dealers, investment advisers, and investment companies (funds) for the period of October 2014 through September 2015. In its report, OCIE identified issues of continuing concern, and articulated some best practices recommendations.

Overall, OCIE noted an observable increase in examined firms' cybersecurity preparedness in comparison to the prior examination. All broker-dealers, all funds, and nearly all investment advisers now maintain written cybersecurity policies and procedures. To varying degrees, a majority or many of the examined firms: conduct periodic risk assessments; conduct penetration tests and vulnerability scans (although they did not always remediate the weaknesses identified); have tools to prevent, detect, and monitor data loss; maintain processes to ensure regular system maintenance (although patches are not always installed immediately); maintain cybersecurity organizational charts; have obtained authorization from customers and/or shareholders to transfer funds to third-party accounts; and require vendor risk assessments or risk management and performance reports.

Despite that progress, OCIE highlighted three persistent issues. First, policies and procedures are often not reasonably tailored to the firm or risk, instead offering general or vague guidance and limited examples of appropriate safeguards. Next, firms maintain policies and procedures but neglect to meaningfully enforce compliance with them, or such policies and procedures fail to accurately reflect the firms' actual practices. For instance, annual reviews are not conducted annually, ongoing reviews of security protocols are conducted only annually, or firms fail to ensure that employees attend required cybersecurity trainings. Finally, firms failed to adequately maintain their systems as related to Regulation S-P, for example by neglecting to install software security patches, using outdated operating systems, or not conducting appropriate remediation efforts in response to risk assessments.

The risk alert concluded with OCIE's identification of so-called "robust" policies and procedures for firms to consider, including:

- maintaining a complete inventory of data, information, and vendors;
- maintaining detailed instructions regarding penetration tests, security monitoring, system auditing, rights of access to information, reporting, and other cybersecurity-related protections;
- maintaining strict processes regarding data integrity and vulnerability tests, including prescriptive testing schedules, beta-tests of security patches and other solutions, and prioritization of corrective actions for identified vulnerabilities;
- establishing data and system access controls and enforcing those controls;
- imposing mandatory employee training requirements and instituting procedures to ensure those training requirements are satisfied; and
- maintaining active engagement by senior management officials with all cybersecurity policies and procedures from formulation to enforcement.

While OCIE emphasized these policies as options to consider to improve cybersecurity preparedness, throughout the risk alert it noted that the examinations revealed that untailored policies or general guidance were causes for concern. Affected firms in the industry should not expect that blindly adopting the best practices identified by OCIE will constitute a safe harbor, nor necessarily constitute the most secure approach for every individual firm. Firms should conduct thorough reviews of their policies and procedures in light of their everyday practices, individual circumstances, and current and developing threats to assess their cybersecurity preparedness. Reliance on off-the-shelf and generic boilerplate language is insufficient. This recent initiative built on the Cybersecurity 1 Initiative and involved more validation and testing of procedures and controls. Registered entities should prepare for additional validation and testing in any future SEC examination initiatives.

NAIC Cybersecurity Working Group Votes to Approve Insurance Data Security Model Law

BY JOSEPHINE CICCHETTI

The National Association of Insurance Commissioners (NAIC) Cybersecurity (EX) Working Group (Cybersecurity WG) approved Version 6 (Finalized) of its Insurance Data Security Model Law (Model) on August 7 at the NAIC Summer 2017 National Meeting in Philadelphia. The following day the Model was approved by the Innovation and Technology Task Force. Next, it will be considered by the NAIC Executive Committee, and if approved, sent to the Joint Meeting of the Executive Committee and Plenary for vote by all NAIC Members.

Version 6 of the Model incorporates significant changes from the first version released March 2, 2016, including the narrowed purpose of establishing "standards for data security and standards for the investigation of and notification to the Commissioner of a Cybersecurity Event applicable to licensees..." The Model applies to all licensees, defined as individuals or non-governmental entities required to be authorized, registered, or licensed pursuant to a state's insurance laws. There are very limited exceptions to the definition. The Model also requires that all licensees develop, implement, and maintain a comprehensive written Information Security Program (ISP).

The ISP should be based on an individual risk assessment and be commensurate with the licensee's size and complexity, the nature and scope of its activities, and the sensitivity of the nonpublic information used or in the licensee's possession, custody, or control. The program should cover electronic and non-electronic nonpublic information. Nonpublic information includes information that is not publicly available and covers material business information of the licensee as well as specified personal, financial and health information concerning a consumer or a family member.

The Model calls for oversight by the board of directors or an appropriate board committee, the designation of a responsible person for the ISP and oversight and due diligence of all third-party service providers. A licensee must also monitor its program to adjust for changes in technology and must establish a written incident response plan.

The Model includes specific requirements for investigation and notification to the commissioner in the case of a cybersecurity event. A cybersecurity event is defined as an event resulting in unauthorized access to, disruption, or misuse of an information system or information stored on such system. It does not include encrypted information where the key has not been acquired, released or used, or events where the licensee has determined that the nonpublic information has not been used or released and has been returned or destroyed. Notification to the commissioner of the domicile or home state, and any other state where 250 or more impacted insureds reside, is required within 72 hours from determining a cybersecurity event has occurred. Notification to affected consumers is governed by the state general data breach notification laws with copies of such notices provided to the commissioner.

A Licensee is required to certify to the commissioner annually (no later than February 15) that it is in compliance with the requirements of "Section 4 – Information Security Program," as well as maintain the materials and documentation used to support the certification for five years.

The Model provides for three exceptions from the Section 4 ISP requirements: a licensee with fewer than 10 employees (including independent contractors), licensees who certify in writing that they have established and maintain an ISP that meets HIPAA requirements, and a licensee who is an employee, agent, representative, or designee of another licensee, but is covered by that licensee's ISP as long as that program complies with Section 4.

After evolving through multiple versions and considering a multitude of comments from the insurance industry and interested parties, Version 6 of the Model significantly tracks New York's Cybersecurity Regulation (NY Regulation). Importantly, the Model includes a drafting note indicating that the Cybersecurity WG intends compliance with NY Regulation to satisfy the Model's requirements. The note states, "The drafters of this Act intend that if a Licensee, as defined in Section 3, is in compliance with N.Y. Comp. Codes R. & Regs. tit.23, § 500, *Cybersecurity Requirements for Financial Services Companies*, effective March 1, 2017, such Licensee is also in compliance with this Act."

Examples of some major similarities with the NY Regulation include:

- Several similar definitions such as: cybersecurity event, information system, multi-factor authentication, nonpublic information, person, and publicly available information. Unlike the Model, it is important to note that the New York Regulation covers electronic information only, and, with respect to the cybersecurity event definition includes "any act or attempt, successful or unsuccessful."
- Both the Model and the NY Regulation require that the licensee perform a risk assessment.
- Written policies and procedures addressing the ISP, third-party vendor management and incident response.
- Annual reporting to the board of directors, or similar authority, by the person responsible for an ISP.
- Requirement to ensure the use of secure development practices for in-house developed applications and procedures for evaluating, assessing or testing the security of externally developed applications.
- Notification to the commissioner as promptly as possible but in no event later than 72 hours from a determination that a cybersecurity event has occurred.
- Annual documentation of compliance with the ISP.
- An exemption for licensees with fewer than 10 employees.

While many industry participants view the inclusion of the NY Regulation concepts as a positive development, there is still industry concern regarding several aspects of the Model, including its confidentiality and notice requirements.

Carlton Fields Jorden Burt, P.A. will continue to monitor the Data Security Model Law's progress, including whether eventual state adoption of the Model is uniform and includes the New York safe harbor intended by the Cybersecurity WG.

NAIC Big Data Working Group Update

BY BEN SEESSEL

Regulators are hard at work considering insurers' use of big data and analytics. The Big Data (Ex) Working Group, chaired by Oregon Commissioner Laura Cali Robison, adopted three charges for 2017. Briefly, these charges are to: (a) consider any necessary changes to the existing regulatory framework; (b) propose a mechanism to provide resources, and allow states to share resources, to facilitate the review of complex underwriting, rating, and claims models; and (c) assess data and tools required for regulators to appropriately monitor the marketplace. For each charge, the working group will first address property and casualty insurance before moving to life and health.

The working group's first and current focus is on charge b. A small group of regulators has drafted a proposed structure to help the states review complex rating models for automobile and home insurance. This proposal contemplates that the NAIC would hire a predictive analytics team with predictive modeling, insurance, and actuarial expertise to help the states review complex rating models. It further envisions the appointment of five to 10 state regulatory actuaries to a predictive analytics working group, which would, among other things, develop a checklist of data that companies must provide with their rate filings.

Industry groups have correctly voiced concerns about this proposal, including that it would improperly delegate regulatory authority to the NAIC. No decision was made regarding the proposal after much discussion at the working group's recent meeting in Philadelphia. Notably, although the proposed framework is intended to address the review of automobile and home insurance rating models, Commissioner Cali has stated that it could be modified to fit other lines of business. Although the working group has considerable work remaining on its 2017 charges, Commissioner Cali repeatedly noted that it will formulate additional charges for 2018.

SEC Scrutinizes Multi-Manager Arrangements

BY ED ZAHAREWICZ

Many mutual funds implement their investment strategies through "multi-manager" (also called "manager of manager") arrangements, particularly funds used to support variable life insurance and annuity products. Among other things, these arrangements allow a fund's primary investment adviser to efficiently replace underperforming sub-advisers without shareholder approval.

The SEC's Office of Compliance Inspections and Examinations (OCIE) appears to have recently commenced examinations of the multi-manager activities of a number of fund advisers. For example, the information request OCIE sent to at least one fund group suggests the examination staff intends to closely scrutinize a range of issues, such as:

- compliance with applicable exemptive and no-action relief, including whether the overall arrangement and any material changes to the primary investment advisory contract were properly approved by fund shareholders
- the rationale for hiring and firing sub-advisers, including related fund board materials
- whether fund shareholders were properly notified when new sub-advisers are hired
- potential conflicts, including in relation to the use of sub-advisers affiliated with the primary adviser and fee renegotiations with existing sub-advisers
- the rationale and process for reallocating assets between sub-advisers
- the effectiveness of the oversight of the primary adviser and sub-advisers
- the fund board's process for determining if fund counsel is "independent"
- the impact of the hiring or firing of sub-advisers on the primary adviser's profitability

While most of these issues will not surprise those familiar with the compliance aspects of multi-manager arrangements, they suggest the SEC staff will be especially focused on potential conflicts in this round of examinations. Take, for instance, the staff's interest in the primary adviser's profitability in relation to the hiring and firing of sub-advisers. All the same, now may be a good time for funds and fund advisers to review their multi-manager arrangements for compliance with applicable federal securities laws.

SEC Cautions on Use of Distributed Ledger/ Blockchain Technology to Raise Capital

BY ED ZAHAREWICZ & JOSHUA WIRTH

In July, the SEC issued a report addressing the applicability of U.S. federal securities laws to the offer and sale of securities by "virtual corporations or capital raising entities that use distributed ledger or blockchain technology to facilitate capital raising and/or investment." The report stemmed from an SEC investigation into whether The DAO, an unincorporated organization, its promoters, and certain intermediaries may have violated federal securities laws in connection with an "initial coin offering" of blockchain-based digital tokens known as "DAO Tokens."

The report describes The DAO as one example of a Decentralized Autonomous Organization ("DAO"), "a term used to describe a 'virtual' organization embodied in computer code and executed on a distributed ledger or blockchain." In 2016, DAO Tokens were offered in exchange for Ether, a virtual currency, raising the equivalent of $150 million, to be used to fund certain projects on an ongoing basis. DAO Token holders stood to profit from these projects as a return on their investment. In addition, they could monetize their tokens by reselling them on a number of web-based platforms.

Based on its investigation, the SEC determined that DAO Tokens are securities and strongly cautioned "those who would use a [DOA entity], or other distributed ledger or blockchain-enabled means for capital raising, to take appropriate steps to ensure compliance with the U.S. federal securities laws." In addition, the SEC warned that "any entity or person engaging in the activities of [a securities] exchange must register as a national securities exchange or operate pursuant to an exemption from such registration." And, although the report did not analyze whether The DAO was an "investment company," the SEC cautioned that "[t]hose who would use virtual organizations should consider their obligations under the Investment Company Act."

Whether a particular transaction involves the offer and sale of a security depends on the facts and circumstances. While acknowledging this, the SEC emphasized that the federal securities laws apply "regardless whether the issuing entity is a traditional company or a [DAO], regardless whether those securities are purchased using U.S. dollars or virtual currencies, and regardless whether they are distributed in certificated form or through distributed ledger technology." In the case of The DAO, the SEC decided against pursuing an enforcement action in favor of cautioning market participants generally regarding its views on the use of virtual organizations and other distributed ledger or blockchain-enabled means for raising capital. Those who fail to heed the SEC's guidance are unlikely to be as fortunate.

SEC Stays Approval of Quadruple-Leveraged ETF

BY JOSHUA WIRTH

On May 25, 2017, the SEC stayed a May 2 order issued by the Division of Trading and Markets, acting for the SEC pursuant to delegated authority, that would have permitted the listing and trading of shares of the first "quadruple-leveraged" exchange-traded products (ETPs). The stay puts the May 2 order on hold pending review by the SEC. The SEC also gave the public until June 15, 2017, to provide additional comments.

The release announcing the stay did not describe the SEC's rationale for doing so, but the action follows closely on the heels of the appointment of the SEC's new chair, Jay Clayton, on May 4, 2017. Whether the stay is an indication of Chair Clayton's views is unclear.

On June 13, 2017, NYSE Arca, Inc. (Exchange), which had proposed the listing and trading of shares of the ForceShares Daily 4X US Market Futures Long Fund and ForceShares Daily 4X US Market Futures Short Fund (the Funds), filed a comment letter expressing its strong belief that its proposal is consistent with the Securities Exchange Act of 1934 and that the SEC should affirm the May 2 order. In support, the Exchange asserted that concerns about the complexity and risks associated with inverse and leveraged ETPs are "appropriately addressed" by extensive risk disclosures provided by the Funds. The Exchange also asserted that sales of Fund shares would be subject to extensive sales practice obligations, and that trading in Fund shares would be subject to surveillance both by the Exchange as well as FINRA.

Notwithstanding the stay, on July 31, 2017, the Exchange filed a proposal seeking permission to list four ProShares quadruple-leveraged exchange-traded funds.

As of this writing, the SEC has not removed the stay of the May 2 order or acted on the ProShares proposal.

SEC Investor Advocate's 2018 Objectives Target Key Issues for Life Insurers

BY THADDEUS EWALD

On June 29, the SEC's Office of the Investor Advocate released a report that prioritizes addressing the inconsistency in the standard of care applicable to broker-dealers (a suitability standard) versus investment advisers (a fiduciary standard) in fiscal year 2018. The investor advocate emphasized the confusion this inconsistency can cause for investors, which has been compounded by the Department of Labor's recently-adopted fiduciary rules concerning recommendations made in the retirement plan context.

However, the investor advocate expressed concern about possible consumer harm if the SEC were to weaken the fiduciary standard for investment advisers or further confuse investors by purporting to provide them with the protections of a "fiduciary" duty that is actually less stringent than the traditional notion of fiduciary duty enshrined in other areas of law. The investor advocate, therefore, would have the SEC tailor any revised standard of care so that it deviates as little as possible from the current fiduciary standard applicable to investment advisers.

It will be interesting to see whether the SEC's commissioners and investor advocate ultimately agree on the extent to which deviations from such a fiduciary standard are necessary or appropriate. Formal and informal statements made to date by SEC Chairman Jay Clayton and Commissioner Michael Piwowar suggest that they, at least, would be more flexible in tailoring a standard of care to different circumstances than the investor advocate may support.

The investor advocate's report also called for Congress to provide the SEC with a respite from its various statutory mandates to free up resources for other rulemaking on "noncontroversial" and "promising ideas" that have taken a backseat. In this connection, the investor advocate singled out the proposal for a variable annuity summary prospectus as a worthy candidate for SEC action. Nevertheless, observers in the insurance industry who have long awaited SEC action on this proposal know better than to read too much into this statement. The variable annuity summary prospectus has been on the SEC's "to-do" list for several years now, without ever, apparently, enjoying a high enough priority to be formally proposed for adoption.

Nevada Securities Act Amendments – What's Next?

BY ANN FURMAN

Over the summer, much was written about amendments to the Nevada Securities Act provisions governing financial planners, which became effective July 1, after being signed by the Governor on June 2.

Prior to the amendments, Nevada law excluded from the definition of financial planner insurance producers, broker-dealers, sales representatives, and investment advisers. As amended, the exclusion for insurance producers was maintained but those for broker-dealers, sales representatives, and investment advisers were removed. Thus, unless an individual is an insurance producer only, such person is a financial planner subject to Nevada law imposing fiduciary duties in connection with their investment advice to clients.

The Nevada statutory fiduciary duties include 1) providing compensation disclosure to clients and 2) making diligent inquiry of each client, to ascertain and keep currently informed, concerning the client's financial circumstances and present and anticipated obligations to his or her family. Loss resulting from a financial planner's advice subjects a financial planner to fiduciary duty liability.

The amendments also authorize the Nevada Securities Administrator to adopt regulations concerning fiduciary duty and penalties. The Nevada Securities Division is in the process of considering the adoption of regulations pursuant to Nevada administrative procedure requiring soliciting comments, conducting a workshop, and holding a public hearing on any proposed regulations. The Nevada Securities Division anticipates that a public hearing will be held after January 1, 2018.

Trade groups and interested parties have submitted comments opposing the amendments. A chief concern raised by several commenters is that Nevada's authority to impose regulatory requirements on investment advisers and broker-dealers is preempted by the National Markets Improvement Act of 1996 (NSMIA). In this regard, the SEC has noted that Section 203A(b) of the Advisers Act preempts "all regulatory requirements imposed by state law on Commission-registered advisers relating to their advisory activities or services, except those provisions that are specifically preserved by [NSMIA]." A similar provision with regard to federally registered, FINRA member, broker-dealers preempts state regulations relating to, among other things, making and keeping records.

So, although Nevada's amended financial planner law is in effect, the reach of the amended law and the scope of regulations remain open issues.

The Fiduciary Rule Status Update

BY BRIAN PERRYMAN & GAIL JANKOWSKI

On April 8, the Department of Labor published the so-called "Fiduciary Rule." It defines who is an employee benefit plan's "fiduciary" for purposes of the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code as a result of giving compensated investment advice regarding assets of a plan or individual retirement account. The Department simultaneously published two new administrative class exemptions from the prohibited transaction provisions of ERISA: the best interest contract exemption, and the class exemption for principal transactions in certain assets between investment advice fiduciaries and employee benefit plans and IRAs.

The Fiduciary Rule had an initial applicability date of April 10. However, by memorandum dated February 3, President Trump directed the Department to prepare an updated analysis of the Fiduciary Rule's likely impact on access to retirement information and financial advice. On March 2, the Department proposed a 60-day delay of the applicability date of the Fiduciary Rule and prohibited transaction exemptions, and also sought public comment on their implementation and effect.

On April 7, the Department promulgated a final rule extending the applicability date by 60 days — from April 10 to June 9. As such, the Fiduciary Rule took effect June 9 pursuant to a phased implementation period for compliance with the new exemptions. Under the phased implementation, providers need only comply with the impartial conduct standards to avail themselves of the exemptions. To satisfy these standards, providers must follow the best interest standard of care, receive no more than reasonable compensation, and make no materially misleading statements. On August 9, the Department submitted to the Office of Management and Budget proposed amendments to three exemptions, which would extend the transition period and delay applicability dates from January 1, 2018 to July 1, 2019.

The Department stated that it will continue to review the Fiduciary Rule and seek public comments on potential changes. Relatedly, on July 6, the Department published a request for information seeking public comment on several aspects of the Fiduciary Rule, including ideas for possible new exemptions or regulatory changes. The deadline for submitting comments closed August 7, although Department officials have publicly indicated they will continue to accept comments beyond that deadline.

The DOL Fiduciary Rule: Charting a Course, Avoiding Collisions and Potential Litigation

Q&As on Annuity Sales Practices, 'Investment Advice' and Litigation

BY JAMES F. JORDEN

Last month, we wrote about potential litigation issues under the "revised temporary" DOL Rule involving the offer and sale of annuities in the IRA market. That discussion continues here. We emphasize that the questions and answers below are limited to the Rule's impact during this "temporary" period, which will apparently extend for 12 additional months, at least. This is especially true for the class action litigation issues we discuss. Recent reports of actions taken by the administration in one of the lawsuits challenging the rule indicate that the "no class action waiver" requirement for the BIC will be scuttled. That action's impact will likely result in the use of such waivers — mooting, in those instances, some of our questions and predictions.

Last month's questions, with supplemental answers based on reader comments, and several new Q&As, follow:

Q We asked whether it matters. "… from a potential litigation perspective, whether a commissioned sale of an annuity to an IRA relies on [PTE 84-24] or the [BIC] for its exemption?" We answered, probably not. We noted that 84-24 requires written disclosure of "material conflicts," but the BIC does not. We have since been asked whether this difference might potentially impact future litigation risks, depending on which exemption the sales entity relies on.

A Again, we think probably not. As we stated earlier, under either the BIC or PTE 84-24, the Impartial Conduct Standards (ICS) will apply to the sale and the potential exists for litigation asserting the violation of "fiduciary" duties. Under the DOL's ICS, financial institutions and advisers must "make no misleading statements about compensation, and conflicts of interest." A written disclosure must be made under 84-24, but, as some observers noted, none is required under the temporary BIC. However, 84-24 states that the sales agent or broker's "failure to disclose a Material Conflict of Interest relevant to the services it is providing or other actions it is taking in relation to a Plan's or IRA owner's investment decisions is considered a misleading statement." We assume the DOL, for consistency's sake, would apply this position on affirmative disclosure of material conflicts to any IRA transaction regardless of which exemption the selling entity relies on, and also during the transition period.

As we previously noted, for IRA transactions, any litigation to enforce "fiduciary" duties would have to be pursued in state court under state law fiduciary standards, which may or may not incorporate the standards established under the DOL's Fiduciary Rule. We continue to believe that a plaintiff's pleadings in some future allegation of a fiduciary breach involving IRA sales, absent a federal cause of action, are likely to focus primarily on the applicable state law fiduciary standards, which typically involve requirements for disclosure of material conflicts.

Q We also previously asked, "Can we assume that all state courts, when confronted with an IRA sale not tethered to existing ERISA case law and principles, will nonetheless conclude that the DOL's "Best Interest" standard must necessarily be followed in determining the boundaries of any "fiduciary duty" assumed by the agent or broker for the sale under state law?

A Our answer was, It depends. Further analysis on this issue follows the answer to the next question.

Q What are the primary areas of concern during the transition period for litigation, particularly class action litigation, involving financial institutions and advisers under the DOL's temporary rule?

A One concern is that due to a financial institution or adviser's treatment as an "investment adviser" fiduciary for purposes of ERISA, plaintiffs will argue that status in assessing the application of state law relationship characteristics that give rise to fiduciary status. It is likely any litigation, particularly any class action litigation against advisers and financial institutions, will allege that the defendant(s) are, by definition, investment advisers and therefore have a heightened duty — likely a fiduciary duty — to follow applicable fiduciary standards. This concern is tempered by the recognition that in virtually all states we have considered, the state law investment adviser standards apply only to sales of securities and that, regardless of the theory propounded, state courts will ultimately rely on more traditional standards to determine fiduciary status, such as those we referenced in our citation to the Pennsylvania Supreme Court's decision in *Yenchi v. Ameriprise*. There, the court characterized the standards for establishing a "fiduciary" relationship as follows:

> "Where no fiduciary relationship exists as a matter of law,

> Pennsylvania courts have nevertheless long recognized the existence of confidential relationships in circumstances where equity compels that we do so… . The circumstances in which [such] confidential relationships have been recognized are fact specific and cannot be reduced to a particular set of facts or circumstances."[1]

That said, labeling insurance agents and affiliated financial institutions as fiduciary investment advisers under ERISA presents an additional concern that must be addressed and protected against, lest it become a standard for applying fiduciary standards under state law.

Q How likely is it that a class action complaint for breach of fiduciary duty will be certified by a state court — assuming the traditional standards of "commonality" apply to the certification decision? And, relatedly, what is the likelihood of a plaintiff making a case for certification of a nationwide class?

A Our experience with class action theories premised on state law claims of fiduciary violations indicates such claims are difficult to assert and support on behalf of a class of persons because, under most circumstances, establishing a fiduciary relationship in a given transaction requires demonstrating the creation of a special, unique relationship between the alleged fiduciary and the alleged beneficiary. Normally, the sale of an investment or similar complex consumer product, and the interactions between the consumer and the agent involved, would not lend themselves to a common set of facts. However, during the past 10 years, several federal court fiduciary claims were allowed to proceed through class certification.[2] Most recently, in *Abbit v. ING USA Annuity and Life Insurance Company*,[3] the class allegation was for improper sales of annuities both as to product structure and sales practices. One count was for breach of fiduciary duty by the insurer. A series of motions followed, ultimately resulting in a complete victory for the insurer, but not before the federal district court in California denied a motion to dismiss the fiduciary count and then certified the "fiduciary" class. The court recognized that under California law, an insurer and a prospective insured do not have a fiduciary relationship, but nonetheless denied the motion based on the plaintiff's allegations of targeting seniors.[4] The court later certified the class on the basis that common legal and factual questions existed as to "whether ING owed a special and/or fiduciary obligation to senior citizens and retirees" for sale of its annuities.[5]

The same court recently granted ING's Motion for Summary Judgment as to all claims. Most interesting is the court's analysis of why it dismissed these claims on the motion for summary judgment. The court first acknowledged that "California courts have refrained from characterizing the insurer-insured relationship as a fiduciary one."[6] In an extensive discussion, the court concluded that plaintiffs produced no evidence of actions by ING to support creating a "fiduciary relationship that would not otherwise exist as a matter of law."[7] The court's analysis included a two-page footnote addressing plaintiff's attempt to use the DOL Rule to support its fiduciary arguments. In rejecting the plaintiff's analysis, the court stated:

> "Plaintiff misreads the DOL rules… as requiring FIA issuers….to adhere to fiduciary responsibilities and as creating a fiduciary relationship with every purchase of an FIA. In addition, neither the second or third DOL rules apply to Defendants in the manner Plaintiff asserts, **as Defendants have not provided Plaintiff with investment advice.** (emphasis added) ING at 28)."[8]

Q Would a plaintiff face other issues in attempting to certify a national class of purchasers?

A Yes. For example, given the differences in state law fiduciary standards, and the way "investment adviser" is defined from state to state, there would be no "common" law applicable to all transactions within the class. In most states, this lack of commonality or cohesiveness would preclude certification.

Q In the scenarios described above, will the financial institution (or insurer), as well as the insurance agent, face potential claims of fiduciary breach, given that it is unlikely the institution itself has established the requisite relationship of trust and dominance?

A We will address that question in more detail next month. The *Yenchi* and *Abbit* cases did allege that the financial institution was a fiduciary. Regardless, we recommend that sales practice standards established by any financial institution be clear to reflect that each sale is unique and that the sales agent/broker should follow procedures that insure recommendations and sales practices are tailored to the individual investor — recognizing that no two investors are identical. (In our next edition, we will offer specific ongoing recommendations for broker-dealers, insurers, and other financial institutions as defined in the DOL's Rule).

Read the full version here: http://bit.ly/2eq8FcF

1 *Yenchi*, 61 A.3d at 820.
2 *See e.g. Abbit v. ING USA Annuity & Life Ins. Co.*, No. 3:13-cv-02310-GPC-WVG , 2017 WL 2123616 (S.D. Cal. May 16, 2017); *see also Negrete v. Fidelity & Guar. Life Ins. Co.*, 444 F. Supp. 2d 998 (C.D. Cal. 2006).
3 *Abbit v. ING USA Annuity & Life Ins. Co.*, No.: 3:13-cv-02310-GPC-WVG , 2017 WL 2123616 (May 16, 2017).
4 *Abbit v. ING USA Annuity & Life Ins. Co.*, 999 F. Supp. 2d 1189, 1199 (S.D. Cal. 2014) (internal citation omitted).
5 *Abbit v. ING USA Annuity & Life Ins. Co.*, No. 13cv2310-GPC-WVG, 2015 WL 7272220 at *4 (S.D. Cal. Nov. 16, 2015).
6 *Abbit*, 2017 WL 2123616 at *14.
7 *Id.* at *15. The court also cited to *In re Conseco Ins. Co. Annuity Mktg.& Sales Practices Litig.*, 2007 WL 48637 (N.D. Cal. Feb. 12, 2007) and *Solomon v. N. Am. Life & Cas. Ins. Co.*, 151 F.3d 1132 (9th Cir. 1998) for the proposition that "an insurer owes no fiduciary duty to its insured under California law."
8 *Abbit*, 2017 WL 2123616 at *14 n.7 (emphasis added).

Certified Financial Planner Board Proposes Fiduciary Obligations for All CFP Financial Advice

BY GAIL JANKOWSKI

In June, the Certified Financial Planner (CFP) Board released proposed revisions to its standards of professional conduct that would require CFPs to adhere to a fiduciary standard at all times when providing any "financial advice" to a client. This expands the current standards, which hold CFPs to a fiduciary standard only when providing "financial planning" services, or at least material elements of such services.

Generally, this change will most heavily impact CFPs that are not already subject to fiduciary standards applicable to registered investment advisers. Therefore, many insurance companies will be particularly interested in the implications of this proposal for CFPs, including broker-dealer registered representatives, that:

- give financial advice to clients under circumstances where the CFP is not functioning in a registered investment advisory capacity; and
- such advice is in connection with the CFP's offer or sale of (a) the company's insurance products or (b) other financial products or services offered through a company affiliate with which the CFP is associated.

Not only do the proposed revisions affect when a CFP must act in a client's best interest, but they also require all CFPs to provide clients with written "introductory information" amounting to a "plain English summary" of material information about the CFP and his or her firm.

Accordingly, as to financial advice rendered in the retirement plan context, the CFP board's proposal parallels in some respects the U.S. Department of Labor's (DOL's) recently-adopted expanded definition of "fiduciary" and related "best interest" standard and disclosure requirements for investment advice rendered in that context. However, compliance with the revised CFP board standards would by no means satisfy all of the DOL requirements, which would still have to be separately considered.

Pennsylvania Court Holds Fiduciary Duty Exists Only Where Consumer Cedes Decision-Making Control to the Fiduciary

BY THADDEUS EWALD

The Pennsylvania Supreme Court recently held in *Yenchi v. Ameriprise Financial, Inc.* that a financial adviser owed no fiduciary duty to a couple who purchased a life insurance policy based on the adviser's advice where they did not cede all of their decision-making control to him.

An Ameriprise financial adviser (Holland) established a relationship with the Yenchis with a cold call. After a series of initial meetings, he collected an adviser fee and prepared a financial management plan for the couple. Based on Holland's advice, the Yenchis cashed out several existing life insurance policies to purchase a new life policy, but declined to follow some of his other recommendations. Years later, when they learned the life policy was severely underfunded, the Yenchis sued Ameriprise for breach of fiduciary duty. The trial court dismissed the fiduciary duty claim because no fiduciary relationship existed where the Yenchis continued to make their own investment decisions, but the appellate court found error where the trial court focused too rigidly on the couple's decision-making control.

The state's high court was careful to address the concept of fiduciary relationships that exist based on undue influence exerted by the fiduciary over the individual. In those instances a party with some special vulnerability — such as disease, advancing age, or inability to understand the transaction's nature or terms — puts her entire trust into someone else's hands such that she has effectively ceded her control and decision-making processes to the other party. However, the court emphasized, no fiduciary relationship exists even where a special vulnerability is present if the party continues to act on her own and does not submit to the "overmastering influence" of the relationship.

Applying that framework to the Yenchis' relationship with Holland, the court sided with the trial court, finding no fiduciary relationship existed because the Yenchis continued to make their own decisions, albeit with the benefit of Holland's advice. Of particular importance was the fact that the Yenchis declined to follow some of Holland's recommendations while choosing to follow others, demonstrating autonomy and control over their own decisions and undermining the idea that they were subject to any overmastering influence. The court specifically rejected the Yenchis' argument that they had relied on Holland's expertise and specialized skill (juxtaposed with their high school education) because such a standard would grant fiduciary status to any relationship where one party had a marginally greater skill level than the other. Instead, the critical issue is whether there exists something beyond mere reliance on superior skill or knowledge that shifts the relationship to one of overmastering influence such that the individual effectively cedes her decision-making control.

Plaintiffs Survive Standing-Based Challenge to California Senior Notice and Financial Elder Abuse Claims

BY SHAUNDA PATTERSON-STRACHAN

In California, actions predicated on alleged senior notice requirement violations and financial elder abuse continue to challenge life insurers. For example, in June, a California federal district court denied the insurer's summary judgment motion in a putative class action where plaintiff alleged that inadequate disclosures of information regarding the policy's right to return and surrender and associated penalties on the face of her fixed indexed annuity, which violated California's senior notice statute, also violated the unlawful and unfair prongs of California's Unfair Competition Law (UCL), and the financial elder abuse provisions of the state's Welfare and Institutions Code. *Goertzen v. Great Am. Life Ins. Co.*

Great American's motion was laser-focused on the question of plaintiff's standing, both under the UCL and Article III of the U.S. Constitution, to assert these claims. Plaintiff, who purchased the fixed indexed annuity at issue when she was 80-years-old, argued she had standing to pursue the claims in federal court because the surrender charges she was assessed when she took an early withdrawal from the annuity constituted an injury in fact, and the injury was traceable to the insurer's failure to make the requisite disclosures.

Relying partly on the Ninth Circuit's May ruling in *Friedman v. AARP, Inc.* (*see* Expect Focus, Vol. II 2017), in which the court recognized that reliance need not be proved for violation of the UCL's unlawful prong where the predicate legal violation is not based on fraud or deception, the district court rejected Great American's contention that the plaintiff's inability to establish causation left her without standing. As to the claim under the unfair prong, the court recognized that, to the extent that claim relies on alleged deceptive conduct, an offer of evidence that she "'would not have bought the product but for the misrepresentation' ... is sufficient to establish both causation ... and injury." The court ruled that the plaintiff's deposition testimony that she would not have purchased the annuity had she known of the surrender charges and their duration was sufficient to create a triable issue on the question of causation and injury, preventing summary judgment.

Notably, the court rejected Great American's argument that in order to be misled in the way alleged, in addition to the jacket and cover page, the plaintiff would have also had to read the annuity contract sections regarding the surrender charges, and still fail to understand that there were surrender charges. As the court explained, "[t]he [senior notice statute's] protections would be rendered meaningless if a claimant could only show she was misled based on a reading of the entire policy, or evidence that some different disclosure would have sufficed."

Eleventh Circuit Affirms Summary Judgment for Insurer in STOLI Case

BY GAIL JANKOWSKI

In *Sun Life Assur. Co. of Canada v. U.S. Bank Nat. Ass'n*, the Eleventh Circuit recently clarified that where a life insurance policy lacks an insurable interest at its inception and is thus void *ab initio*, prejudgment interest accrues from the date of payment.

The case involved a $5 million life insurance policy issued in 2006 on a woman in her mid-seventies. Two years later, U.S. Bank purchased the policy from the policy's funder and made premium payments on it until the insured's death in 2014. After U.S. Bank made a claim for benefits, Sun Life refused to pay, alleging that the policy constituted a "stranger originated life insurance" (STOLI) policy. Sun Life sought an order declaring the policy void *ab initio*, and U.S. Bank filed counterclaims seeking a return of all premium payments made pursuant to the policy. The District Court for the Southern District of Florida entered a judgment in favor of Sun Life as to its declaratory judgment claims and in favor of U.S. Bank as to its counterclaim seeking the return of premium payments. In a post-judgment order, the district court clarified that U.S. Bank was not entitled to an award of prejudgment interest on premium payments made after its 2008 acquisition of the policy.

On appeal, the Eleventh Circuit affirmed as to all issues except the district court's finding regarding prejudgment interest. The panel recalled the "general rule" in Delaware that "interest starts on the date when payment should have been made." Specifically, the panel disagreed with the district court's conclusion that U.S. Bank was not entitled to an award of prejudgment interest on the premium payments it made between 2008 and 2014. The panel distinguished the present STOLI case from those where a defendant insurer wrongfully refuses to pay. In those cases, the panel reasoned, prejudgment interest accrues from the date of the defendant's refusal to pay. However, the Eleventh Circuit clarified that "where, as here, the claimant seeks a refund of payments it never should have made, prejudgment interest accrues from the date of the claimant's payments." Therefore, the panel remanded for re-calculation of the amount of prejudgment interest due to U.S. Bank.

Dismissal of Individual Claims Cap Insurer's Winning Streak in Action Challenging FIA Product Features

BY CHRISTINE STODDARD

In May, the Southern District of California handed ING a win in a case involving allegations that the company targeted seniors with annuities that hid an embedded derivative structure that made them worth less than promised. *Abbit v. ING USA Annuity & Life Ins. Co.* The court previously granted plaintiff's motion for class certification in part but thereafter granted summary judgment in ING's favor on all of the certified class claims. ING subsequently moved for summary judgment on the remaining individual claims as well, which included causes of action for breach of contract, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, failure to supervise, fraud, and violations of the California Unfair Competition Law (UCL) and False Advertising Law (FAL).

The court followed up on its prior ruling by granting ING's motion for summary judgment on the individual claims as well. In particular, plaintiff failed to show that he was charged anything that violated a contractual term or that ING failed to credit interest as the policy required. The court further found that ING had acted in good faith in exercising its discretion regarding interest-crediting strategies. Moreover, ING did not owe plaintiff a fiduciary duty under California law, nor did it have a duty to supervise the independent agents who sold its annuities. Plaintiff likewise failed to show that ING had violated the UCL and FAL in connection with its sales brochures and applications, which provided relevant disclaimers, and ING had not made misrepresentations or failed to disclose the embedded derivatives for purposes of the fraud claim.

Instead, the contract explained how interest was credited, the embedded derivatives were disclosed in public SEC filings, and ING had no duty to disclose its pricing and ratemaking policies. In its decision, the court emphasized that plaintiff had acknowledged on his application that, except for guaranteed minimums, the values shown were not guaranteed, and he had spoken only with his independent agent rather than ING before and after purchasing the contract. Given these findings, ING was entitled to judgment as a matter of law.

Communications With Auditors and Audit Committees May Change

BY TOM LAUERMAN

The SEC has proposed for comment major revisions in the disclosures auditors are required to make in their reports on financial statements audited pursuant to Public Company Accounting Oversight Board (PCAOB) standards.

PCAOB auditing standards are required to be followed for the financial statements of most public companies. This includes insurance companies, unless the company's only outstanding publicly-held securities are variable annuities or variable life insurance policies.

The new disclosures required in PCAOB-compliant audit reports would include information about any critical audit matters (CAMs) or, if the audit did not uncover any CAMs, a statement to that effect. A CAM is defined as a matter that:

- is communicated to the company's audit committee, either voluntarily or pursuant to PCAOB guidance about such communications;
- relates to accounts or disclosures that are material to the financial statements (although the CAM itself need not be material); and
- involves "especially challenging, subjective, or complex auditor judgment."

The disclosure about any CAM must include:

- the principal considerations causing the auditor to conclude that the matter was a CAM;
- how the auditor addressed the CAM in conducting the audit; and
- reference to the relevant financial statement accounts or disclosures.

Certain types of companies would be excepted from these new CAM disclosure requirements, including: mutual funds and other registered investment companies that are not business development companies; registered broker-dealer firms; and "emerging growth companies" as defined under the Jumpstart Our Business Startups Act.

If approved by the SEC, the new CAM disclosure requirements may have the unintended consequence of impairing full and frank discussions among management, audit committees, and auditors. As the PCAOB has acknowledged, statements about CAMs could provide the basis for legal claims, leading to increased litigation costs and audit fees.

Serious comments have been filed with the SEC on both sides. For example, some public companies, as well as the U.S. Chamber of Commerce, oppose the CAM disclosure requirement, while some money managers and institutional investors support it.

New Partnership Audit Rules – Plan Ahead Before the Tax Bill Arrives

BY JORDAN AUGUST

A new set of rules for partnership audits (New Audit Rules), which generally take effect January 2018, fundamentally alter the manner in which the Internal Revenue Service (IRS) will conduct audits of partnerships, multi-member LLCs, and certain unincorporated organizations, including joint ventures, treated as partnerships for federal income tax purposes (collectively, Partnership).

The New Audit Rules, created under the Bipartisan Budget Act of 2015 (P.L. 114-74, Act § 1101), will not only govern IRS procedures for conducting a Partnership audit but their application will also have the potential to shift the tax burden resulting from an audit among the Partnership and the partners.

Under the default rule of the New Audit Rules, if an IRS audit of the Partnership results in an increase in its taxable income — the Partnership itself will be responsible for paying the additional taxes. If there has been any change in the Partnership's ownership from the year under audit to the year the IRS assesses the additional Partnership tax, this default rule could effectively shift the tax burden from the former partners to the current partners. Thus, in some cases, current partners could be left paying the former partners' tax bill under the New Audit Rules.

The New Audit Rules permit a Partnership to opt out of the default rule by making an affirmative election with the IRS to shift the tax liability from the Partnership to those taxpayers that were partners during the year(s) under audit. However, the discretion as to whether such an election should be made is granted to a "partnership representative," who will have the sole authority to act on behalf of the Partnership and the partners during the course of the audit.

This represents a significant change in partnership tax law that may not be contemplated in many existing LLC operating agreements or partnership, joint venture or collaborative agreements (collectively, the Partnership Agreement). As a result, any entity or individual invested in a Partnership should take steps to review the terms of the governing Partnership Agreement to determine whether the New Audit Rules are addressed, and if not, to supplement the Partnership Agreement with a plan for how the Partnership will respond to a potential IRS audit.

The failure to properly cover the New Audit Rules in a Partnership Agreement could leave an unsuspecting partner in the unfortunate position of paying a Partnership tax bill for a former partner without knowledge that the Partnership was even under audit review. Thus, it is critical for any partner invested in a Partnership to understand the function of the New Audit Rules by consulting a tax advisor; and, together with the other partners, formulating a plan for handling a possible audit.

A Ticking Clock: New York's Pending Non-Guaranteed Elements Rule for Life Insurance and Annuity Products

BY STEVEN KASS

The clock is ticking on the New York Department of Financial Services' issuance of new Regulation 210 "Life Insurance and Annuity Non-Guaranteed Elements" (the Rule). The Rule would impose comprehensive requirements on insurers offering individual and group life insurance and annuity products in New York containing non-guaranteed elements (NGEs), including requirements for board-approved determination policies, substantive requirements for NGE determinations, and mandated disclosures and notices to the Department and policy owners of NGE changes. Notably, the Rule deems any violation of its provisions to be an unfair method of competition or unfair or deceptive insurance trade practice.

The Rule's genesis dates back to between 2008 and 2010, when the Department published successive versions of then-proposed Regulation DA (Discretionary Amounts). Following critical industry comment on that proposed rule, the Department did not finalize it.

In November 2016, the Department published a draft of the Rule that resurrected much of Regulation DA's conceptual basis as well as significant portions of its language. In the "Regulatory Impact Statement" for Regulation 210, the Department stated, "[t]his rule addresses a number of issues that have been highlighted by company announcements, media commentary, and complaints" regarding NGE determinations and readjustments. Focusing on policy lapses resulting from decreased credited rates and increased policy charges, the Department noted that "[t]he rule should assist consumers to better understand - at time of purchase, and upon any adverse [NGE] readjustment - how [products with NGEs] operate, and thereby reduce consumer dissatisfaction and the number of lapsed policies." The November 2016 draft of the Rule engendered substantial industry and other comments, with the Department publishing an updated draft on May 24, 2017, along with an "Assessment of Public Comments" on the November 2016 draft (the Assessment).

Having received and reviewed all comments on the May 24 draft, the Department informally indicated that the final Rule will be published in the coming month and will incorporate only "nonsubstantive" changes to the May 24 draft. The Rule is expected to take effect in March or April of 2018 (i.e., 180 days after publication of the final Rule in the state register). Accordingly, we expect the following requirements will apply to insurers writing life and annuity products in New York with NGEs:

- Each insurer must establish board-approved criteria for determining NGEs, with mandated and permissive content requirements for such criteria.
- Prior to the issuance of any new product form, a qualified actuary must prepare a detailed actuarial memorandum that includes comprehensive tabulations, by pricing cell and duration, of the insurer's current NGE scale and underlying anticipated experience factors. The memorandum must also include the reasoning and analysis that underpinned the insurer's anticipated experience factors as well as the insurer's processes and methods used in the NGE determinations.
- For product sales after the Rule's effective date, the insurer must provide to policy owners the current scale of NGE elements by no later than the date of issue.
- The insurer must satisfy certain requirements when setting and adjusting NGEs, including:
- required practices for assigning products into classes for NGE determinations;
- specific experience factors, by product type, the insurer may and may not use;
- prohibitions against recouping past losses, including related prospective "profit margin" constraints; and
- specific requirements for assumed and acquired business.

- For any post-issuance adverse changes to NGEs (including NGE changes applicable only to new policy issuances), the insurer must:

- have a qualified actuary prepare an updated actuarial memorandum that includes a detailed tabulation, by pricing cell and duration, of all proposed NGE scale changes, and which identifies all changes in anticipated experience factors and profit margins. This memorandum must also include a description of the experience or other rationale underlying the new factors. And for life insurance policies only, the insurer must file this actuarial memorandum (along with the prior actuarial memorandum) with the Department no later than 120 days prior to implementation of the NGE change.

- no later than 60 days prior to implementation, provide policy owners with a disclosure document containing, among other things, the proposed new and prior NGE scales along with narrative disclosure regarding the nature of the change and the fact that it is adverse (or the conditions under which the change would be adverse).

- By May 1 annually, the insurer must file with the superintendent a listing of any adverse NGE changes during the prior calendar year together with an actuarial certification of compliance with the Rule.

The Department's Assessment of the comments on the November 2016 version of the rule provides important insights into its positions on a number of the matters described above, such as policy class assignments, permitted experience factors, and prospective profit margins. Given the spate of class action litigation over NGE changes (and insurers' alleged failures to make NGE changes), any insurer with New York issued policies will want to study those positions closely, both when evaluating whether and how to implement future NGE changes as well as in defending any litigation or regulatory challenges to past NGE changes. In addition, for insurers issuing policies only outside New York, the Department's positions may afford useful guidance for NGE change structuring and litigation and might also serve as "the canary in the coal mine" for dealings with other state regulators.

Copies of the May 24 version of the Rule and the Department's *Assessment of Public Comments* are available upon request.

Sticking Firmly to Contract Terms, Court Dismisses Premium and COI Overcharge Claims

BY PAUL WILLIAMS

In July, in *Hancock v. Americo Financial Life & Annuity Co.,* Americo achieved a total victory on its motion to dismiss a putative class action in the Eastern District of North Carolina that challenged its premium and COI charges. *Hancock v. Americo Financial Life & Annuity Co.* The putative class representative purchased a flexible premium adjustable life insurance policy in 1985, and claimed that defendant breached the policy by raising his premiums. These raises, plaintiff alleged, began about a decade earlier, and led defendant to take money out of the cash value of the policy to cover the difference between the monthly premium paid and the increased premiums being charged. For an additional breach of contract claim, plaintiff alleged that defendant assessed cost of insurance (COI) charges that exceeded those the policy permitted. Attendant to these allegations, plaintiff also brought implied covenant and several tort claims.

The first breach claim, based on premium overcharges, failed because the policy allowed for increased premiums, and set out the circumstances in which those increased premiums would be necessary to keep the policy active. The court looked at multiple provisions and read them as a whole, including the "flexible premium adjustable life insurance" title and the clauses requiring premium payments to meet levels sufficient to keep the cash value above cost of insurance deductions. The court concluded: "premium increases were allowed and nearly inevitable based on the terms of the policy and the interest rates applicable to the policy." The court noted that the table of insurance rates in the policy plainly showed the COI increasing significantly and steadily each year, preventing any argument that the policy was ambiguous or gave the impression COI charges could go down.

Plaintiff's second breach claim argued that defendant assessed COI charges in excess of those permitted by mortality tables (the contract permitted COI rates to be based on expectations as to future mortality). The court saw no facts permitting "a plausible inference that defendant charged a [COI] rate any different from what was specified in the policy." Plaintiff's second COI-based argument, that defendant failed to follow "regulatory or industry standards" in charging COI, was also dismissed as extra-contractual.

Plaintiff's implied covenant and tort claims fared no better. According to the court, the implied covenant claim failed to allege defendant took any action to prevent plaintiff from receiving the benefits of the policy, and the tort claims of fraud, unfair and deceptive trade practices, and RICO were all "premised upon the terms contained in the policy" and thus a matter for contract law alone. Any concealment and misrepresentation claims that were not grounded in contractual duties failed anyway for lack of particularity.

Summary Judgment Win for Insurer in "Stable Value" Interest Rate Setting Case

BY CHRISTINE STODDARD

In July, MetLife obtained a win in the Northern District of Illinois when the court granted summary judgment in its favor on a claim that it had breached the duty of good faith and fair dealing in setting interest rates for a retirement plan. Plan participants, employees of manufacturer Midco International, received interest annually pursuant to a declared rate set by defendant MetLife. The contract gave MetLife complete discretion in setting the interest rate. After MetLife transferred Midco's business to Great West as part of an indemnity reinsurance transaction, Great West assumed responsibility for setting the declared rate — which, due to Great West's more conservative investment strategy, began decreasing. Thereafter, Midco sued, alleging that MetLife's delegation of the rate-setting authority breached its duty of good faith and fair dealing.

Applying Illinois law, the court analyzed whether MetLife had acted unreasonably, without a proper motive, arbitrarily, or contrary to the parties' reasonable expectations. Although Midco claimed that it expected MetLife would not delegate the rate-setting authority and that any changes regarding the rate would be disclosed, the court found no evidence to support that understanding. For example, there were no communications between the parties suggesting such an expectation, nor could Midco have inferred as much from the language of the contract given MetLife's complete discretion as to rate-setting. Absent any evidence regarding the parties' expectations, the court explained that Midco could have attempted to show the reinsurance arrangement with Great West itself deviated from general practices or that MetLife had no legitimate business reason to enter the transaction; however, the only evidence in that regard was from MetLife's expert indicating the opposite. The court further noted that MetLife had no fiduciary duty to disclose the delegation of the rate-setting authority, nor was there any evidence that Great West's investment strategy was unreasonable. As such, the court found MetLife had not acted in bad faith and granted summary judgment in its favor.

Jump in Credit Scores Means Dip in Underwriting Predictability

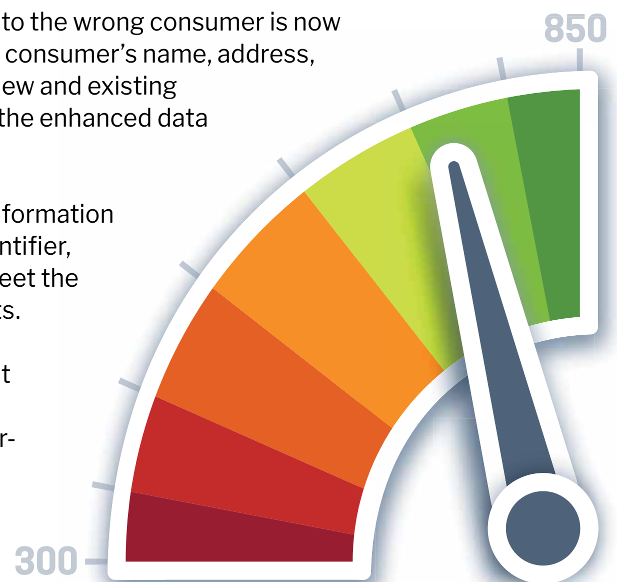
BY SARAH JOHNSON AUCHTERLONIE

Underwriters that rely on popular credit-scoring models like FICO and VantageScore to assess risk may have noticed that some consumer credit scores jumped recently. The nationwide credit reporting agencies, Equifax Inc., Experian PLC, and TransUnion began excluding incomplete records of bankruptcies, tax liens, and civil judgments beginning on July 1, 2017. The changes to public record reporting requirements should eventually improve modeling predictability after the market adjusts.

Public records information that poses a risk of attributing the information to the wrong consumer is now left off credit reports. Incomplete records are those that don't include the consumer's name, address, and either a Social Security number or date of birth. The decision covers new and existing bankruptcies, tax liens, and civil judgments. Bankruptcies generally meet the enhanced data standards already. So, this data point is unlikely to waver much.

But unlike credit applications, court judgments don't collect and furnish information in the same formats. Many courts require redactions of the ubiquitous identifier, the Social Security number. Most civil judgment records will not initially meet the enhanced standards. About half of tax liens will fail the completeness tests.

It's a positive change for consumers. All bankruptcy, tax lien, and judgment information is negative. For report and score users, it's a dip in efficacy. While the move omits unreliable data which increases predictability it over-excludes accurate but incomplete data. Fair Isaac Corporation (FICO) says it's caused a "modest" impact on score predictability. Until public records furnishers become more reliable, predict moderate surprise at finding you have clients with undisclosed tax liens and civil judgments.



NEWS & NOTES

Carlton Fields is a sponsor of the American Council of Life Insurers (ACLI) Annual Conference October 8-10, in Orlando, FL. Shareholders **James Jorden** and **Richard Choi** will speak on the "Legal/Compliance — 'Bullet-Proofing' Your Qualified Plan Sales" panel. The panel will discuss ways to avoid potential pitfalls related to the DOL Fiduciary Rule; new state fiduciary initiatives; and the latest putative class action litigation against pension plans, their fiduciaries, and providers that sell insurance products and mutual funds in the qualified plan market. Shareholder **Ben Seesel** will speak on the panel, "Regulatory Sandboxes: Lessons for U.S. and Around the World." This session will include a discussion around successful regulatory trends and fast-tracks from around the world.

Carlton Fields shareholder **Richard Choi** will co-chair the 2017 American Law Institute's Life Insurance Company Products Conference. This CLE program will be held November 1-3, at the Capital Hilton, Washington, D.C. Panels include "SEC Registered Insurance Products: Recent Disclosure, Regulatory" with Carlton Fields shareholder **Chip Lunde**, and "SEC Regulatory Reforms in the Trump Era" with Carlton Fields of counsel **Gary Cohen**.

In four recent surveys conducted by BTI Consulting Group, general counsel, chief legal officers, direct reports to general counsel, and other legal decision makers identified Carlton Fields as a top law firm for client service. These accolades include:

- "Most Recommended Law Firm" for the third year in a row *(BTI's 2017 Most Recommended Law Firms);*
- One of only nine law firms nationally with "standout collaboration" skills *(BTI's 2017 Law Firms with the Best Collaboration);*
- One of only 38 law firms with "standout associates" *(BTI's 2017 Law Firms with the Best Associates); and,*
- One of only 21 law firms nationally with the best insurance industry client relationships for the second year in a row *(BTI's 2017 Industry Power Rankings).*

Carlton Fields was chosen as a top law firm, ranked 11th in the nation, by the *Vault Guide to the Top 100 Law Firms* for "Overall Diversity." We were also ranked 10th for "Diversity for Minorities" and 11th for "Diversity for LGBT Individuals" and "Diversity for Disabilities."

Carlton Fields was ranked 4th in the nation for midsized firms (300 to 599 lawyers), by the *Law360* annual Glass Ceiling Report, which lists law firms that have the largest percentage of female equity partners.

Carlton Fields welcomes the following attorneys to the firm: shareholder **Brian Hart** (real estate and commercial finance, Miami), of counsel **Steven Sidman** (intellectual property, Atlanta), associates **Alex Silverman** (property and casualty insurance, New York), and **Michael Vandormael** (business transactions, Miami).

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