Legal Backgrounder

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PLAINTIFFS' LAWYERS HAVE NO BUSINESS REGULATING INSURANCE

by

Commissioner Lawrence H. Mirel

A rash of large, nationwide class action lawsuits has recently been filed against insurance companies, claiming that specific practices of those companies are unfair to consumers. The suits certainly pose an immediate threat to the insurance companies, and pressures are great on the companies to settle rather than face protracted and expensive litigation. The threat is equally significant, however, for the authority of those of us who regulate insurance, because making determinations about what is or is not fair to consumers is at the heart of our responsibilities.

Many different kinds of class action attacks on insurance companies are currently pending in local courts around the country. This LEGAL BACKGROUNDER will focus on a series of lawsuits filed in trial courts in New Mexico claiming that charges made by insurers for allowing the payment of annual premiums in installments, called "modal payments," are illegal.

The New Mexico suits claim that insurance companies engage in unfair trade practices by not disclosing an annual percentage rate ("APR") when charging a service fee to customers who make "modal payments" on their policies. Some fifteen cases have been filed so far and others are in the works. The carriers sued in these cases — all large, national companies — have issued policies on the lives of persons in each of the fifty states who, together, comprise a substantial segment of the nation's population. The potential liability to the insurers who have been sued is in the billions of dollars.

"Modal payments" are payments made more often than once a year — for example, semi-annually, quarterly, or monthly. Most insurance companies allow their customers to pay annual premiums in installments, and most add small fees to these "modal payments" to cover the additional administrative costs associated with the installment payments.

The suits do not allege that the companies fail to disclose the fees, because companies routinely do so. Nor do they claim that the charges are excessive, and in fact they are usually nominal. The primary claim is that the companies fail to specify an "APR" when imposing a fee for allowing installment payments of premiums.

The suits are based on a theory long held by Professor Joseph Belth of Indiana University that carriers should be required to disclose "APR" information whether or not the consumer is contractually obligated to continue making payments. Prof. Belth has tried for some 20 years to persuade insurance regulators across the country to mandate such disclosure. No state legislature or

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insurance regulator has ever adopted Prof. Belth's disclosure ideas. On more than one occasion, the National Association of Insurance Commissioners (NAIC) has carefully considered Prof. Belth's proposals and rejected them. Congress also declined to adopt his theory. The reason for this universal rejection is clear; if the insured is not "contractually obligated" to "continue making payments," there is no loan of money by the carrier to the insured. When there is no loan of money, there is no "interest" or "APR" to be disclosed. The insured can simply stop making his or her payments without further obligation to the carrier.

The plaintiffs in the New Mexico cases are working with Prof. Belth. By taking his disclosure ideas to the state courts in New Mexico, the plaintiffs are by-passing the state regulators in New Mexico and elsewhere who have the statutory duty to assure that consumers in their jurisdictions receive full and fair disclosure from insurers, and to fashion relief where appropriate. Insurance commissioners all over the country routinely approve policy forms without the disclosures called for by Prof. Belth. A regulator's approval of an insurance policy form is an administrative determination that the policy form meets the state's requirements for protection of the public. The courts in New Mexico, both at the trial level and at the appellate level, have turned down every attempt to have the issues raised in the lawsuits referred to the New Mexico Department of Insurance.

The plaintiffs in New Mexico seek to recover treble or punitive damages along with compensatory damages measured by the difference between the annual premium amount and the sums paid by consumers on a "modal" basis, unlimited by any applicable statute of limitations. If they were to succeed, the compensatory damages alone could amount to scores of billions of dollars for the industry. These costs, of course, would ultimately be passed on to consumers in the form of higher premiums.

Facing potential exposure of this magnitude, two carriers recently tried to settle with plaintiffs. These proposed settlements were in separate New Mexico trial court rooms and produced inconsistent results on the "APR" issue:

- In one case, Primerica Life Insurance Company agreed to pay $7.5 million to the plaintiffs' lawyers and to make certain future disclosures throughout the country *not* including disclosure of "APR" information. The lawyers for the settling plaintiffs in that case admitted there are serious legal questions as to whether the modal charges are interest, or could be fairly described as either an annual percentage rate or annual interest rate. As part of this settlement, all claims for compensation to policy holders were dropped by plaintiffs; the entire amount of the settlement is to go to the plaintiffs attorneys.

- In the other nationwide settlement, Massachusetts Mutual Life Insurance Company agreed to pay approximately $10 million to plaintiffs' lawyers and to make certain future disclosures *including* "APR" information in each policy sold around the country. Here again, all monetary claims for relief to members of the class were to be dropped. The settlement in this case was opposed by the Washington Legal

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Foundation in an *amicus* brief as "grossly excessive." It was also opposed by Trial Lawyers for Public Justice, a plaintiffs' lawyers trade association, as "outrageous" and "an abuse of both the class-action device and class members." Perhaps as a result of this vigorous opposition, the plaintiffs in the case withdrew their support for the proposed settlement.

Why are insurance companies seeking to settle these suits? Because a settlement of several millions of dollars is preferable to the possibility of hundred million dollar or even billion dollar judgments that could put a well financed company out of business. And the risk of losing in the New Mexico suits is real. On March 9, 2001, one trial judge, on cross motions for summary judgment in *Azar v. Prudential Ins. Co.*, ruled in favor of the plaintiff class and against the insurer defendant on all substantive issues. That ruling is currently on appeal to the New Mexico Court of Appeals.

From the perspective of each defendant insurance company, settlement makes sense. The cost of the litigation, even if the outcome is favorable, can be very high. A loss could be ruinous. From the perspective of the industry as a whole, however, these early settlements simply encourage suits against other large targets. And from the perspective of regulators these suits contain the seeds of real disaster. At best, they can lead to large increases in premiums paid by policy-holders; at worst, they can trigger multiple failures by companies that could strain the resources of guaranty funds and threaten to leave policyholders without insurance and without recourse.

As a regulator, I am concerned that a ruling of a New Mexico trial court judge will have a direct effect on my authority — and the authority of every insurance commissioner — to determine what is an unfair trade practice under local statutes. In the District of Columbia, for example, we allow charges for modal payments, so long as the amount of the charge is disclosed to the buyer, is a reasonable charge, and the buyer is given a choice whether to pay annually or in installments. Allowing installment payments is obviously a benefit to the consumer, and it is not unreasonable for a company to charge for the extra administrative burden of processing more than one check. Such charges are not "interest."

As part of its proposed settlement, Massachusetts Mutual had agreed to print an "APR" on its policies. My office communicated to Massachusetts Mutual that if they put such language on policies offered in the District of Columbia, we would reject those policy forms, because they are deceptive. Showing a service charge as an "APR" rate implies that there has been a loan to the consumer, when in fact there has been none. The Federal Reserve Board has ruled that there is no loan "unless the consumer is contractually obligated to continue making payments." If an insurance policy is cancelled for any reason the customer is not obliged to pay any money back to the company for allowing the use of modal payments, and therefore it is misleading to quote an "AAPR rate." If a company attempted to collect on such a "loan," that would be considered an unfair trade practice.

These lawsuits are part of a growing and disturbing trend toward "regulation by lawsuit." Every time a nationwide class action suit involving a regulated industry is won, the authority of the

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elected or appointed regulator is diminished. As Insurance Commissioner for the District of Columbia, I am charged by law with protecting the citizens of the District against unfair treatment by insurance companies. My office cannot do that job if our authority is subject to challenge by a trial judge in a remote jurisdiction. The District of Columbia has an Administrative Procedures Act, as do most states, and any District resident who is unhappy with a decision made by my office can challenge it in the District of Columbia courts. Therefore, a ruling by a New Mexico trial court that would require changes in policy forms offered to citizens of the District would challenge not only my authority but the authority of the District of Columbia Court of Appeals.

In fact, no District resident has ever challenged the charges made for modal payments. We have never received even a single complaint on that issue. Why, then, should my rulings on policy forms be subject to attack in a New Mexico trial court?

The issues raised by the New Mexico modal payment suits, and by other nationwide class action litigation of this kind against insurance companies, are important not only to insurance companies but to insurance regulators and to all insurance policy holders. The costs of fighting or settling these lawsuits are very large, and the cost of losing could be catastrophic. And who pays these costs? The policyholders we regulators are bound to protect. These suits, then, hurt rather than help the very people in whose name they are filed. The only winners are the lawyers.

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