Case No. S246541

IN THE SUPREME COURT OF THE

STATE OF CALIFORNIA

THE NORTHWESTERN MUTUAL LIFE INSURANCE COMPANY,

Defendant-Petitioner,

v.

SANFORD J. WISHNEV,

Plaintiff-Respondent.

After Order Certifying Question, U.S. Court of Appeals, Ninth Circuit, No. 16-16037; On Appeal from U.S. District Court, Northern District of California, Hon. Edward M. Chen, No. 3:15-cv-03797-EMC

APPLICATION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF AND BRIEF FOR THE ASSOCIATION OF CALIFORNIA LIFE AND HEALTH INSURANCE COMPANIES IN SUPPORT OF DEFENDANT-PETITIONER THE NORTHWESTERN MUTUAL LIFE INSURANCE COMPANY

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APPLICATION TO FILE BRIEF AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANT-PETITIONER THE NORTHWESTERN MUTUAL LIFE INSURANCE COMPANY

The Association of California Life and Health Insurance Companies ("ACLHIC") applies for leave to file the attached brief as amicus curiae in support of Defendant-Petitioner The Northwestern Mutual Life Insurance Company. (Cal. Rules of Court, rule 8.520.)

ACLHIC is a California not-for-profit corporation, comprised of 44 member life and health insurance companies doing business in California. ACLHIC's members represent an industry that provides more than two trillion dollars of insurance coverage to Californians and has contributed more than $400 billion to California's economy. ACLHIC represents its constituent insurers with respect to, among other things, legislative and regulatory issues affecting life and health insurers. ACLHIC frequently advocates the interests of its member companies in the California state and federal courts by filing amicus curiae briefs in cases involving issues of import to the insurance industry and its California customers.

ACLHIC has reviewed the briefing in the United States District Court, Ninth Circuit, the decisions therein and the parties' briefs in this Court. ACHLIC is familiar with the issues and believes that it can assist the court by providing an important perspective on the life insurance industry's longstanding understanding of California law as currently

applied, the potential impact the change sought by Plaintiff-Respondent could have on California insurers and insureds, and what ACLHIC believes are errors in Plaintiff-Respondent's legal theories.

ACLHIC's members have a vital interest in ensuring that the two questions of state law certified by the Ninth Circuit are decided as correctly argued by Defendant-Petitioner. Namely, (1) that life insurers exempted from the Usury Law in accordance with Article XV of the California Constitution are indeed exempt from all restrictions in the Usury Law and therefore not subject to California Civil Code section 1916-2; and in any event, (2) that an agreement comprised of an application for insurance signed by the borrower and a policy of insurance containing an agreement for compound interest, subsequently attached and made a part of the insurance contract pursuant to California Insurance Code section 10113, meets the requirement for California Civil Code section 1916-2. The solitary decision by one Northern District of California judge holding otherwise is inconsistent with over 80 years of life insurance legislation, regulation and practice, and would prevent or at least inhibit ACLHIC's members from offering policy loans, a valuable and widely-used benefit by insureds. (See *Wishnev v. Nw. Mut. Life Ins. Co.* (N.D. Cal. 2016) 162 F.Supp.3d 930.)

Indeed, to agree with the District Court could result in insureds being unable to obtain policy loans easily and create an unintended threat to

policyholders, including lapses. Insureds often set up their life policies to automatically make a payment by taking a loan on the policy to prevent it from lapsing due to nonpayment of premiums. This provides valuable protection to insureds. Insurers would need to address practical impediments to continuing to provide loans on existing policies if the District Court's interpretation is upheld. In the case of policies lapsing for nonpayment of premium, for example, it may not be possible to obtain a signed acknowledgement (in addition to the already signed application attached to the policy) thus preventing the insurer from extending coverage under premium loan non-forfeiture options. This being just one example of the harmful unintended consequences to policyholders wrought by Plaintiff-Respondent's legal theories.

To follow the District Court's interpretation would also require an unnecessary and costly overhaul of insurers' business processes, and create uncertainty around existing policy loans. ACLHIC's members have understood life insurers were exempt from all restrictions in California's Usury Law for over 35 years. To hold otherwise materially changes that understanding with far-reaching impact on policyholders, as discussed above, as well as on the business of life insurers who priced the policies they issued in part premised on how the loans would incur interest. Should this issue be resolved against life insurers, it will be necessary for insurers to implement new business practices and to determine how to proceed with

respect to policies with outstanding loans. In the meantime, interest which potentially is not recoverable by insurers will continue to accrue while they operate under the uncertainty created by the District Court's decision. The implications on both insurers and policyholders are profound.

In simple terms, the interest charged on the loans compensates the life insurer for lost investment income. The policies provide in the contracts how interest is charged. A finding that the insurer is no longer able to collect interest during the life of the policy and the outstanding loan term would substantially impair the insurer's financial expectations as provided in the contracts with the insureds and fundamentally changes the economics of the policy loan. There could be adverse implications for dividends to insureds and to premiums for all policy owners, whether they intend to borrow from the policy or not, going forward.

If followed, the District Court's interpretation would also undermine fundamental insurance contract law in California. Plaintiff-Respondent signed a life insurance policy application for a policy which expressly informed him that the insurer would compound interest on any policy loans taken by the insured. The insured signed the application which was attached to the policy. By statute, a signed life insurance policy application becomes part of the insurance contract when it is attached to the policy. Ins. Code, § 10113.

The District Court's decision also provides no material benefit to

consumers. Policyholders receive a written disclosure that interest on policy loans will be compounded in the delivered insurance policies prior to the taking of a policy loan. Requiring that policyholders also sign the policies themselves in order to comply with the District Court's interpretation of Civil Code Section 1916-2 will not improve policyholder understanding that interest on policy loans is subject to compounding. This form over substance interpretation should be rejected.

Given the certainty insurers have operated under regarding the exemption provided by California for insurers from the Usury Law, and the integration of a life insurance policy application with the life insurance contract providing the terms including the compounding of interest of any policy loans, it is of no wonder that the District Court's decision here is in conflict with three other opinions issued in the same District Court, two of which expressly rejected the District Court's decision.

Certainty and proper application of the laws at issue in this case is of great significance to ACLHIC's members, the more than 300 life insurers doing business in California and the millions of California policyholders who have policies at issue. The Court should find that lenders exempted under Article XV of the California Constitution are not subject to California Civil Code § 1916-2, and that a life insurance agreement comprised of a signed application and copy of the policy containing the terms of any loan on the policy including compound interest meets the

requirement of California Civil Code § 1916-2.

No party or counsel of any party to this action has authored ACLHIC's proposed amicus curiae brief in whole or in part. Nor has any party or counsel for any party made a monetary contribution intended to fund the preparation or submission of the brief.

Respectfully submitted,
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_____

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PROPOSED *AMICUS CURIAE* BRIEF OF THE ASSOCIATION OF CALIFORNIA LIFE AND HEALTH INSURANCE COMPANIES

INTRODUCTION

ACLHIC submits this *amicus curiae* brief in support of Defendant-Petitioner The Northwestern Mutual Life Insurance Company ("Northwestern Mutual") because the underlying District Court decision in this case threatens to diminish access and availability of life insurance policy loans, and because the decision is inconsistent with existing legislation, regulation and practices related to life insurance.

When the California Legislature exempted insurers from the Usury Law over 35 year ago, it did so to put in place a comprehensive regulation scheme tailored to the unique conditions and interests presented by life insurance policy loans, in the same manner as the Legislature regulates other aspects of insurance. This was the core purpose of the 1934 Amendment. The District Court's order disregarded this common sense interpretation of the 1934 Amendment, the 1979 Amendment and the subsequent California Insurance Code enactments which specifically exempted life insurers from the Usury Law and heavily regulated life insurance policy loans. The 1934 Amendment exempts classes of lenders from the Usury Law altogether. For this reason, the Court should find that exempt life insurers are not subject to California Civil Code section 1916-2.

The District Court's decision also fundamentally misconstrued how

insurance policies are treated in California. Plaintiff-Respondent signed a life insurance policy application for a policy which expressly informed him that compound interest would be charged on any policy loans. A signed life insurance policy application becomes part of the insurance contract when it is attached to the policy. This has long been the law in California, and is codified in the California Insurance Code. Following the District Court in this case would upend this principle of insurance law, significantly impacting the business practices of life insurers doing business across the State of California and undermining policyholders' ability to utilize all the benefits of their policies.

ARGUMENT

I. Ignoring The District Court's Decision Will Preserve Policyholders' Ability To Use The Accumulated Cash Value In Their Life Insurance Policies

ACLHIC's members primarily issue two types of life insurance policies: term and permanent (whole life). At issue here are primarily whole life insurance policies which provide protection for as long as the insured lives and has a savings component, building up cash value that can be used by the owners to help meet financial goals, provide for emergencies or provide income in retirement. As opposed to withdrawing assets from the policy, many policies permit the policyholder to borrow up to the accumulated cash value in the policy, *e.g.*, allowing insureds to borrow their own premium. Thus, the insured has immediate access to the value in

their policy, without the need to qualify for a loan or provide other paperwork. Unlike a traditional lending arrangement, a policyholder does not need to repay a policy loan, either in part or in full, while the policy is in force. The availability of loans against the cash value is often an important feature considered by insureds in determining whether to purchase term or whole life policies.

Critically, policy loans can also provide protection against lapse of the policy due to nonpayment of premium, whether through inadvertence or inability to pay. Policyholders can set up their policies to pay premiums through a loan on the policy to avoid lapse. Some policies perform this feature automatically. There is no question that these loans provide a valuable benefit where an insured may be unable to qualify any longer for life insurance due to changes in health; or face dramatically increased premiums on a new policy they cannot afford. The ability to take loans for immediate use, and to use policy loans to avoid lapse are valuable benefits. Moreover, the terms including the interest charged for policy loans are set forth in the policy. Ignoring the interpretation of the District Court and affirming the long-held interpretation of both the exemption to the Usury Law and integration of the signed application to the terms of life insurance policies is necessary to ensure policy loan benefits remain readily accessible and available to policyholders in the future.

II. Life Insurance Generally And Policy Loans Specifically Are Heavily Regulated By California Law.

The District Court's ruling is inconsistent with the intent of the 1934 Amendment and 1979 Amendment, as well as the history of insurance regulation by the California Legislature. The Legislature "enjoy[s] broad authority in regulating the dealings between insurers and their policyholders." (*Am. Int'l Group, Inc. v. Superior Court* (1991) 234 Cal.App.3d 749, 757 (citing *Cochran v. Paco, Inc.* (5th Cir. 1979) 606 F.2d 460, 463).) The California Legislature has thus "enacted comprehensive legislation expressly designed to regulate the business of insurance." (*Id.* at p. 764.) California Insurance Code section 1100.1 provides:

> Every admitted incorporated insurer may under a certificate of authority issued pursuant to the provisions of Article 3 (commencing with Section 699), engage in this state in the type of loan transactions otherwise permitted by law without obtaining any other license or certificate.
>
> Pursuant to the authority contained in Section 1 of Article XV of the State Constitution, the restrictions upon rates of interest contained in Section 1 of Article XV of the California Constitution shall not apply to any obligation of, loans made by, or forbearances of, any incorporated admitted insurer.
>
> **This section creates and authorizes incorporated admitted insurers as an exempt class of persons pursuant to Section 1 of Article XV of the Constitution.**

(Ins. Code, § 1100.1 (emphasis added).) Under this statute, incorporated insurers admitted to do insurance business in California—including ACLHIC's members—are an exempt class of lenders. (*Ibid.*) This means

they are exempt from the Usury Law and have been since 1981, when section 1100.1 was enacted.

Like other areas of insurance, life insurance policy loans are specifically regulated by the California Insurance Code. (See Ins. Code, §§ 1230-1239.5.) Section 1239 provides that "[n]o other provision of law shall apply to policy loan interest rates unless made specifically applicable to these rates." (*Id.* at § 1239.)

The 1934 Amendment authorized exemptions from California's Usury Law. The exemption was "intended to free the legislature . . . so that interest and charges more appropriate to the business conditions peculiar to each of the exempted classes could be established." (*Carter v. Seaboard Finance Company* (1949) 33 Cal.2d 564, 582.) The 1979 Amendment in turn gave the California Legislature broad authority to expand the classes of exempt lenders. Pursuant to that authority, California Insurance Code section 1100.1 made admitted incorporated insurers an exempt class of lenders. California Insurance Code sections 1230 et seq. then regulated life insurance policy loans. The Legislature thus established "interest and charges more appropriate to the business conditions" of insurers—precisely what the 1934 Amendment was intended to accomplish. (*Carter*, *supra*, 33 Cal.2d at p. 582.)

The District Court's conclusion that the 1934 Amendment intended to carve out compound interest, even for exempt lenders, conflicts with this

Court's pronouncements in cases like *Carter*, and conflicts with the longstanding and comprehensive record of legislative regulation of insurance interest rates and life insurance policy loans. It is also inconsistent with all of the decisions to ever address Plaintiff-Respondent's theory, with the single exception here of the District Court's decision. (*Washburn v. Prudential Insurance Company* (N.D. Cal. 2015) 158 F.Supp.3d 888, 896 (insurers are exempt from the entirety of California Civil Code § 1916-2); *Martin v. Metro. Life Ins. Co.* (N.D. Cal. 2016) 179 F.Supp.3d 948, 957 (same); *Lujan v. New York Life Ins. Co.* (N.D. Cal., Aug. 9, 2016, No. 4:16-cv-00913-JSW) 2016 WL 4483870, at *7 (same); see also *Thomason v. Bateman Eichler, Hill Richards, Inc.* (1988) 199 Cal.App.3d 1100 [245 Cal.Rptr. 319, 322–23] (depublished opinion) (same).)

III. The District Court's Decision Disregarded Fundamental Principles Of Life Insurance Contract Formation

The District Court also erred by ruling that Defendant-Petitioner Northwestern Mutual had not complied with the requirements of California's Usury Law. As Petitioner's Opening Brief explains, Plaintiff-Respondent Mr. Wishnev signed a life insurance policy application for a policy which expressly informed him that compound interest would be charged on any policy loans he borrowed. (See Petitioner's Opening Brief at pp. 7, 34-39.)

A signed life insurance policy application becomes an integrated part of the insurance contract when it is attached to the policy. This has long been the law of insurance contracts in California. (See, e.g., *New England Mut. Life Ins. Co. v. Lauffer* (S.D. Cal. 1963) 215 F.Supp. 91, 97 ("The life insurance policies with the applications attached are construed together as they constitute one contract."); *Boyer v. U.S. Fid. & Guar. Co.* (1929) 206 Cal. 273, 276-77 ("The policy and the application therefore constitute the contract").) This principle is so ingrained in California insurance contract law that it was codified in the Insurance Code. (See Ins. Code § 10113.)

It is therefore not surprising that the other two courts to consider Plaintiff-Respondent's theory assaulting this fundamental principle of California insurance contract law rejected it outright. (See *Martin*, *supra*, 179 F.Supp.3d at 957 (finding that even if life insurers were not exempt from California's Usury Law, Met Life did not violate that law because the plaintiff had signed a policy loan application and the policy disclosed that compound interest would be charged); *Lujan*, *supra*, 2016 WL 4483870 at *7 (same as to identical claims against The New York Life Insurance Company).)

Following the District Court in this case would upend this fundamental principle of insurance law, significantly impacting the business practices of ACLHIC's members with far reaching implications. It is not feasible to present the full contract at the time of application

because the insured's eligibility or choice of product may not have been determined yet. An application for insurance is treated as a proposal by the applicant for insurance, which also provides the information necessary for the insurer to conduct the underwriting process. (See *Vyn v. Northwest Cas. Co.* (1956) 47 Cal.2d 89, 94; *Rios v. Scottsdale Ins. Co.* (2004) 119 Cal.App.4th 1020, 1029.) When the final policy is issued, the application and any amendments are attached to the policy and incorporated into the final contract. California Insurance Code section 10113 specifically endorses this process.

As the courts in *Martin* and *Lujan* recognized, by incorporating the application into the complete contract, the insured plaintiffs' signatures were effectively affixed to the life insurance policies once they accepted them. (*Martin*, *supra*, 179 F.Supp.3d at 957; *Lujan*, *supra*, 2016 WL 4483870 at *7.) The District Court's decision here is inconsistent with this longstanding industry practice and state regulation.

If the Court were to hold that the legislature's exemption of insurers from the Usury Law did not extend to compound interest, and that the integrated insurance contract does not satisfy the Usury Law, that ruling would impose significant operational costs on insurers and impair policyholders' ability to access their life insurance policies and protect those policies against forfeiture. Policy loans offer flexibility and convenience; requiring insurers to revise their forms to require

policyholders to sign and return a second compound interest disclosure (even where that disclosure already appears in the policy previously delivered to the owner) will add additional steps to the loan process and slow down the processing of loans.

Requiring an additional signed document would also interfere with the policy-lapse-protection function of policy loans. Automatic premium loans, for example, protect from lapse. Following the District Court would create a new rule of insurance law which would require policyholders to take action to avoid a policy lapse by submitting another signed document. This would undermine that protection.

Finally, such a ruling would also depart from long-accepted and widely relied-upon settled law. (See *Grobeson v. City of Los Angeles* (2010) 190 Cal.App.4th 778, 796–797 [a ruling which departs from long-accepted, widely relied-upon and previously-thought settled law should only be applied prospectively and should not apply retroactively].) At a minimum, if the Court were to follow the District Court's decision—something ACLHIC strongly urges the Court not to—the Court's ruling should not be applied retroactively but instead only prospectively.

CONCLUSION

The District Court's decision would rewrite many decades of life insurance policy loan regulation. The California life insurance industry generally, ACLHIC's members specifically and millions of life insurance

policyholders would be negatively impacted by the consequences of that decision.

For the above reasons and those stated in the briefs of Defendant-Petitioner Northwestern Mutual, ACLHIC joins Defendant-Petitioner in asking the Court to answer the certified questions as follows: (1) that life insurers exempted from the Usury Law in accordance with Article XV of the California Constitution are indeed exempt and therefore not subject to California Civil Code section 1916-2; and in any event (2) that an insurance agreement comprised of an application for life insurance *signed by the borrower* and a policy of insurance containing an agreement for compound interest, subsequently attached and made a part of the insurance contract pursuant to California Insurance Code section 10113, meets the requirement for California Civil Code section 1916-2.

Dated: August 31, 2018

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CERTIFICATE OF WORD COUNT

The text of this brief consists of 3,382 words according to the word count feature of the computer program used to prepare this brief.

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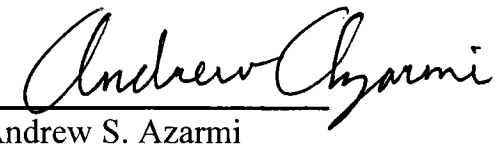
By: 

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PROOF OF SERVICE

I, Winifred K. Owen, declare that I am employed in the City and County of San Francisco, State of California. I am over the age of 18 years and not a party to the within action; my business address is Dentons US LLP, One Market Plaza, Spear Tower, 24th Floor, California 94105. On the date of execution hereof, at my place of business, I served copies of the following:

APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF AND BRIEF FOR THE ASSOCIATION OF CALIFORNIA LIFE AND HEALTH INSURANCE COMPANIES IN SUPPORT OF DEFENDANT-PETITIONER THE NORTHWESTERN MUTUAL LIFE INSURANCE COMPANY

on the parties listed below:

☒ **BY MAIL:** By placing a true copy in an envelope addressed as shown to the parties below. I am familiar with the Dentons US LLP practice whereby each document is placed in an envelope, the envelope is sealed, the appropriate postage is placed thereon and the sealed envelope is placed in the office mail receptacle. Each day the mail is collected and deposited in a United States postal mailbox at or before the close of business each day.

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I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct and that I am employed in the office of a member of the bar of this Court at whose direction the service was made. Executed on August 31, 2018 at San Francisco, California.

W. Owen

WINIFRED K. OWEN