AKIN GUMP
STRAUSS HAUER & FELD LLP
Attorneys at Law

August 5, 2005

LITIGATION ALERT

FEDERAL COURT IMPOSES NEW DUTIES ON ISSUERS OF VARIABLE ANNUITIES UNDER SECURITIES EXCHANGE ACT OF 1934

In a case that has captured industry attention, a Georgia federal court has ruled that variable annuity issuers owe an independent duty to conduct a suitability analysis prior to making the sale, even where the registered representative may have completed such an analysis at the point of sale. Violation of this duty, the court ruled, may support a claim for securities fraud.

Variable annuities are registered investment products that are often sold within a qualified plan, such as an IRA. In *Nelson v. Pacific Life*, the court certified a national class of investors who purchased Pacific Life variable annuities within a qualified plan.[1] The plaintiffs in *Pacific Life* allege that the primary benefit of a variable annuity is tax-deferred investment growth. They allege that persons who invest within a qualified plan do not need the tax deferral provided by a variable annuity — and its associated fees — because the qualified plan independently provides such tax deferral, irrespective of what is purchased within the qualified plan.

The district judge seemed to accept plaintiffs' position in his order granting their motion for class certification. The court began its analysis by finding that Pacific Life imposed "insurance charges" on annuity investors of 140 basis points, while the insurance benefit provided was worth only about 5 basis points to the investor. The court found the disparity between amount charged and benefit received was a material fact that a reasonable investor would consider in deciding whether to purchase a variable annuity within a qualified plan. The court ruled that Pacific Life's omission in failing to disclose this disparity to investors could support a claim for fraud under Section 10 of the Securities Exchange Act of 1934.

Plaintiffs submitted testimony that Pacific Life registered representatives and other broker-dealer employees were not aware of — and thus did not disclose — the magnitude of the charge/benefit disparity. The court found that this lack of awareness meant that Pacific Life's registered representatives could not conduct an appropriate suitability analysis. Because only

[1] Akin Gump does not represent Pacific Life in this case. However, our lawyers are involved in a number of similar cases.

This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.
© 2005 Akin Gump Strauss Hauer & Feld LLP

akingump.com

Pacific Life was aware of the disparity, the court ruled that Pacific Life owed a duty to perform a separate suitability review as it processed annuity applications submitted by its registered representatives.

No other court decision, statute or rule has recognized the duties imposed by the court in *Pacific Life*. The NASD rules require a registered representative to make a suitability determination when a variable annuity is recommended to a customer. Not surprisingly, Pacific Life conceded that it did not perform a separate suitability analysis when representatives submitted variable annuity applications, but instead relied on the registered representative to determine suitability at the point of sale. The court rejected Pacific Life's position, instead finding that Pacific Life may have "rigged" the sales by failing to provide sufficient information for anyone other than Pacific Life to conduct an appropriate suitability analysis.

Because the court found that Pacific Life's "suitability omission" was the predominant issue in the case, it rejected Pacific Life's argument that individual variations among class members should preclude certification.

The court's ruling in *Nelson v. Pacific Life* is troubling to life insurers generally, and variable annuity issuers in particular. First, under the guise of determining whether there was an actionable omission under the securities laws, the court seems to find that variable annuities are never a good investment, whether or not they are purchased within a qualified plan. Second, the court's finding that variable annuity issuers must conduct an independent suitability analysis upon submission of an application, and cannot rely on their registered representative to conduct that analysis, is an extreme departure from existing law. No issuer could have anticipated this new duty, much less complied with it. Finally, the court clears the way for creative plaintiffs' lawyers to challenge the sale of other insurance products based on the failure to disclose actuarial analysis that customarily is not disclosed to purchasers of insurance products.

Pacific Life filed a petition for permission to appeal the decision to the 11th Circuit in Atlanta, which was denied. Pacific Life then filed a motion for reconsideration, which the ACLI supported in a separate amicus brief. The 11th Circuit denied the motion. The case is now proceeding before the district court.

CONTACT INFORMATION

Our lawyers are involved in several cases similar to the *Pacific Life* case. If you are interested in learning more about the decision and what it might mean to the industry, please contact:

David Jones ....210.281.7281 ....djones@akingump.com ....San Antonio

Neel Lane ....210.281.7070 ....nlane@akingump.com ....San Antonio

Austin Brussels Dallas Houston London Los Angeles Moscow
New York Philadelphia Riyadh (Affiliate) San Antonio San Francisco Silicon Valley Washington, D.C.

This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.
© 2005 Akin Gump Strauss Hauer & Feld LLP