

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION —SDNY: Investors Adequately Alleged MetLife Knew Reserves Were Inadequate to Meet Obligations, (Mar. 4, 2013)

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By Rodney F. Tonkovic, J.D.

Exchange Act fraud claims brought against MetLife, Inc. were dismissed by a district court for failure to adequately allege loss causation. Securities Act claims relating to offering documents were dismissed in part (*City of Westland Police and Fire Retirement System v. MetLife, Inc.*, February 28, 2013, Kaplan, L.).

An institutional investor filed this action against MetLife, individual officers and directors, and its underwriters. The action arose out of state investigations into MetLife's possible violations of unclaimed property laws. According to the complaint, MetLife had not been using the Social Security Administration's Death Master File (SSA-DMF), which is an aggregation of basic information on all deceased persons, when paying life insurance benefits to beneficiaries. MetLife did not monitor the SSA-DMF to determine when it needed to pay beneficiaries and instead only paid upon the filing of a claim. In short, the investor argued that MetLife made statements about its life insurance business that were materially false and misleading due to its knowing failure to use the SSA-DMF to identify deceased group life policy holders.

The complaint alleged that in 2007, MetLife cross-checked its records against the SSA-DMF and discovered \$80 million in benefits that were not paid on individual policies because no claims were filed. According to MetLife, this amount represented only a small fraction of the billions of dollars of benefits paid out during the relevant decades-long period. These claims were also not captured in MetLife's estimates of benefits that it anticipated paying for insured individuals who had died, but whose beneficiaries had not yet filed a claim (the "incurred but not reported" (IBNR) reserves). MetLife did not perform a similar cross-check on its group life insurance records, but maintained that its reported IBNR reserves were materially accurate.

In 2009, Florida and Illinois began to examine insurance companies' use of the SSA-DMF, and, in 2010, New York began investigating whether MetLife was holding money in violation of unclaimed property laws. MetLife claimed the allegations were without merit. Also in 2010, AIG acquired a large amount of MetLife stock as part of a deal to purchase of AIG's American Life Insurance Company. These holdings were disposed of in a common stock offering in 2011, which the plaintiffs alleged was rushed into because states were pressuring MetLife to use the SSA-DMF, and this would have resulted in large payments to beneficiaries and downward pressure on share prices.

As time went on, more states began investigating the possible violations of unclaimed property laws by insurance companies. In public testimony before Florida and California officials in May 2010, MetLife executives admitted that it used SSA-DMF in certain areas of its business, but not to cross-check group life insurance reserves. In 2011, MetLife disclosed in a Form 10-Q that more than 30 jurisdictions were investigating its compliance with unclaimed property laws. The investors claimed that this disclosure caused a drop in stock prices and that prices dropped further after MetLife announced that it was taking a one-time after-tax charge to increase its reserves to account for payments it needed to make after using the SSA-DMF to identify insured deaths.

Exchange Act claims. The court first concluded that the investors' Exchange Act fraud claims must be dismissed for failure to adequately allege loss causation. According to the court, the complaint's allegations regarding the reasons for the drop in price of MetLife's stock failed to mention that the drop occurred after Standard and Poor's downgraded the credit rating of the U.S., which resulted in precipitous market drops in the following days. The court stated that the investor "misleadingly" attempted to attribute the price drop to MetLife's corrective disclosure instead of the credit downgrade.

Securities Act claims. MetLife argued that the investor failed to allege any actionable misstatements or omissions under Securities Act Sections 11 and 12(a)(2). The court disagreed, finding first that MetLife knew that

its estimated reserves were insufficient to meet its obligations, or, at least, that it knew that it had no reasonable basis for believing the estimates. Similarly, MetLife had reason to doubt its estimates because it knew that use of the SSA-DMF would likely show that its reserves were understated. Disclosure of the state investigations was required under Item 303 of Regulation S-K because of the investigations' potential for substantial consequences. Finally, through its allegations that MetLife's shares dropped in value after the disclosures, the investor adequately pleaded materiality.

Individual defendants not sellers. Claims under Section 12(a)(2) against the individual and director defendants, however, were dismissed because the investor failed to allege that they were "statutory sellers." The court found that the investor failed to adequately allege the required solicitation. Merely signing registration statements, as the defendants here did, is insufficient to constitute solicitation.

Controlling person claims. Finally, the investors claimed that the individual and director defendants were controlling persons. The court concluded that the complaint adequately alleged that these defendants, including the CEO and CFO, had actual control, mainly through the signing of registration statements.

The case is No. 12 Civ. 0256 (LAK).

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