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AALU Bulletin No: 08-48

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Subject: **Banks Sue Insurance Company and Consulting Firm for Losses on BOLI Policies**

Major References: [\*Complaint: Fifth Third Bank, et. al. v. Transamerica Life Insurance Company, et. al., Case No. 1108CV269 \(S.D. Ohio April 17, 2008\)\*](#)

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*In an action filed in the U.S. District Court for the Southern District of Ohio on April 17, 2008, Fifth Third Bank of Ohio and Fifth Third Bank of Michigan (collectively "Fifth Third") have sued Transamerica Life Insurance Company ("Transamerica") and Clark Consulting, Inc. ("Clark") to recover damages of \$323 million allegedly incurred in connection with bank owned life insurance ("BOLI") products. The BOLI policies, which were said to be issued by Transamerica and with respect to which Clark allegedly offered consulting services, were invested in hedge funds that lost hundreds of millions of dollars in the sub-prime mortgage markets. Fifth Third alleges that Transamerica and Clark have engaged in breach of contract, breach of fiduciary duty, fraud, professional negligence, negligent misrepresentation and insurance bad faith.*

According to the Complaint, Transamerica and Clark, each of which the Complaint describes as an indirect subsidiary of AEGON, USA, Inc. and AEGON, NY, collected over \$612 million in premiums from Fifth Third for the BOLI products and then invested the premiums in an investment vehicle -- the Falcon Fund -- that required close monitoring and management in light of its unique nature and the structure of the BOLI transaction. However, according to the Complaint, despite their alleged knowledge of the Falcon Fund's unique characteristics and despite their alleged obligation to monitor and manage the BOLI assets in the best interest of Fifth Third, Transamerica and Clark "utterly failed to properly manage and monitor the investment," resulting in Fifth Third's write down of its investment, after the market value of the assets of

the Falcon Fund plunged dramatically. Falcon Fund is a fixed income hedge fund managed by Citigroup that is said to have lost over 75% of its value. Citigroup is not named as a defendant in the lawsuit.

Transamerica and Clark allegedly:

- (i) failed to monitor the performance of the Falcon Fund so as to recognize that an “Automatic Re-allocation Event” occurred that would have triggered a transfer of the underlying assets into a more conservative investment and would have prevented or significantly limited Fifth Third’s losses;
- (ii) failed to advise and implement “Elective Re-allocation” options that also would have triggered a transfer of the assets into a more conservative fund; and
- (iii) misled Fifth Third into believing that it had more cash surrender “stable value” protection respecting these investments than it actually had. The purpose of the “stable value” commitment - in this case with Bank of America - was to ensure that the book value of the BOLI Policies after application of the crediting rate was equal to their actual cash surrender value (so long as the spread between the book value and market value stayed within the limits of the stable value coverage).

As is common with variable life insurance products, although the owner of BOLI may select the strategy for the investment, it has no control over the active management of the underlying assets. Pursuant to Treasury regulations applicable in general to variable contracts, the BOLI purchaser may not correspond with the investment manager (in this case, Citigroup) of the underlying assets about particular investment decisions. The insurer, who is the legal owner of the assets, must directly correspond with the investment manager, often with the advice of a broker who specializes in BOLI products. Moreover, it is the insurer who exercises any rights pursuant to the BOLI policy in connection to the underlying assets -- again, often in conjunction with a BOLI broker.

According to Fifth Third, “as is common for BOLI products and due to the nature of the relationship among the parties,” Transamerica and Clark had contractual and fiduciary obligations to monitor the performance of the underlying assets and take appropriate actions (such as advising and implementing an elective re-allocation or declaring an automatic re-allocation event), as warranted by the circumstances. Due to Fifth Third’s inability to monitor its investment directly, it was contended to be “crucial” that Transamerica and Clark “discharge their duties to monitor and manage the BOLI Policies and their underlying assets with competence and the utmost good faith.”

As a result, Fifth Third allegedly suffered harm in excess of \$323 million and continues to suffer additional harm as the market value of the assets invested in the Falcon Subaccount continues to fall. In its “Prayer for Relief,” Fifth Third demands:

- (i) compensatory damages in an amount to be determined at trial, but not less than \$323 million;
- (ii) consequential and incidental damages, including out-of-pocket expenses, attorneys fees and court costs;
- (iii) punitive damages in an amount to be determined at trial;
- (iv) pre and post judgment interest; and
- (v) such other and further relief as the Court may deem necessary or appropriate.

According to the Wall Street Journal (May 28, 2008), at least two other banks, one of which is Wachovia (which allegedly invested more than \$1 billion), and the other of which is not named, invested heavily in Falcon Fund through their BOLI programs.

We will continue to monitor and report on this case as it moves through the courts. As of the time this Washington Report is being published, the defendants have not filed an Answer in this action, a step which, we understand, is likely to occur sometime this month. As a consequence, we will not have an opportunity to report on the response to the Complaint until that Answer is filed.

Any AALU member who wishes to obtain a copy of the Complaint in *Fifth Third Bank, et. al. v. Transamerica Life Insurance Company, et. al.* may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at [www.aalu.org](http://www.aalu.org) and enter the *Member Portal* and select *Current Washington Report* for linkage to source material or (3) email Erik Ruselowski at [ruselowski@aalu.org](mailto:ruselowski@aalu.org) and include a reference to this *Washington Report*.

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