THE ATTORNEY GENERAL OF TEXAS

AUSTIN 11, TEXAS

PRICE DANIEL
ATTORNEY GENERAL

June 30, 1947

Honorable George B. Butler, Chairman,
Board of Insurance Commissioners,
Austin, Texas

Opinion No. V-279

Re: Whether specimen copies of policy forms of life and health and accident insurance are consistent with and not prohibited by Section 11 of Article 4859f, V. C. S.

Dear Sir:

Your request for an opinion is as follows:

"Southern Medical Hospital Service is licensed under the provisions of Chapter 8a, Title 78, as amended, and Article 5068-1 to 5 inclusive, of Vernon's Texas Civil Statutes.

"Will you please advise me whether the attached forms of policy prepared by Southern Medical Hospital Service is consistent with and not prohibited by Section 11 of Chapter 8A."

Southern Medical Hospital Service is a statewide mutual assessment company issuing life, health and accident policies. According to the charter of the company, as amended in 1933, the purpose is stated as follows:

"The purpose of the corporation is and shall be the creation, operation and maintenance of a mutual insurance association, on what is known as the statewide assessment plan, for the protection, indemnification, and insurance of the lives of its members and against loss to them by reason of ill health and/or accident."

The 43rd Legislature in 1933 passed House Bill No. 303, Chapter 245, page 856, which regulates mutual assessment associations engaged in issuing policies or certificates of life insurance. This bill has become known as Article 4859f, V. C. S. The 46th Legislature in 1939 passed Senate Bill No. 135, Chapter 6, page 401, which is now known as Article 5068-1, V.C.S. The scope of this Act embraced all mutual assessment companies and associations issuing certificates of life as well as health and accident certificates. Section 9 of Article 5068-1 contains the following provisions:

> "All certificate forms hereafter used must be in accord with the provisions of this Act and with all other laws regulating such associations as are embraced in this Act."

Article 5068-1 does not repeal any laws relating to mutual companies, except those in conflict with it. Obviously, the Article is an effort by the Legislature to clarify and harmonize the laws governing mutual assessment companies. The above quoted provision of Article 5068-1 permits Section 11 of Article 4859f to cover not only life policies but health and accident as well.

The pertinent part of Section 11, Article 4859f, provides:

> "No corporation hereunder shall issue any certificate or policy upon a limited payment plan, nor guarantee or promise to pay any type of endowment or annuity benefits, but shall confine its operation to the issuance of certificates looking to continuous payment premiums or assessments during the life time of the policyholder. And provided further that no such corporation shall issue any certificate or deposit agreeing to pay any benefits until a copy of such certificate or policy has been filed with the Board of Insurance Commissioners and approved by them as being in compliance with this Act."

One of the policy forms submitted is entitled "Hospitalization, Medical Care and Surgery with 20 Year Pay Participating Reserve," which shall hereafter be referred to as health policy. The other is entitled "Fam-

ily Group Life Policy ____ Year Pay," hereinafter called life policy.

The health policy calls for an advance premium payment by the first insured of _____ dollars and a like amount on the _____ day of _____ thereafter for a period of 20 consecutive years from date of issue. The Service agrees to create and maintain an amount not to exceed _____ dollars as a 20 year participating reserve. The certificate contains provisions concerning the manner of establishing the value of the reserve and further provides under "Conditions and Privileges" for extended insurance, a schedule of 20 year pay participating reserve, and the manner in which the assured may withdraw the amount of the participating reserve. The funds of this reserve may be withdrawn in a lump sum at any time while the policy is in force, or extended as retirement income for a period of 120 months. The sum withdrawn is less indebtedness, which according to the policy shall include any obligation of the insured on the policy or reserve; all benefits paid during the term of the policy; all premium payments made by the Service on behalf of the assured for extended insurance; and all unpaid due premiums. Another feature contained in this policy is that after the expiration of 20 years, if continuous premiums have been paid by the insured, the policy may remain in force with a further premium payment of $1.00 per year. If the assured withdraws the cash in the participating reserve fund, it shall be in lieu of all other benefits and all liability of the Service shall cease. This policy further provides that no extra assessments will be made upon the assured, and that the policyholder's liability is to the extent of the premium rates shown on the face of the policy.

The life policy form calls first for the payment of an advanced premium and a like amount on or before _____ day of each month thereafter for _____ full years and a further payment of $1.00 a year thereafter so long as the policy is in force. The policyholder's liability for premiums is the same as that contained in the health policy. This policy carries provisions relating to settlement; cash withdrawal value; loan value; cash value of the reserve, and extended insurance. Concerning cash withdrawal value, the company agrees to pay in cash not later than 60 days after legal surrender of the policy, the matured reserve shown under "Schedule of Cash Value of the Reserve" less indebtedness (not defined by this policy). This payment is made subject to

a deduction of death benefits paid under the policy. The Service further agrees to advance to the last surviving insured, if he so desires, a loan of all or any part of the sum shown by the Schedule of Cash Value of the Reserve, subject to deductions of all indebtedness. The loan shall bear interest at the rate of 6% per annum payable in advance. Failure to repay such a loan will not void the policy until the indebtedness shall equal or exceed its loan value. Under extended insurance, the Service agrees to pay any premiums which the insured does not pay, such payments to be made out of the cash value of the reserve; and will be made for the insured until the funds in the cash value of the reserve are exhausted.

In the case of Banker's Life and Loan Association vs. Chase (Court of Civil Appeals), 114 S.W. (2d) 374, writ dism., we have found the only construction of Section 11, Article 4859f, made by any of the Courts in Texas. The Court said, after quoting the first part of Section 11:

> "The limitation contained in this section, we think, is a limitation on the time and method of payment rather than on the amount the insurer must pay under the policy; a restriction confining it to the issuance of certificates of ordinary insurance."

The Court then defines limited payment plan, endowment insurance and annuity insurance as follows:

> "37 C. J., page 362, par. 6, is as follows: 'Endowment insurance is a contract to pay a certain sum to insured if he lives a certain length of time, or, if he dies, before that time, to some other person indicated. * * *'
>
> "'Annuity insurance is a contract to pay the insured or the beneficiary a sum for a certain period or during life.' Couch, Cyclopedia of Insurance Law, Vol. 1, page 38, par. 25.
>
> "A policy upon a limited payment plan, as we understand, is a paid-up policy, and insurance upon which no further

> premium is to be paid. 37 C. J., page 364, par. 11."

Under the Court's definition of endowment insurance, we conclude that neither of the policies attempts to "promise or guarantee the payment of endowment benefits." The definition makes it plain that the amount to be paid shall be certain and that the contract must be for a certain length of time. Neither of these policies contracts to pay a certain sum; rather, the sum is indefinite and uncertain. The health policy establishes the value of the reserve by setting aside a sum not to exceed 5% of the earned income during the preceding year. The income of the company will, by the very nature of the business, vary from year to year. In some years there may not be any earned income, in which event, it is stated in the policy that the deficit shall be prorated to each policy holder's schedule of the value of the reserve as his interest appears. And if the company is unable to establish the value within 5 years after a deficit occurs or within the 20 years, the Service shall be relieved of the liability to make adjustments. This manifestly renders the sum to be paid the insured from the participating reserve fund indefinite and uncertain and cannot be said to constitute endowment insurance.

The same reasoning answers an objection that the life policy is a type of annuity insurance. But the health policy, wherein it provides for the payment of whatever sum has accumulated in the reserve fund as a retirement income for a period of 120 months, is a type of annuity insurance under the definition above. We hold that this policy violates the provisions of Section 11 prohibiting the issuance of policies with a promise to pay <u>any type</u> of annuity insurance.

Aside from the questions raised by the provisions of the policy relating to endowment and annuity insurance, the provision of Section 11 of the statute which more strongly indicates the intention of the Legislature in the regulation of mutual companies is:

> " . . . but shall confine its operation to the issuance of certificates looking to continuous payment premiums or assessments during the lifetime of the policyholder."

As the Court said in the Chase case, supra:

> " . . . a restriction confining it to the issuance of certificates of ordinary insurance."

According to the definition of "ordinary insurance" found in 44 C. J. S., page 487, Section b, par. 27, it is:

> "Where the insurance is on a level or flat rate plan, that is, where for a fixed premium payable, without condition, at stated intervals, a sum certain is to be paid on death without condition, it is known variously as 'general insurance','ordinary insurance', 'old-line insurance', or 'level-premium insurance', even though insurer is doing business on the assessment plan, and payments to be made by insured are designated as assessments."

Measured by this standard, these policies not only contract to pay death and health benefits, but also contract to pay the assured the amount accumulated in the special reserve fund, even though the assured has not sustained a loss under the policy. These provisions setting up the participating reserve fund on the basis of a 20 year pay program, cash withdrawal value, loan value and extended insurance, are in addition to a contract of ordinary insurance. In other words, by the creation of this special reserve fund, in addition to covering the assured for either life or health, the policies have not remained within the bounds of the limitations prescribed by the Legislature. Neither can such provisions be reconciled with the purpose of the company as is stated in the charter quoted above. The life policy itself is entitled "_____ year pay life", and the health policy carries with it a twenty year pay participating reserve on a premium plan exactly as the life policy. It is true that ordinary policies of life insurance set up schedules of reserve values relating to cash surrender values, and some of them may possibly provide for similar features carried by the health and life policies. There is a fundamental difference, however, between an ordinary policy of life insurance and these policies in the manner of establishing the

reserve. An ordinary life policy establishes the reserve upon the basis of the actual premium paid by the assured. These policies establish the reserve by setting aside each year a certain amount of the earned income from all of the policies containing such provisions. The value thus created may, depending upon the amount of earned income, far exceed, or be much less than, a reserve value established upon the basis of an individual's premium. The policyholders are sharing in the proceeds derived from other policies and in this way take on some of the characteristics of tontine insurance, which is not necessary to discuss here. In any event, these forms are different from ordinary insurance and additional evidence that the company has exceeded the limitation declared by the Legislature in Section 11 of Article 4859f, and by the Court in the Chase case, supra.

It is obvious that before this company could be financially able to establish such a reserve fund as contemplated by these policies, it would, of necessity, be forced to charge a premium in excess of a premium on an ordinary policy. This must have been carefully considered by the company when provision was made to charge the assured only $1.00 per year after he had paid regular premiums for twenty years and still carry the policy in force. The solvency of the company could not survive otherwise. This is doing nothing more than issuing a policy on what is known as a twenty year plan. For all practical purposes the assured has completed the payment of what can be termed regular premiums at the end of twenty years, and his obligation to pay $1.00 per year after such time does not meet any standard of premium charge based upon losses. Certainly this is true if the premium paid for twenty years be considered an adequate premium to meet losses and expenses during such period. It amounts to nothing more than a token payment -- a flaccid attempt to meet the statutory requirement of "continuous collection of premiums or assessments during the lifetime of the policyholder." Were it not for this requirement in the statute, there would be no need whatever under this plan of insurance to call for further collection of $1.00 premium at the expiration of the participating period. The policies, then, are actually "paid up" policies at the end of the participating period; and, come within the definition of "limited payment plan" adopted in the Chase case, supra. They are in violation of the express prohibition against issuing any certificate or policy on a

"limited payment plan".

Where no express authority is to be found in either the charter or the statutes permitting a mutual assessment company to issue policies of this nature, the rule is that such policies are ultra vires. This rule is well expressed on page 635, par. 256, Couch, Cyclopedia of Insurance Law:

> "The measure of the powers of mutual companies or benefit societies to contract whether they be voluntary organizations or incorporations is found in their charters or articles of association, since these constitute their fundamental and organic law, the compact governing their acts, subject to the Constitution and laws of the State. This, of course, means that such companies and societies have only such powers as are therein specifically enumerated, together with such others as are incidental, or necessary, to carry the express powers into effect, and necessary to the enjoyment of the rights and privileges included in the original authorization. And, of course, acts which do not fall within such express or implied powers are ultra vires and void; and where an act is ultra vires, the motive which prompted it is not of great importance."

We have found no cases either in or out of Texas construing similar policy forms under statutory prohibitions such as we have here. However, in Vol. 128, A. L. R., page 639, we find this general rule:

> "Provisions for extended or paid-up insurance or for loan or surrender values or endowment provisions doubtless cannot be included in life policies issued by companies operating strictly and exclusively on the assessment plan, because in such case, the assessments being limited to the amount necessary to pay death claims, no reserve fund can be accumulated with which to fulfill such provisions. Companies doing business under this strictly assessment plan

> possess no power to require the payment of fixed assessments or premiums at stated periods, regardless of the current mortuary claims against the company, and it is the lack of this power on the part of a life insurance company that precludes it from putting such provision in its policies. There are, however, many assessment plans of doing life insurance business, under some of which companies, dependent upon the statutes under which they are organized, possess the power to fix a premium that will create a reserve fund to pay for extended or paid-up insurance or endowments, and which will give to their policies a loan or surrender value." (Emphasis ours.)

Our statute contains no language, either expressly or impliedly, giving such companies a right to issue policies with provisions for loan or cash withdrawal values or a participating reserve fund. The very nature of the plan upon which this company operates is founded upon the levying of assessments limited to the amount required to pay losses and operating expenses. Section 11 of Article 5068-1 apparently recognized this very principle when it provides:

> "Each association shall levy regular and periodical assessments by whatever name they may be called. These assessments must be in such amounts and at such proper intervals as will meet the reasonable operating expenses of the association, and pay in full the claims arising under its certificates. . . ."

We believe after a thorough examination of both policies in the light of Section 11 of Article 4859f, Article 5068-1, and the charter purposes of this company that both the life and health policies are ultra vires and prohibited by Section 11, Article 4859f.

SUMMARY

Where the certificates or policies of a mutual insurance company operating on the mutual assessment plan for the protection, indemnification, and insurance of the lives of its members and against loss to them by reason of ill health and/or accident, contain provisions for the creation of a participating reserve fund on the basis of a twenty year period, together with cash withdrawal value, loan value, and extended insurance features, such policies are inconsistent with and prohibited by the provisions of Section 11, Article 4859f and Article 5068-1 V. C. S.

Yours very truly

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APPROVED:

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