Opinion No. 37-1512

January 28, 1937

BY: FRANK H. PATTON, Attorney General

TO: Mr. George M. Biel Superintendent of Insurance Santa Fe, New Mexico

*{*45}* You have asked for an opinion in regard to a clause entitled "Persistency Bonus Fund" in a participating twenty year life insurance policy reading as follows:

"PERSISTENCY BONUS FUND

The company guarantees to create a Persistency Bonus Fund, to the credit of all policies containing this clause and issued during the same calendar year as this policy, by setting aside therefor an amount equal to one annual standard life premium on each such policy in full force and effect five years after its date of issue.

The company guarantees to improve said Fund with interest at the rate of 3 1/2 % per annum, compounded annually, such interest to be calculated on the entire Fund on July 1st of each calendar year and credited to the Fund on the following January 1st.

In the event that this policy shall mature as a death claim before the end of the 20th policy year and while no premium is in default, the company shall deduct from the Fund and pay to the beneficiary hereunder a sum equal to the amount placed in said Fund on account of this policy plus interest thereon calculated as above. **Otherwise, no deductions shall be made from the Fund for any purpose whatever prior to its distribution.**

At the end of 20 years from the date hereof, the company guarantees to pay to the insured hereunder, provided this policy is then in full force and effect by the payment of all premiums thereon, such a portion of the Fund as one annual standard life premium on this policy bears to the total of the annual standard life premiums on all policies entitled to share in said Fund."

Under this clause a sum (in the nature of a deferred dividend) is set aside at the end of the fifth year, payable to the beneficiary if the insured dies without lapsing his policy, but which is forfeited if the policy lapses; and another dividend is declared on the twentieth year in favor of all survivors from a fund composed of all the deferred dividends accruing from policies of this class which have lapsed, and which is paid in cash together with the deferred dividend previously declared on the policy of such surviving policy holder.

Your first inquiry is whether this clause violates Section 71-146 of the 1929 Code, as a special contract prohibited thereby, and further you inquire whether it is in violation of sub-sections (6), (7) and (8) of Section 71-161 of the 1929 Code.

The first of these sections prohibits the issuance of "any special advisory board or other contract of any kind promising returns and profits as an inducement to insurance." That section, standing alone, and taking the wording thereof at its face value, would seem to indicate that such a clause might be prohibited thereby. The contract with respect to this fund does not constitute insurance, *{*46}* and in that sense it might be considered as a special contract tending to induce the taking of insurance.

However, the evils which such statutes are designed to correct are well known and understood -- contracts which are collateral to the contract of insurance, and not merely covenants special in their nature but which merely constitute special features enhancing the merits of the contract of insurance. Utah Insurance of Life Underwriters vs. Mountain States Life Insurance Company, 200 P. 673. This is made clear by a reading of the second section following the one here in question which reads:

"Nor shall any company * * * give, directly or indirectly, as an inducement of the purchase of an insurance policy * * * any special favor or advantage of any kind or nature whatsoever **not plainly** designated in the policy."

In my opinion this clause is a special advantage, and is impliedly permitted by this section so long as specified in the policy itself.

As to subsection (8) of Section 71-161 of the 1929 Code, it is my opinion that the clause in question does not violate its provisions. It is to be noted that the Persistency Bonus Fund clause prohibits the use of the fund or dividend set aside for any purpose other than specified therein and which does not include the purchase of extended insurance.

In the case of United States Life Insurance Company vs. Spinks, 96 S. W. 889, (see also 103 S. W. 335), it was held that since a statute such as ours required that upon the lapse of a policy paid up insurance was to be credited to the insured equal to the net value of the reserve of the policy "and on any dividend additions thereto," dividends such as those here in question had to be applied to extended insurance. However, the Supreme Court of the United States in Williams vs. Union Central Life Insurance Company, 78 L. Ed. 713, and several other cases, have interpreted the phrase "dividend additions" to mean paid up or extended insurance after dividends have been declared and applied to that purpose. A collection of those cases may be found in 33 Mich. Law Review 311. See particularly Jefferson vs. New York Life Insurance Company, 152 S.W. 780.

As to subsection (7), in view of the decisions above referred to interpreting the words "dividend additions," it is my opinion that this Persistency Fund clause does not reduce the amount of the loan procurable under the terms of that section and does not violate that section.

The real difficulty, as I see it, arises with respect to sub-section (6) of Section 71-161. I am strongly of the opinion that this Persistency Bonus Fund clause does in effect provide for a deferred dividend declarable at the end of the fifth year, payable at the end

of the twentieth year period, and subject to forfeiture by lapse of the policy; and that it in effect provides for another dividend declarable and payable at the end of the twentieth year. Insurance writers as well as law writers so treat such semi-ton-tine funds. The Liberalization of Life Insurance Companies by George L. Amheir, page 190, et. seq., 1 Cooley's Brief on Insurance, pages 164 and 172.

If so, the Legislature must have intended to prohibit such deferred dividends in this kind of a policy by the inclusion of subsection (6) in Section 71-161 enacted for the first time in 1925. By that section it is provided that it shall be unlawful for any life insurance company to issue any life policy unless it shall contain substantially:

"If it be a participating policy, a provision that the policy shall participate in the surplus of the company and that * * * the company will annually determine the portion of the divisible surplus accruing on the policy, and that the owner of the policy *{*47}* shall have the right each year to have the **correct** dividend arising from such participation * * * paid in cash, etc."

The object of all participating policies is to provide a method whereby the policy holders, being equitably entitled to the surplus, may have that surplus paid or credited to them. Our statute specifically provides one method of dividing that surplus and this method must be included in all participating policies. It thereby, in my opinion, prohibits any other method of distributing that surplus.

This section does not provide that some dividend, or a dividend that the company may appropriate for the purpose, shall be paid. It provides that the **correct** dividend shall be paid.

If it is legal to create a fund for a different participation at the end of the fifth year, it would be legal to set aside such a fund every two or three years thereafter. Actuaries are able to determine the approximate amount of what the surplus will be, and a company could by setting aside a sufficiently large participating fund every two or three years, completely nullify the provisions of this section.

From the wording of the section itself I can only conclude that it intends to prohibit any other method of participation. This conclusion is inescapable if we take into consideration the purpose for which such statutes are being passed, to-wit: the prohibiting of forfeitures.

As said in the second of the Spinks cases, 103 S.W. 335, 336:

"It would be inexplicable that the Legislature could have intended to protect policy holders from the forfeiture of their reserves, and additions to their insurance bought by a part of the 'surplus,' and yet allow that their 'surplus' which had not been so applied could be forfeited for the same cause which was deemed inequitable and unjustifiable, and which experience has demonstrated was in truth so."

My opinion therefore is that the clause in question does violate this section. I have not attempted to pass on the merits or demerits of this clause, but I will say that unless it is prohibited by statute, as I think it is, there is no question but what it would be legal.

By A. M. FERNANDEZ,

Asst. Atty. Gen.