

**SECURITIES COMMISSION:** Stock issued by insurance company and retained as collateral for payment of note, whether violation of Insurance Code as inducement for sale of insurance; nature of transaction.

February 19, 1940.

Hon. James M. Tucker,  
Indiana Securities Commission,  
Indianapolis, Indiana.

Dear Sir:

I have before me your letter in which you state that the Commission has under advisement the application of a life insurance company, organized under the laws of Indiana since July 3, 1934, to register and qualify for sale in this state, 100,000 shares of \$5.00 par value Class "B" stock at \$20.00 per share. You further state that the Class "A" stock, having a par value of \$5.00, has, during the past, been qualified by this Commission to be sold at \$15.00 per share.

You further state in your letter that recent information has come to the Commission that prospective policyholders, solicited by agents of the company in connection with the sale of insurance, are told that with each \$1000 worth of life insurance, they will receive one (1) share of the Class "A" stock and that the merit of that offer is further stressed by values which are placed upon such stock.\*

You also state in your letter that information was also disclosed to investigators of the Commission that subscriptions to the Class "A" stock were not referred to the stock clerk of the company for proper entry and issuance, until the book-keeping department had indicated that the initial policy premium had been paid by the insured, who also is the subscriber to the stock in most cases.

You also state in your letter that in connection with the transactions, as above related, the insured and subscriber, executes a note to the company for the payment of the stock and assigns the stock, so issued, to the company as a collateral securing the payment of said note. You further state that the insured and subscriber is then given the option to meet the annual installment on said note with a cash payment or is permitted to apply the dividends from his insurance policy, inuring at the contract rate of \$10 per annum per \$1000 of

life insurance, towards the principal and interest due on said note. You state, however, that the above option, appears to be subordinated by the fact that the coupons, representing dividend payments, are simultaneously assigned to the company with the stock certificates.

You further state in your letter that it has also come to the attention of the Commission that failure to meet the payments of premiums on the insurance policy affects the failure of a dividend earning thereon and results in the failure of the policy dividend to meet the note payment, consequently operating as a forfeiture of the stock held by the company as collateral.

You further state in your letter that this stock, when forfeited, is again used by the company for the purpose of meeting the needs of a future transaction with a future prospect to whom insurance may be sold, and that in some instances, the company is compelled to hold such a new transaction in abeyance pending the acquirement of sufficient forfeited stock, to complete the transaction. You further state in your letter for this purpose, the Commission's investigators were informed, the company uses a blue and a pink subscription blank, the pink blank warning the company that the transaction must be delayed until the proper amount of stock has been acquired. You state further that the heading, printed on both the blue and pink blanks, appears to substantiate this system, as adhered to by the company.

You further state in your letter that the Commission has been informed that the company contemplates selling the Class "B" stock in the same manner as the Class "A" stock was sold.

Based upon the foregoing statements, you submit the following questions:

"1. Assuming the facts to be as above stated, is this contract whole and entire and is the making of the note, the issuance and pledging of the stock as collateral, the issuance of the insurance policy, the assignment of the dividends upon the insured, part and parcel of the same general transaction?

"2. If it is your opinion that such contract is whole and entire and that the particular transactions of which it is composed are but its component parts then does it follow that insurance in such a contract is an

inducement to the purchase of the stock and *vice versa*?

"3. If it is your opinion that such contract is whole and entire and that the particular transactions of which it is composed are but its component parts is it also true that stock purchased under these circumstances is an inducement to the purchase of insurance, constituting a violation of Section 163 of the Insurance Code for the year 1935?

"4. Do said notes, when accepted in payment of stock sold, constitute an executory contract?

"5. If your answer to question 4 is in the affirmative, do such notes become an asset of the company that should be carried as 'notes receivable' or some other such designated item?

"6. If your answer to question 4 is in the negative, in whom is title of ownership in such notes vested? In whom is title to such vested?"

The first three questions may be considered together since they all lead to the same ultimate inquiry contained in question number 3, which is as to whether the method of disposal of said stock as described in your letter violates Section 163 of the Insurance Code for the year 1935. This section reads as follows:

"No life insurance company doing business in this state shall issue in this state, nor permit its agents, officers, or employees to issue or deliver in this state, agency company stock or other capital stock, or benefit certificates or shares in any common-law corporation, or securities, or any special or advisory board or other contracts of any kind promising returns and profits as an inducement to insurance or for the purchase of an annuity; and no life insurance company shall be authorized to do business in this state which issues or permits its agents, officers, or employees to issue in this state or in any other state or territory agency company stock or other capital stock, or benefit certificates or shares in any common-law corporation, or

securities, or any special advisory board or other contracts of any kind promising returns and profits *as an inducement to insurance or for the purchase of an annuity*; and no corporation or stock company acting as agent of a life insurance company nor any of its agents, officers, or employees shall be permitted to sell, agree to offer to sell, or give or offer to give, directly or indirectly, in any manner whatsoever, any share of stock, securities, bonds, or agreement of any form or nature promising returns and profits *as an inducement to insurance or for the purchase of an annuity; OR IN CONNECTION THEREWITH.* The department may, upon due proof after notice and hearing that any such company or agent thereof has violated any of the provisions of this section, revoke the authority of the company or agent so offending." (Our italics and capitals.)

Acts of 1935, page 696.

Your third question is limited to the question as to whether stock purchased under the circumstances set out is an *inducement* to the purchase of insurance, constituting a violation of Section 163 of the Insurance Code for the year 1935, above quoted. Referring to the paragraph of this letter immediately preceding the single asterisk, if it is to be assumed that the meaning intended to be conveyed is that the stock is to be *given* to the purchaser of the insurance without consideration, such gift, I think, would clearly be an *inducement* to the purchase of insurance and in violation of Section 163 *supra*. That, however, apparently is not the meaning intended to be conveyed since later in your letter you state that a note is given to the company in payment for the stock and that the stock is held by the company as collateral to secure the payment of the note. This, it seems to me, is directly opposed to the theory that the stock is *purchased* or *given* as an inducement to the purchase of the insurance in the absence of other facts giving color to the transaction. You further state that the purchaser of the stock is given the option to meet the annual installments on his note with cash payments or by applying the dividends from his insurance policy to that purpose. But in the absence of a showing that the dividends

were improperly computed so that the plan is actuarilly unsound, I do not think that would make any difference. The dividends would belong to the insured and he would be entitled to use them as he desired unless there was something in the contract to the contrary.

This brings me to what it seems to me are the controlling factors. You state that the coupons representing the dividend payments are simultaneously assigned to the company with the stock certificate. I have already had occasion to deal with this practice in a previous opinion in which I held that the contemporaneous assignment of the coupons to the insurance company indicated a *connection* between the sale of the stock and the issuance of the insurance which, in my opinion, is in violation of Section 163 *supra*. I am still of the same opinion. Added to that is the further statement in your letter that information was also disclosed to investigators of the Commission that subscriptions to the Class "A" stock were not referred to the stock clerk of the company for proper entry and issuance, until the bookkeeping department had indicated that the initial policy premium had been paid by the insured, who also is the subscriber to the stock in most cases. If this is correct, it indicates to me that in such cases the right to receive the stock as applied to that particular subscriber, at least, is conditioned upon his purchasing the policy, thus indicating such a *connection* between the sale of the stock and the issuance of the insurance as is, I think, in violation of Section 163 *supra*.

Returning now to your first three questions, I am of the opinion that the first question should be answered in the affirmative. However, I do not think that it necessarily follows that the second and third questions must also be answered in the affirmative. If the insurance issued is issued upon an actuarilly sound basis, it would appear that the insured pays for just what he gets. Moreover, he certainly pays for his stock; and with the exception referred to in the next preceding literary paragraph of this opinion, where the purchase of the *policy* might be considered as an inducement to the purchase of the *stock*, unless it is true that a person desiring to buy the particular policy cannot do so without also buying stock, the buying of the stock does not seem to me to be an inducement to the insurance.

However, as already pointed out, the contemporaneous assignment to the company of the dividend coupons for the purpose of applying same to the payment of the installments due on insured's note, and especially in view of the statement in your letter that no stock is issued until the initial policy premium has been paid, are, in my opinion, sufficient to show such a *connection* between the sale of the stock and the sale of the insurance as is prohibited by Section 163 *supra*.

I think your fourth and fifth questions should be answered in the affirmative. The fourth question, being answered in the affirmative, the sixth question requires no answer.

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**HOUSING BOARD, STATE: Whether commissioner of city housing authority may reside outside city but within authority.**

February 20, 1940.

Mr. Walter B. Stanton,  
Executive Secretary,  
State Housing Board of Indiana,  
Indianapolis, Indiana.

Dear Sir:

I have before me your letter of February 17, 1940, wherein you ask the following question concerning the Housing Authorities Act of 1937:

"Would you please give us your official opinion as to whether Chapter 207, Section 3, sub-section (g) and Section 5, lines 2 to 5 inclusive, permit the appointment of a commissioner to a city housing authority, who resides outside the corporate limits of the city proper but within the five-mile area included in the city's housing authority's 'area of operation.' "

The provisions of Section 3, sub-section (g) of Chapter 207, Acts of 1937, provide for and define the area of operation of a housing authority as follows:

"(g) Area of Operation: (1) In the case of a housing authority of a city or town shall include such