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Filed May 4 - 1962

STATE OF WISCONSIN SS
DEPARTMENT OF STATE
RECEIVED AND FILED
MAY - 4 1962 - 1:15 P.M.
ROBERT C. ZIMMERMAN
SECRETARY OF STATE

STATE OF WISCONSIN )
) ss.
DEPARTMENT OF INSURANCE )

TO ALL TO WHOM THESE PRESENTS SHALL COME, GREETINGS:

I, Charles J. Timbers, Deputy Commissioner of Insurance, and custodian of the official records of said department, do hereby certify that the annexed rule relating to special life insurance policies was duly approved and adopted by this department on May 4, 1962.

I further certify that said copy has been compared by me with the original on file in this department and that the same is a true copy thereof, and of the whole of such original.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the official seal of the Department at the Capitol, in the city of Madison, this 4th day of May, A.D., 1962.

Charles J. Timbers
Deputy Commissioner of Insurance

ORDER OF THE DEPARTMENT OF INSURANCE

Adopting Rules

Pursuant to authority vested in the Commissioner of Insurance by section 200.03 (2), Wis. Stats., the Commissioner of Insurance hereby adopts a rule as follows:

Section Ins 2.08 of the Wisconsin Administrative Code is adopted to read:

Ins 2.08 Special policies and provisions; prohibitions, regulations, and disclosure requirements. (1) PURPOSE. The interest of the public and the maintenance of a fair and honest life insurance market must be safeguarded by identifying and prohibiting certain types of policy forms and policy provisions and by requiring certain insurance premiums to be separately stated. This rule implements and interprets applicable statutes including sections 200.03 (2), 206.13, 206.17, 206.18, 206.33, 206.36, 206.51 (1) and 207.04 (1) (a), (b), (f), (g), (h), and (i), Wis. Stats.

(2) SCOPE. This rule shall apply to the kinds of insurance authorized by section 201.04 (3), Wis. Stats., and shall also apply to fraternal benefit societies.

(3) DEFINITIONS. For the purpose of this rule certain life insurance policy forms and provisions referred to herein shall have the following meaning:

(a) Coupon policy is any policy form which includes a series of coupons prominently and attractively featured in combination with an insurance contract. Such coupons are one-year pure endowments whether or not so identified and whether or not physically attached to the insurance contract. The coupons are

devised to give the appearance of the interest coupons that are frequently attached to investment bonds. Although the face amount of the coupon benefit is essentially a refund of premium previously paid by a policyholder, it is frequently represented that it is the earnings or return on the investment of the policyholder in life insurance.

(b) Charter policy is a term or name assigned by an insurance company to a policy form. Such a policy is usually issued by a newly organized company and it is sold on the basis that its availability will be limited to a specific predetermined number of units of a fixed dollar amount. Such policies generally provide that the policyholder shall participate in the earnings resulting from either or both participating policies and non-participating policies. It is characteristic of such a policy that in its presentation to the public it is represented that the policyholder will receive a special advantage in any future distribution of earnings, profits, dividends or abatement of premium. It is also represented that such advantage will not be made available to the persons holding other types of policies issued by the company. Other names such as Founders, President, and Executive Special are frequently used for policies of the type herein described, and for the purpose of this rule when they are so used they shall be considered as charter policies.

(c) A profit-sharing policy is any policy form which contains provisions representing that the policyholder will be eligible to participate, with special advantage not available to the persons holding other types of policies issued by the same company, in any future distribution of general corporate profits. Such policy forms are so drafted that it appears to a prospective policyholder that he is purchasing a preferential share of the future profit and earnings of the insurance corporation rather than purchasing a life insurance policy which may be subject to refund of excess premium payments. The provisions of the policy may incorrectly represent the amount and source of surplus that will be available for

dividends or abatement of premiums. Therefore, no charter policy shall be approved for use and no charter policy heretofore approved shall be issued or delivered in this state on or after June 15, 1962.

(d) Profit-sharing policy forms are contrary to statute and the public interest by representing as an inducement to insurance that the person who purchases such a policy is procuring a preferential interest in the future profits and earnings of the insurance corporation. Any distribution to a policyholder of the company of earnings, profits, or surplus is a refund of the excess premiums paid by that policyholder. Such distribution must be fair and equitable to all policyholders, it must not discriminate unfairly between individuals of the same class and equal expectation of life, and it must be in the best interest of the company and its policyholders. Therefore, no profit-sharing policy shall be approved for use and no profit-sharing policy heretofore approved shall be issued or delivered in this state on or after June 15, 1962. Further, on or after June 15, 1962, no participating policy shall be approved and no participating policy heretofore approved shall be issued or delivered in this state unless the policy provides without deception or misrepresentation that the source of any dividends or abatement of premium is limited to the divisible surplus derived from participating business.

(5) SEPARABILITY. If any provision of this rule shall be held invalid, the remainder of the rule shall not be affected thereby.

Note: The above rule is the end product of a careful study and evaluation of the transcript of the hearing on January 16 and January 17, 1962, on the proposed rule. Due consideration was given to the exhibits and the prepared statements presented at the hearing and to the several briefs filed subsequent to the hearing. This is the first time since the passage of Public Law 15 that such a large amount of legal and actuarial talent was focused on these specific matters of the life insurance business. The number and size of the briefs and exhibits reflect the substantial time involved with their preparation, and the information they contained cast considerable light on the issues under consideration.

It is of interest to note that the first coupon-type life insurance policy was accepted for use in Wisconsin about 1940. Chapter 207, Wisconsin Statutes, relating to Unfair Insurance Business Methods, was enacted in 1947. In 1959 a newly organized company commenced the use of a charter-type coupon policy with

profit or surplus sharing provisions. Because of the infrequent submission of such a type of life insurance policy, the Insurance Department personnel did not fully appreciate the impact of the provisions of Chapter 207 (1947, c. 520) on the provisions of life insurance policies filed pursuant to section 206.17, Wisconsin Statutes. The information made available as a result of the hearing serves to bring the issues and the requirements of statutes more clearly in focus.

An administrative agency has a responsibility to correct any errors in administration of the statutes which are brought to its attention. The premise suggested at the hearing by the opponents of the proposed rule that a previous administrative ruling (acceptance of the policy) should be controlling and should not be reversed is not supported by the Wisconsin Supreme Court. In Universal Underwriters vs. Rogan 6 Wis. (2d) 623, the court in effect said that, in case of ambiguity in a statute, practical interpretation over a long period by the agency charged with administration of an act or statute may be deemed controlling, but where there is no ambiguity in the law, a previous administrative ruling thereon cannot be given any weight as an administrative interpretation. The basic responsibility for the drafting and construction of lawful policy forms rests with an insurance company and its actuaries and lawyers. In reviewing policy forms, the Insurance Department, while seeking to protect the public interest to the best of its ability, does not inherit any basic responsibility for the lawfulness of any part or all of an insurance contract. Therefore, it appears proper to make a determination of the matters at hand based on the merits of the issues and without an obligation to be controlled by a previous ruling.

Life insurance contracts, more than any other kind of insurance, are made on the basis of the utmost good faith of the insurance company. It is fundamental that the provisions of such contracts be devised with clarity and precision. The commissioner has an obligation to see that the public interest be served and the statute complied with by refusing to accept policies that are or tend to be misleading or deceptive. Section 201.53 (1), Wisconsin Statutes, states that: "No insurance company shall make any agreement of insurance other than as plainly expressed in the policy."

The principal issues involved are whether or not life insurance coupon policies, charter policies, and profit-sharing policies are consistent with and are authorized by statute. Some life insurance companies issue policy forms embodying one or more of these features in a single policy. It is necessary that each of these types of policies be discussed separately even though there is some overlapping of the issues involved and some of the same considerations are present in two or more of these policies.

In respect to the so-called coupon policies, wherein a series of coupons are sold in conjunction with conventional life insurance, there is no dispute but that the coupons are a series of one-year pure endowments. This being true, they should be properly identified as such. To print the coupon in the color and format of interest coupons commonly attached to investment bonds disguises the true nature of the product being purchased by the public. A series of one-year endowments affords a special type of benefit which the average life insurance buyer would seldom purchase if he were in possession of the full information concerning the premiums paid for the pure endowment benefits provided.

The gross premium cost to the policyholder for the pure endowment benefits can be readily determined by the company by loading the benefits to be afforded with the applicable expense items such as premium taxes, acquisition cost, and

company administration expenses, with consideration for items such as interest, mortality, policy lapses, etc. It has been argued that it is only necessary to disclose the net premium cost, which is the premium needed to provide the benefits, without recognition and inclusion of the company administration expenses and overhead. These other expenses do exist and if not shown with the pure endowment premium they then are an additional load on the life insurance being purchased in conjunction with the pure endowment benefit. To argue that it is only necessary to disclose a portion of the premium cost is to argue that it is legal and proper to deceive the public into believing that they are purchasing the endowment benefit at a premium cost that is attractive in relation to the benefits. It is a fact that the gross premium cost will frequently be substantially in excess of benefits returned to the policyholder. At best, the total of the face value of the pure endowment benefits would approximate or be only slightly greater than the total gross premium paid by the policyholder. It is not in the public interest, nor is it consistent with sections 201.53 (1), 206.51 (1), and 207.04 (1) (a), Wisconsin Statutes, to permit such a deception and misrepresentation of the gross premium cost of a series of one-year pure endowments or of any series of guaranteed periodic benefits maturing during the premium-paying period of the policy.

Charter policy is a name given to a life insurance policy, usually by a newly organized insurance company. Its basic purpose is to provide the company agents with a policy form that is especially attractive to the purchaser in order that the new company will have a competitive advantage. The nature of the charter-type policy is that it is profit-sharing or that the policyholder will participate in the long-term earnings of the company. The usual representation is that the policies will be issued to the extent of a predetermined fixed number of units and that the policyholder will be one of a relatively small and limited number of the original policyholders of the company who will ultimately share in the business success of the company. While this may be a useful device to aid a new company in getting started in business, the technique, if it is to be permitted, must be consistent with the requirements of statute. Section 207.04 (1) (f) states that "Issuing . . . any special or advisory board contracts or other contracts of any kind promising returns and profits as an inducement to insurance" is an unfair method of competition and is an unfair and deceptive act or practice in the business of insurance. Such trade practices are prohibited by section 207.03. The technique of offering returns or profits to a small group of the first policyholders of a company is clearly contrary to statute. It is a characteristic of charter policies that they represent that the policyholder will participate with special advantage in the long-term earnings of the company. This is a misrepresentation when viewed in the light of the requirement of section 206.33 (1) that "No life insurance company shall make or permit any distinction or discrimination between insurants of the same class and equal expectation of life in the amount or payment of premiums or in any return of premium, dividends or other advantages." After consideration of the issues involved it cannot be concluded that charter-type life insurance contracts are consistent with the requirement of statute.

Profit-sharing is a name used to describe any life insurance contract which provides that the policyholder will participate with special advantage in the general surplus accumulations of a life insurance company. If the company issuing such policies issues participating policies exclusively, then the right of each policyholder to participate in the surplus of the company is the same as the right of every other policyholder of the company. In such cases the statutes (206.13 (1), 206.33, 206.36, and 207.04 (1) (g)) require equitable and nondiscriminatory annual apportionment and return of the surplus accumulations.

However, the matters involved are much more complex when a life insurance company issues both participating and nonparticipating policies. Underlying the matters to be considered is the fact that any dividend on a participating policy is essentially a return of excess premium paid by the policyholder. Section 206.13 (1) provides that the participating policy, by its terms, must give the policyholder the full right to participate annually in the surplus accumulations from the participating business of the company. The issue in question is whether the statutes authorize a life insurance company to issue contracts which provide that a class of participating policyholders will participate with special advantage in the long-term corporate earnings of the company on both participating and nonparticipating business. Section 207.04 (1) (g) 1 defines as a prohibited unfair discrimination the "making or permitting any unfair discrimination between individuals of the same class and equal expectation of life in the rates charged for any contract of life insurance or of life annuity or in the dividends or other benefits payable thereon, . . ." Section 207.04 (1) (h) defines as rebating, prohibited by section 207.03, the "paying or allowing or giving or offering to pay, allow or give, directly or indirectly, as inducement to such insurance or annuity, any rebate of premiums payable on the contract, or any special favor or advantage in the dividends or other benefits thereon, . . ." From this it can be concluded that the statutes do not permit the issuance of a contract which gives the policyholder a promise of rebate of premium or a special advantage in dividend. Section 207.04 (1) (i) provides that, in respect to discrimination and rebates, the provisions of section 207.04 (g) and (h) do not prevent the abatement of premium out of surplus accumulated from nonparticipating business provided that such abatement of premium shall be fair and equitable to policyholders and for the best interest of the company and its policyholders. This statute is the only authorization for payment of dividends from the surplus accumulated from nonparticipating business. The impact of this statute is that any distribution of surplus accumulated from nonparticipating dividends must be fair and equitable to both participating and nonparticipating policyholders and for the best interest of the company and the participating and nonparticipating policyholders. Thus, a participating policy which purports to provide by its own terms or by the net result of the application of its terms that the policyholder will participate in the surplus accumulated on nonparticipating business is not a true representation of fact since the participating policy can only participate to an extent that is equitable with the participation of the nonparticipating policy,and to be equitable and not misrepresent the rights of the policyholder the nonparticipating policy should have the same provision for participation in the earnings on the nonparticipating business. If such a provision were to be inserted in all nonparticipating policies, such policies then, by their own terms, become participating policies and the distribution of dividends would be governed by the statutes cited above and the purported special advantage would not exist. It can be concluded that participating policy forms issued by life insurance companies should accurately state the conditions imposed by statute for distribution of surplus accumulations.

It is also worthy of mention that the Wisconsin Securities Law, in section 189.02 (1), defines a security as including "any interest, share or participation in any profits, earnings, profit-sharing agreement, . . ." There appears to be substantial evidence that if the profit-sharing or surplus-sharing type of policy were to be considered as complying with the insurance statutes it would then be considered as within the definition of a security and subject to regulation as such.

The provisions of Wisconsin Administrative Code section Ins 2.08 are intended to apply only to policies issued on or after its effective date, and it does not apply to contracts issued prior to the effective date. The adoption of the rule should not disturb or cast doubt about the validity of previously issued contracts of the type described in the rule. Such contracts were issued in good faith by the insurance companies,and there is no retroactive impact of the rule.

The rule contained herein shall take effect on June 15, 1962, as provided in section 227.026 (1) (b), Wisconsin Statutes.

Department of Insurance

Charles J. Timbers

Charles J. Timbers
Deputy Commissioner of Insurance

Dated: May 4, 1962

STATE OF WISCONSIN
DEPARTMENT OF INSURANCE
CHARLES MANSON, COMMISSIONER
STATE CAPITOL, MADISON 2

GAYLORD A. NELSON, GOVERNOR

May 15, 1962

Hon. James J. Burke
Revisor of Statutes
State Capitol - Room 321 N.E.
Madison 2, Wisconsin

Dear Sir:

Wisconsin Administrative Code section Ins 2.08
Adopted May 4, 1962

In reviewing the printer's proof of the rule in caption, we find that an error was made in dictation of the text of the footnote. Please refer to line 29 on page 7 of the typewritten copy filed with your office. The word "dividends" should be "business", and we have made this change on the printer's proof.

We are providing the Secretary of State with a copy of this letter, and we ask that both you and the Secretary of State attach this letter to the filed copy of the rule.

Very truly yours,

S. C. Du Rose

S. C. Du Rose
Assistant Deputy Commissioner

SCD:ECM
cc: Hon. Robert C. Zimmerman
Secretary of State
112 West - State Capitol
Madison 2, Wisconsin