

MEMORANDUM

State of Alaska Department of Law

TO: Martin Richard, Director
Division of Investments,
Department of Commerce &
Economic Development

DATE: July 29, 1997

FILE: 663-97-0396

TEL.NO.: 465-3600

SUBJECT: Proper Disposition of
Refunded Insurance
Premiums

FROM: Vincent L. Usera
Assistant Attorney General
Commercial Section - Juneau

You have requested that we address the question of the proper disposition of credit life insurance premiums refunded to the department by the insurer. We conclude that the State of Alaska is the proper recipient of the refunded premiums. Our analysis follows.

HISTORY

In 1946, the territorial legislature established a revolving loan program to enable Alaskan veterans of World War II to purchase, build, or remodel homes for themselves.¹ These loans were guaranteed by the federal government under provisions of the Servicemen's Re-Adjustment Act enacted in 1944, codified at 38 U.S.C. § 1801 et seq. When Alaska became a state in 1959, oversight of the veterans' loan program was delegated to the Department of Commerce.^{2, 3} The veterans' loan program was amended many times over the years and is now found at AS 26.15.040. The provision authorizing loans for veterans' home acquisition or remodeling was repealed in 1980.⁴

¹ L. Ex Sess. 1946, ch. 27, § 2, p. 110, effective April 3, 1946, compiled at § 44-2-12(c), 2 ACLA 1949.

² Sec. 14, ch. 64, SLA 1959.

³ Renamed the Department of Commerce and Economic Development in 1976. Sec. 95, ch. 218, SLA 1976.

⁴ Sec. 77, ch. 106, SLA 1980.

You indicated some concern about whether entry into this mortgage insurance program was authorized at the time, in light of two Attorney General's opinions to the contrary.⁵ Although it came close on the heels of the later opinion, legislation in 1967 addressed the issue. On March 28, 1967, the Governor signed into law an act adding a provision to AS 26.15.010 which gave the Department of Commerce the authority to "contract with insurance companies for mortgage insurance on veteran [sic] loans."⁶ The act became effective June 26, 1967.

"Mortgage insurance" is a broad enough term to be construed to refer to mortgage life insurance.⁷ Accordingly, the division of veterans' affairs in 1968 contracted with Aetna Life Insurance Company to provide group credit life insurance on veterans' home loans. The program called for the state to hold the policy of insurance, under which an electing veteran's loan would be paid in the event of the veteran's death before maturity of the mortgage loan. The state was responsible for making premium payments, but collected a premium charge added to the veteran's monthly loan payment.⁸

Over time, Aetna was receiving premiums considerably in excess of that required to pay necessary claims and meet required reserves. To guard against future fluctuations in

⁵ In 1965, the Attorney General's office issued an opinion in response to a question by the director of the division of veterans' affairs within the Department of Commerce asking if the division could establish a voluntary mortgage life insurance program to cover veterans' loans. The opinion concluded that the division lacked any statutory authority to implement such a program. 1965 Inf. Op. Att'y Gen. (Nov. 15; Michael C. Holmes, Dep'y Att'y Gen.). The question was posed again in 1967 and the response was the same: there was no authority for the department to participate in a group mortgage life insurance program. 1967 Inf. Op. Att'y Gen. (Feb 17; George L. Benesch, Asst. Att'y Gen.). A few weeks after that latter opinion was issued, the law was changed. This provision was apparently overlooked, principally because the veterans' home loan program was repealed in 1980 and there was no need for anyone to be familiar with the applicable statutes.

⁶ Sec. 1, ch. 249, SLA 1967.

⁷ Although no definitive legislative history is available to explain precisely what the legislature had in mind on passage of the legislation, we believe the division was entitled to make the interpretation it did. The division of insurance within the Department of Commerce and Economic Development has also opined that the term "mortgage insurance" used in the legislation is broad enough to include credit life insurance for mortgagors.

⁸ When the policy was set up, the premiums were set according to the insurance company's actuarial tables which take into account various factors influencing the insurer's risk under the policy. Among those factors are the size of the group being insured, the amount of individual liability, and the fact that risk decreases as the policy ages, at least in terms of the amount to be paid upon the death of an insured. Of course, the risk of death of the insured increases over time, but this is taken into account by the actuarial tables, which are determined by the refined experience of the industry.

claims experience versus premiums paid in, Aetna created a premium stabilization fund.⁹ It is difficult to tell from the records that are available precisely when this fund was established, though it appears that it was some time prior to July 1973. Records accompanying a letter from Aetna to the division dated January 9, 1975, show the stabilization fund having a \$60,000 balance on July 1, 1973, based on policy experience for the July 1, 1973 - July 1, 1974 policy period. The amount suggests that the fund was created with a lump sum payment. Balances in this fund earned interest as well and that statement shows interest earnings of \$3,600 at an annual 6 percent rate.

The letter indicates a refund to the state of a \$25,609 surplus. A surplus is created when an insurer deducts from premiums received amounts necessary to pay claims, fees, and reserves and other retentions. If the premium stabilization fund is sufficient and requires no addition, the surplus, together with the interest earned on the stabilization fund, is refunded to the policyholder. In this case the state received a refund of \$29,209 (surplus plus interest on the stabilization fund). Apparently not certain of what to do with these annual refunds, the division retained them for some years and eventually deposited them into the Alaska World War II veterans' revolving loan fund. The ostensible authority to pay this money to the fund was AS 26.15.040(d), which provides loan repayments, interest, and any proceeds from liquidations should be deposited to the fund. We believe it was a reasonable conclusion to deposit the money in the revolving loan fund.

The division of veterans' affairs for most of the years for which records have been retained was behind in efforts to reconcile accounts with Aetna. The division apparently accepted Aetna's figures without question. An audit of the division conducted by the division of legislative audit in 1978 was highly critical of the manner in which the division of veterans' affairs maintained its filing and accounting for programs under its Supervision. ALASKA DEP'T OF ADMINISTRATION, LEG. AUDIT DIV., REV. OF DIV. OF VETERANS' AFFAIRS, DEP'T OF COMMERCE & ECON. DEV. JUL. 1, 1976 - JUN. 30, 1977 (MAY 15, 1978).

As the department underwent shifting responsibilities and changing structure, at some point the accounting and collection duties of the division began to be taken over by other

⁹ A premium stabilization fund is routinely created for group insurance plans. It is established by an insurer from premium surpluses and is debited as necessary either to pay claims of supplement premiums to keep premium levels static, while still meeting all claims and necessary reserves. Surpluses are ordinarily returned to the policyholder, but in the early stages of a relationship are instead used to create the stabilization fund and later may be used to maintain the fund at desired levels.

groups. In 1980, the veterans' home loan program was repealed.¹⁰ Although no new loans were made after that time, the state continued to service those loans that had previously been made under the program. In 1984, the responsibility for veterans' affairs was shifted to the Department of Military and Veterans' Affairs, created under the Sheffield administration.¹¹ At that point, responsibility for overseeing these loans went to what is now the division of investments within the Department of Commerce and Economic Development.

Over the years, the surpluses grew larger and, in 1978, Aetna suggested to the division that it create an additional, voluntary premium stabilization fund, which the division agreed to do, although there is nothing to indicate precisely why Aetna suggested an additional stabilization fund, rather than outright refund. We presume the motivation to have been retention of the money for investment purposes and as an additional hedge against any unforeseen claims activity. At any rate, surpluses continued to grow even after the home loan program had been discontinued. All but forgotten over time, the two stabilization funds eventually grew to over \$1 million. In 1994, Aetna contacted the division to inform them that it had begun phasing out of the mortgage credit insurance business. Because no new loans were being made, even though the state still had loans on the books, it would have been very difficult to find another insurer to underwrite the mortgage credit life program. Aetna, therefore, offered to continue the policy. As a one-time premium to cover insured borrowers until all loans were paid off or no further liability existed, Aetna agreed to retain the sum of \$407,991 from the premium stabilization funds. The balance was returned to the division on August 29, 1995, by a wire transfer for \$637,555. The question now is the proper disposition of those funds.

DISCUSSION

With respect to the group policy that is the subject of this memorandum, the State of Alaska is designated the policyholder. Group Credit Life Insurance Policy No. GR-72854, signed Aug. 19, 1968, eff. Jul. 1, 1968, copy on file with Dep't of Law, file 663-97-0396. The insureds of the policy are each of the participating debtors under a veteran's home loan funded by the veterans' revolving loan fund. The policy states that it will pay "to the Policyholder" an amount determined under the policy upon notice of the death of an insured. The chief beneficiary of the policy then is the State of Alaska as those monies received would be added back into the revolving loan fund, although the veteran's estate also benefits when the loan is paid off. The policy requires the "Policyholder" to pay the premiums under the policy.

¹⁰ See n. 4, *supra*.

¹¹ Executive Order No. 58, Jan. 9, 1984.

Under the common law, generally, premiums that are earned by the insurer are not refundable once the insurer has incurred the risk. *Humana Health Care Plans v. Snyder-Gilbert*, 596 N.E.2d 299, 300 (Ind. App. 4 Dist. 1992); accord *Euclid Nat'l Bank v. Federal Home Loan Bank Bd.*, 396 F.2d 950, 951 (1968) (in the absence of express agreement or one implied in law, premium not returnable once risk attaches, even if unearned). However, if premiums are returned for whatever reason, "the right of recovery is vested in the person who paid them" *In Re Estate of Inter*, 664 A.2d 142, 145 n. 4 (Pa Super. Ct. 1995) (citing *Fidelity-Philadelphia Trust Co. v. Bankers Life Ins. Co. of Nebraska*, 88 A.2d 710 (1952)).

Here the premiums were returned according to a formula, to the party responsible for payment of the premiums. Additionally, the insurance contract called for the return of "experience credits"—essentially, return of unearned premiums—which could then be applied to future premiums.¹² The insurer performed a set of calculations on an annual basis to determine precisely the amount of the premiums it had earned. These calculations took into account the amount of the premiums received, the cost of administrative fees, claims paid during the period, and amounts required to be set aside as retentions for various reasons, including statutory mandates.¹³

Further, Alaska's insurance code, AS 21.36.255, in pertinent part, provides:

- (a) If an insurance policy is canceled, rejected, or rescinded by the
 - (1) insurer, the insurer shall return or credit any unearned premium paid to the agent or broker of record, or directly to the insured or premium finance company, if applicable; or

Ordinarily the "insured" is the person whose life is the subject of the insurance contract.¹⁴ In this case, however, we conclude that the reference in the statute is to the entity which is the

¹² "As of the end of any policy year the Insurance Company may declare an experience credit in such amount as the Insurance Company shall determine. The amount of each experience credit declared by the Insurance Company shall be refunded to the Policyholder, or, upon request by the Policyholder, a part or all of the experience credit shall be applied against the payment of any premium or premiums under this policy."

Group Credit Life Insurance Policy No. GR-72854, signed Aug. 19, 1968, eff. Jul. 1, 1968, p.11-A, copy on file with Dep't of Law, file 663-97-0396.

¹³ See generally AS 21.18.

¹⁴ "Insured," in the context of life insurance means the person whose life is the subject matter of the insurance policy. "[T]he person who places his name in a blank on a policy form following the words "does insure" or some phrase of similar import." *White v. Alaska Ins. Guar. Ass'n*, 592 P.2d 367, 369 (Alaska 1979).

policyholder or beneficiary of the insurance policy. According to the Alaska Division of Insurance, the industry interprets the Policyholder to be “the insured” in cases of group life insurance, and that, therefore, the state is the proper recipient of the returned premiums under this statute.

You informed us that the division continues to collect premiums on those veterans’ loans that are still open. Aetna promised full coverage under the terms of the policy on payment of the lump sum continuation premium mentioned above. Thus the persons who pay the premiums will receive the benefit of their bargain, even though no payments are being made to Aetna. It does not appear to be improper, therefore, to continue to collect these premiums. Because there is essentially no difference between premiums returned by Aetna and premiums being paid by those still under coverage, these premiums should be treated the same way.

We conclude that the premiums returned by Aetna to the division belong to the State of Alaska as do the premiums which are still being collected. Following the dictate of AS 26.15.040(d), these monies, together with payments still being received, should be “turned over to the commissioner of revenue for deposit in the Alaska World War II veterans’ revolving loan fund.” Since the fund does not make any further loans, there is no need for large balances in the fund. In 1990, the legislature amended AS 26.15.090 by adding subsection (d) providing: “On June 30 of each fiscal year the unexpended and unobligated cash balance of the fund that is attributable to loans owned by the fund lapses to the general fund.”¹⁵

We hope this resolves your questions. If there is anything further you require in this regard, please don't hesitate to contact us.

¹⁵ Sec. 44, ch. 36, SLA 1990.