Comment
LISA—INSURANCE, SAVINGS, OR BOTH?

Under a widely advertised plan, featuring the picture of an attractive girl called LISA, the Bank of America now offers a Life-Insured Savings Account, which purports to combine the virtues of an insurance policy and a savings account at no cost to the depositor. As with her famous namesake, there is some doubt as to what is behind LISA’s lovely smile.

The plan as presented is simple. Anyone in “good health” between the ages of three months and forty-six years may open a life-insured savings account. The depositor sets a savings goal (“maturity value”) limited to a maximum of $1,000 and agrees to make fifty monthly deposits. If he dies within this period, the named beneficiary or the estate receives the full amount of the savings goal, so that, prior to maturity, the bank has insured the depositor in an amount equal to the difference between what he has deposited in the account and the maturity value. If he survives but fails to live up to his agreement, he is charged what the bank refers to as a

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1. LISA should not be confused with Massachusetts savings bank insurance, originated by the late Justice Brandeis. Savings bank insurance cuts the cost of life insurance by selling only over-the-counter in savings banks. See Mason, The Brandeis Way (1938).

2. For example, if the depositor having entered the $1,000 plan should die after one year, his estate would receive $1,000 although he had deposited only $240, and would thus have had insurance in the amount of $760.
“nominal” or “small” amount for the insurance protection. The plan is "subject to" a group policy issued by the Occidental Life Insurance Company of California, premiums on which are paid by the bank. The policy has been approved by the insurance commissioner as group life insurance under the provisions of Section 10203.5(a)(1)(B) of the Insurance Code. But apparently, the bank itself has not sought a “certificate of authority” for LISA. If LISA is insurance business, the failure of the bank to secure a certificate reveals a gap in or an unwise application of our system of insurance regulation.

Is the Bank Engaged in the Business of Insurance?

In determining whether a given plan of risk distribution is insurance for the purposes of regulation, the courts will as a rule ascertain whether it permits abuses, such as failure to maintain adequate reserves or lack of provision for a reasonable distribution of risk. The most recent decision of the California Supreme Court which approached the problem from this viewpoint was California Physicians’ Service v. Garrison. Plaintiff was a non-profit corporation consisting of so-called professional and beneficial members. The former were certified physicians and surgeons compensated by plaintiff, while the latter were the potential patients paying monthly dues. The court held that plaintiff was not subject to insurance regulation, because it was regulated under the Civil Code which specifically authorizes a plan of this type, and because additional regulation would achieve nothing but the maintenance of adequate reserves which were not necessary in this plan.

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8 See pamphlets advertising LISA distributed by the Bank of America.
4 Group Policy No. 1933L, issued August 14, 1950. This policy is not the only connection between the Occidental and the bank. Transamerica Corporation has 100% control of Occidental. Walker’s Manual of Pacific Coast Securities 853 (1950). While Transamerica no longer holds all of the capital stock of the bank, it still owned, as of Jan. 10, 1950, together with its subsidiaries, approximately 11.1 % of the outstanding common stock. Id. at 98.
8 A person shall not transact any class of insurance business in this State without first being admitted for such class. Such admission is secured by procuring a certificate of authority from the commissioner ... “Cal. Ins. Code § 700.
10 It has been pointed out that without a statute specifically authorizing a medical service plan of this type, the regulatory agency would have to find that it was insurance to regulate. Note, 20 Rocky Mt. L. Rev. 407 (1948).

The court also reasoned that the corporation was not in the business of insurance because service rather than assumption of risk was the primary purpose of the plan. But as was pointed out by Chief Justice Gibson in his concurring opinion: “A contract still partakes of the nature of insurance, whether the consideration agreed to be furnished is money, property or services, if the agreement is aleatory and the duty to furnish such consideration is dependent upon chance or the happening of some fortuitous event.” [Emphasis added] Supra note 8, at 811, 172 P. 2d at 18; see Patterson, Essentials of Insurance 43 (1935).
There is no statute authorizing and supervising a plan like LISA, yet both protection of funds and a reasonable plan of risk distribution are needed. Although there is some merit to the argument that as to funds the public is adequately protected because Occidental is a licensed insurer, the fact remains that the depositor has his contract with the bank and not with Occidental. If the Occidental were to become insolvent, the beneficiary or estate would still look to the bank for payment. Moreover, regulation of the Occidental fails to secure a reasonable distribution of risks, which is ordinarily accomplished through medical examinations and the computation of rates imposing on each class of risks a proper contribution. By use of a uniform rate, the bank fails to comply with these standards. These facts seem to lead to the conclusion that through LISA the bank is engaging in the business of insurance, while Occidental acts as a reinsurer.

Is LISA Permissible as Group Life Insurance?

The only ground on which the bank could, and in fact does, claim that its plan is permissible without a certificate of authority, is that it is only part of the Occidental group plan approved under Section 10203.5(a)(1)(B) of the Insurance Code. This provision recognizes life insurance of groups all members of which "are or become purchasers of securities, merchandise or other property under an agreement to pay the balance of the purchase price." It is claimed that a savings account is a "security" which the depositor agrees to purchase in installments on the understanding that breach of that agreement will obligate him to pay "damages" in the stipulated amount of the payable premium.14

The bank's argument is ingenious but untenable. There are no cases interpreting Section 10203.5, but it is clearly intended to meet the need of installment sellers to protect themselves against losses they might sustain by the death of their purchaser-debtors.15 There is no such need in this case. If an installment purchaser dies and thus fails to live up to his agreement the seller may suffer substantial loss by the impossibility or impracticability of recovering the balance of the purchase price. It is against this loss that the law permits the seller to insure at the purchaser's expense. If a depositor with an ordinary savings account were to die, the bank would suffer no loss and no savings bank has ever sought insurance against its

12 Mowbray, op. cit. supra note 7, at 25.
13 See Vance, Insurance § (1930).
14 Letter from Powell E. Smith, Counsel, Occidental Life Insurance Company of California, dated Oct. 17, 1950. The theory under which this policy was issued is "...that a savings account is a security and, in any event, it is a form of property. By the terms of the application, the depositor or purchaser agrees to make a monthly deposit with the Bank of America for a period of fifty months. In other words, he agrees to purchase a savings account with a goal of $1,000, for example, at the rate of $20 a month. If he...breaches this agreement, the bank does not have a cause of action against the purchaser for the balance of the unpaid monthly deposits, but it might be said that the damages are stipulated to be a charge levied against the account by the bank equal to the cost of this insurance carried on the life of the purchaser."
15 This is the interpretation placed upon New York Insurance Law § 204(1)(c), a statute similar to Cal. Ins. Code § 10203.5(a)(1)(B). See Patterson, op. cit. supra note 10, at 159.
depositors' death. A LISA account differs from an ordinary savings account in that a "maturity value" is set, and the bank agrees to pay that "maturity value" to the named beneficiary or the estate of the depositor in the event of his death prior to completing the savings plan. True, this agreement does impose a risk on the bank. But, this risk arises because the bank agrees to pay a death benefit to the insured depositor, rather than because the bank is a creditor of the depositor. The risk is an insurance risk rather than a credit risk; and whatever a savings account may be for other purposes, it is not a "security" within the meaning of Section 10203.5.

LISA must be understood, therefore, as an attempt by a savings bank to engage in the business of selling insurance. It sells insurance to create a risk, reinsures to cover that risk, but claims it is not in the business of insurance because it is only a creditor protecting itself against loss. The approval of this plan has apparently defeated the strict requirements of reserves and reasonable risk distribution otherwise established for the protection of the public.

Perhaps realization of the weakness of LISA's legal position has led to the recent introduction of a bill in the legislature, which would specifically authorize the operation of plans like LISA as group life insurance. The bill paraphrases the LISA plan without apparent regard to the concept or economic basis of group life insurance, or for that matter of any insurance.

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10 Actually, the bank is the depositor's debtor. A far-fetched argument could be made that the bank is considered the depositor's creditor since the depositor has a contingent obligation to pay the penalty in the event he fails to complete the plan. See Cal. Civ. Code §§ 3429-3430. However, there is no risk of non-collection of this debt, and the debt may be set off against the deposit. Furthermore, the insurance could hardly be considered to cover the risk of non-collection of this debt, since by the terms of the policy, this debt does not arise until the insurance ceases.

17 "It is difficult if not impractical to define accurately, for all purposes, the legal relation that exists between a savings bank and its depositors, for while the courts have frequently stated the character of this relation, it has usually been with respect to the particular circumstances presented by the particular case under consideration." 9 C.J.S. 1414. The problem has generally arisen in cases involving a bank's solvency. Two such cases are Blakely v. Brinson, 286 U.S. 254 (1932), which held that a savings deposit was a debt making the depositor a general creditor of the bank; People v. Calif. Safe Dep. & Trust Co., 160 Cal. 374, 117 Pac. 321 (1911), which rejected the contention of the depositors that they had a preferential claim over commercial depositors.

18 A.B. 1676; S.B. 792 (1951). The bill proposes a new Section 10203.8, which reads as follows: "Life insurance conforming to all of the following conditions is another form of group life insurance:

"(a) Covering the lives of every eligible member of a group of persons who become or are named depositors under a savings account plan, established by a financial institution including subsidiary or affiliated persons, which plan provides for periodic deposits of like amounts.

"(b) The period during which such deposits may be made under the plan does not exceed 60 consecutive months, and the total amount of insurance under the policy on any one depositor does not exceed the difference between the amounts deposited and the maximum amount which may be deposited under the plan and does not exceed One Thousand Five Hundred dollars ($1,500.00) on any one life.

"(c) The group numbers 100 new entrants yearly.

"(d) The policy is issued upon application of and made payable to the financial institution as beneficiary, and the premiums are paid by or through the financial institution."

Social Utility of LISA

Little would be gained by this analysis if it succeeded merely in subjecting to criticism a socially valuable institution. Whatever its legal shortcomings, LISA may very usefully induce savings so desirable in these inflationary times. But if this is all the plan achieves then it offers nothing more than ordinary life insurance, which, in contrast to LISA, is secured by adequate reserves and a proper risk distribution plan providing for graduated rates and a reasonable selection of risks.

It is claimed, however, that LISA offers such insurance protection without charge. Careful analysis indicates that LISA, far from offering free insurance protection, is quite expensive.

Assume $X$, at the age of 30, entered upon a $1,000 plan and paid for two years when he died. His beneficiary will receive $1,000, of which $480 plus $1\frac{1}{2}\%$ interest was $X$'s contribution, and $520$ minus interest is the bank's. In other words, $X$ has paid approximately $480$ for $1,000$ worth of protection. If he had taken out a $1,000$ 5-year renewable term policy with one of the large mutual companies his premiums would have been $8.61$ a year, or $17.22$ for the two years. Upon his death $X$'s beneficiaries would have received the same $1,000$. Thus $X$ has sacrificed approximately $462.68$.

But, the bank might argue that $X$ has received more than term insurance, he has been treated as a depositor and could at any time have withdrawn his deposit. This is true, but $X$ could not cut down his savings or take them out without losing his protection. As soon as he stops making deposits or withdraws part of his savings, his protection ceases. If $X$ had a term policy of the type mentioned above, he could afford to cut down his savings, or use them, and still have his protection by paying the relatively small premium.

If $X$ lives until the end of the fifty months and completes the plan, he is said to have had "free" insurance. This is not true. If he completes the plan, the protection element ceases to have meaning. He gets back his savings plus interest at $1\frac{1}{2}\%$ but no longer has the protection. The insurance has not been free; had $X$ died and used the insurance, he would have paid for it by sacrificing his savings. In addition the interest which the bank earned on his money will be more than enough to pay the cost of the insurance and give him his regular savings bank interest.

This figure is an approximation since the $1\frac{1}{2}\%$ interest on the $480$ is not included. Term insurance compares even more favorably, when it is realized that the policy holder will probably receive substantial dividends after the policy has been in force for a short period.

Insurance companies seek to avoid this criticism by providing for loans against policies up to a certain portion of the cash value. However, the criticism is as applicable to ordinary insurance as it is to LISA, since, if the insured were to die before the loan was repaid, the benefits his beneficiary would receive would be reduced by the amount of the loan. Thus, the insured in effect borrows from his beneficiary, yet must still pay a higher than market rate of interest to the insurance company on his own money.

One of the merits of this plan from the bank's point of view is greater assurance of continuing deposits for 50 months. The restriction on withdrawal imposed by LISA should give the depositor a higher rate of interest, since the bank is able to make longer term investments which will return a higher rate.
The penalty $X$ must pay if he withdraws his savings is said to be "nominal" or "small." Assume $X$ opens a LISA account with a savings goal of $1,000, deposits $20 each month for a year, and then decides to take out his money. $X$ has deposited $240, and has had an average of $870 of insurance for the year. In order to withdraw his money he must pay a penalty of $4.66. This is not a "nominal" amount, when it is realized that at the age of 18, for example, $X$ can get a $1,000 5-year renewable term policy, with one of the large mutual companies, for $6.71. For $2 more, $X$ can get an average of approximately $130 more insurance for the year, and at the same time not have his savings tied up.

If $X$ were older than 18 the term insurance would cost him more, and therefore LISA would compare more favorably. But, this only points up another objection to the plan—the rates are the same for all depositors, whether three months or forty-six years of age. Insurance rates are normally based on the life expectancy of the insured—on the risk involved in insuring a particular age group—it is obvious that when the rates are the same for a large span of ages, the rates paid by the younger depositors are much higher than they should be. This is inevitable, since the rates must be computed to cover the greater risk of the older depositors.

Conclusion

When someone attempts to buy two mutually exclusive items in one contract, he must sacrifice one of them. If he dies he loses his savings; if he lives to "maturity" he has lost his protection and has paid for it by tying up his savings at interest rates computed for accounts subject to free withdrawal; and if he attempts to utilize his savings he loses his protection.

Although LISA's smile may be deceiving, perhaps we should not be

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22 Supra note 3.

23 This does not appear as bad as it actually is. The amount paid for LISA is paid after the insurance protection has ceased, and is in reality more like a penalty for not completing the plan, than like an insurance premium. The purpose of this analysis is merely to show that had the "nominal" amount originally been put into term insurance, the insured could have received almost as much protection. The actual cost of LISA insurance is shown supra note 19.

24 By the same token, if $X$ were younger than 18 the term insurance would cost him less, and LISA would compare less favorably.

25 GILBERT, LIFE INSURANCE: A LEGALIZED RACKET 42 et seq. (1936).

26 The fact that LISA purports to be group insurance has no effect on the reasonableness of the rating scheme, since the theory of group insurance is a fairly uniform class of risks, which does not exist when such a large span of ages is included.

27 GILBERT, op. cit. supra note 25, at 125. "For unless you accomplish the contradiction of both dying and living at the same time, you must lose one of the items you pay for: if you die, you lose your savings; if you survive, you lose your protection." (Italics deleted.) This is true of whole-life, 20-pay life, and endowment policies, as well as LISA.

28 Under LISA, the penalty takes the form of a charge made for not completing the plan. With ordinary insurance, the penalty is in the form of interest payments, if the insured borrows on the policy, or a sacrifice of a part of the premiums he has paid if he cashes it in.