Volume 15 | Number 4 Article 18

6-1-1937

Usury -- Insurance -- Life Insurance as Condition Precedent to Loan

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the manufacturer. But rather than bearing down on the retailer, it is submitted that a more equitable result would be reached by application of the doctrine of *res ipsa loquitur* against the manufacturer.

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Usury—Insurance—Life Insurance as Condition Precedent to Loan.

A North Carolina statute, enacted in 1915, provides that an insurance company, as a condition precedent to lending money, and in addition to other collateral, may require the borrower to take out an insurance policy with the company on his own life, or that of another, and deposit such policy as collateral with the company.[1] A recent North Carolina case held that the statute was not unconstitutional as being violative of §7 Article I of the Constitution of North Carolina, which provides, "No man or set of men are entitled to exclusive or separate emoluments or privileges from the community but in consideration of public services."[2]

The court admits that the statute is unconstitutional if its effect "is to exempt insurance companies from the provision of" the usury statutes. The holding that the statute does not so exempt insurance companies reverses decisions made prior to the enactment of the statute that it was usurious to require a borrower to insure with the company as a condition precedent to making the loan.[3] The federal courts hold that such a transaction is usurious.[4]

It is uniformly stated by the courts that if an insurance company, with the purpose of evading the usury statutes, requires a borrower to take a policy with the lender company, merely as a device to conceal its usurious nature, the transaction is nevertheless usurious.[5] It is difficult to understand how the courts determine that a guilty intent is lacking in most cases where the point under discussion is involved. Why should an insurance company require a policy as a condition precedent, if it does not seek a profit in addition to the maximum rate of interest allowed by law? It is well known that insurance companies do not

[1] N. C. CODE ANN. (Michie, 1935) §6291.

[2] Cowan v. Security Life and Trust Co., 211 N. C. 18, 188 S. E. 812 (1936).

[3] Roberts v. Life Ins. Co. of Virginia, 118 N. C. 429, 24 S. E. 780 (1896); Miller v. Life Ins. Co. of Virginia, 118 N. C. 612, 24 S. E. 484 (1896); Carter v. Life Ins. Co. of Virginia, 122 N. C. 338, 30 S. E. 341 (1898).

[4] Moore v. Union Mutual Life Ins. Co., Fed. Cas. No. 9, 777 (C. C. D. Neb. 1876); Missouri Valley Life Ins. Co. v. Kittle, 2 Fed. 113 (C. C. D. Neb. 1880); National Life Ins. Co. v. Harvey, 7 Fed. 805 (C. C. D. Iowa, 1881); Brower v. Life Ins. Co. of Virginia, 86 Fed. 748 (C. C. W. D. N. C. 1898); see Brown v. Fletcher, 244 Fed. 854 (D. C. S. D. N. Y. 1917), *aff'd*, 253 Fed. 15 (C. C. A. 2nd, 1918).

[5] John Hancock Mutual Life Ins. Co. v. Nichols, 55 How. Prac. 393 (N. Y. 1878.)

lend a greater amount on a policy than the cash surrender value of that policy. Usually an insurance policy has no cash surrender value until it has been in effect for some three years. Hence, to say that a policy bought at the time that the loan was made is required as *collateral* is to put an argument that will not hold water. Of course, in the event of the insured's death during the term of the loan, the debt would be paid out of the insurance, but the insurance company requires ample security in addition to the policy. Six states hold that in the absence of proof of actual intent to evade the statute the transaction is not usurious.[6] These decisions are generally based on the argument that the insurance company gives protection in exchange for the premiums, and therefore the borrower-insured gets value for value. Where the borrower is allowed to deposit a policy taken out with another company, it is clearly not usurious, because the lender has no interest in the premiums which are paid to keep the policy in force.[7]

Only one other statute similar to the North Carolina statute has been found.[8] Its constitutionality has not yet been passed upon. A somewhat analagous situation exists where states have, to varying extents, exempted building and loan associations from usury laws, by permitting them to take premiums, fines, etc., in addition to the maximum legal rates of interest.[9] The borrowers are generally required to

[6] Craig v. McMullin, 39 Ky. 311 (1840) (A free negro, desiring to free his son, borrowed money to purchase the boy, agreeing to pay ten per cent interest, and an additional ten per cent per year for the risk the lender would bear of the boy's dying before he was paid for by his father. The stipulation for ten per cent for insurance was held not to be usurious.); Washington Life Ins. Co. v. Paterson Silk Manufacturing Co., 25 N. J. Eq. 160 (1874); Homeopathic Mutual Life Ins. Co. v. Crane, 25 N. J. Eq. 418 (1874); Stitch v. Samek, 19 Misc. 534 43 N. Y. Supp. 1068 (1897) (A pawnbroker made an extra charge in addition to the maximum legal rate of interest, for insuring the property against dust and moths. *Held,* not usurious.); New York Fire Ins. Co. v. Donaldson, 3 Edw. Ch. 199 (N. Y. 1838); John Hancock Mutual Life Ins. Co. v. Nichols, 55 How. Prac. 393 (N. Y. 1878); Union Central Life Ins. Co. v. Hilliard, 63 Ohio St. 478, 59 N. E. 230, 53 L. R. A. 462 (1900) (borrower was required to insure the life of his grandson); Heaberlin v. Jefferson Standard Life Ins. Co., 114 W. Va. 198, 171 S. E. 419 (1933); see Niles v. Kavanagh, 179 Cal. 98, 175 Pac. 462 (1918).

[7] See Sledd v. Pilot Life Ins. Co., 52 Ga. App. 359, 183 S. E. 199 (1935). In this case the court points out that the borrower would have been permitted to take out insurance with "any reputable company," but the policy was actually taken out with the lender.

[8] KY. STAT. ANN. (Baldwin, 1936) §2219a.

[9] ALA. CODE ANN. (Michie, 1928) §7107, "The premium to be charged upon any loan must be fixed by the by-laws, but such premium and the interest on the loan taken together shall not exceed one per cent per month on the amount actually lent or advanced." The maximum legal rate of interest in Alabama is eight per cent. ALA. CODE ANN. (Michie, 1928) §8563; ARIZ. REV. CODE ANN. (Struckmeyer, 1928) §619; COLO. ANN. STAT. (Michie, 1935) Vol. 2c.5 §14(17); CONN. GEN. STAT. (1930) §4017(3); DEL. REV. CODE (1935) §2339; DIST. OF COL. CODE (1930) §46; FLA. COMP. GEN. LAWS ANN. (1927) §6165; GA. CODE ANN. (Harrison, 1933) §16-210; KY. STAT. (Baldwin, 1936) §865a (impliedly grants permission to charge premium in addition to the legal rate of interest); MD. CODE

be members of the association, and are not allowed to borrow more than a certain percentage of the amount represented by their stock. These statutes are generally held constitutional.[10] It seems that this practice, but for the statutes, clearly would be usurious. But since the rule against usury is purely of statutory origin, it follows that the definition of usury can be changed by the legislatures.

Granting the constitutionality of the North Carolina statute, there remains the question of its advisability. A possible argument in favor of the North Carolina statute, from the standpoint of public policy, is that the statute enables insurance companies to increase their business, and to become increasingly prosperous financially. It is desirable that through the medium of insurance, risks of various sorts be spread out over the general public. Hence, broadly stated, where the insurance company benefits, the public benefits through better and cheaper insurance protection. The validity of this argument is open to question.[11]

On the other hand is found the policy back of usury statutes. It is desirable to protect the person in straitened circumstances, with poor bargaining power, as against the lender who, of course, generally has the superior bargaining power. One can only speculate as to the purpose of the North Carolina statute. It probably was passed exclusively for the benefit of the insurance companies. Little benefit results to the borrower when he is forced to buy insurance which he may not need, can not afford, and would not buy if he were not pressed for money. Still less benefit accrues to the borrower where he is required to insure the life of a third person, with the insurance company as beneficiary,

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ANN. (Bagby, 1924) art. 23 §164; MINN. STAT. ANN. (Mason, 1927) §7754; MISS. CODE ANN. (1930) §3986 (Permits building and loan associations to charge ten per cent on loans to members. Otherwise the legal rate is lower.); NEB. COMP. STAT. (1929) §8-315; N. Y. CON. LAWS (Cahill, 1930) Ch. 3 §378(3); ORE. CODE ANN. (1930) §25-308; TENN. CODE ANN. (Williams, 1934) §3900, "The premiums bid by borrowing stockholders for the preference or priority of a loan shall be paid before the loan is consummated, not as a part of the loan, not as interest, but as a means of determining which one of the shareholders shall receive the loan."

[10] Linton v. Fulton Building and Loan Ass'n, 262 Ky. 198, 90 S. W. (2d) 22 (1936); Livingston Loan and Building Ass'n v. Drummond, 49 Neb. 200, 68 N. W. 375 (1896). In view of the constitutional provision quoted in the text, what would North Carolina hold as to the constitutionality of a statute specifically exempting building and loan associations from the usury statute? North Carolina appears to have no such statutory exemption.

[11] Another argument advanced in favor of the statute is that where a fraternity or other similar organization borrows money from an insurance company, an easy method of collecting the debt is established in the following way. Several members of the fraternity are persuaded to buy participating policies of life insurance, and the lender company is named beneficiary to the extent of each member's proportionate share of the indebtedness. The policyholders pay regular premiums and each dividend paid by the company is applied to the indebtedness until it is paid off. But this method is apt to be an expensive way of collecting, in so far as the members of the fraternity are concerned. Also, unless the policies are allowed to be taken out with a company other than the lender, the transaction is usurious in spirit and should not, therefore, be allowed.

which requirement the North Carolina statute would permit an insurance company to make. Often the borrower, as the insurance company well knows, does not intend to continue paying the premiums after repayment of the loan. In other words, he buys insurance, not for his own protection, but simply because he is forced to do so. Therefore, by strict analysis, the insurance company gets, in addition to the legal rate of interest, extra business, a bonus as it were, that the company would not ordinarily get. Such transactions should therefore be discouraged as violating the purpose, if not the letter, of the usury statutes.

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