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Texas Department of Banking

OPINION COMMITTEE

Randall S. James
Banking Commissioner

FILE # ML-42152-01

I.D. # 42152

September 13, 2001

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OFFICE OF THE ATTORNEY GENERAL
EXECUTIVE ADMINISTRATION

OPINION COMMITTEE

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John Cornyn, Attorney General of Texas
Office of the Attorney General
PO Box 12548
Austin, TX 78711-2548

RQ-0434-JC

RE: Potential Application of Finance Code Section 154.155(d) to Insurance-Funded,
Prepaid Funeral Benefits Contracts

Dear General Cornyn:

Recent legislation enhanced the refund available to a consumer upon cancellation of a prepaid funeral benefits contract by amending Finance Code Section 154.155(d). The amendment plainly applies to a trust-funded prepaid funeral benefits contract. I request your opinion regarding whether the enhanced refund provision also applies to an insurance-funded prepaid funeral benefits contract.

Texas Finance Code Section 154.155 is entitled "Cancellation of Contract" and describes the procedures for cancellation and the amount of a refund. Effective September 1, 2001, Section 154.155 (d) provides as follows:

(d) The purchaser is entitled to receive [only] the actual amount paid by the purchaser and half of all earnings attributable to that money, less the amount permitted to be retained as provided by Section 154.252, except as provided by Subsection (e) and by Sections 154.205 and 154.254.

Subsection (d) was amended as marked by Act of May 24, 2001, 77th Leg., S.B. 314, §7. According to S.B. 314, §21(a), amended Sec. 154.155(d) does not apply to cancellation of a contract that was executed and binding on all parties before September 1, 2001.

As the following paragraphs demonstrate, the statutory structure and the history preceding codification indicate that Section 154.155 applies to *all* prepaid funeral benefits contracts, both insurance-funded and trust-funded. The legislative history of and terminology used in the 2001 amendment to Section 154.155(d) suggest that the legislature addressed only trust-funded contracts, thus creating an interpretive difficulty.

Legislative history prior to 2001

Prior to codification in 1997, prepaid funeral benefits were regulated under V.A.C.S. Art. 548b. Article 548b, §1A(e) provided that the refund due a consumer upon cancellation of an insurance-funded contract “shall be handled as provided by Section 5(b) of this Act.”

Article 548b, §5(b)(1) explicitly addressed cancellation of a trust-funded prepaid funeral benefits contract. Upon cancellation, the purchaser could “receive only the actual amounts paid in by him less the amounts permitted to be retained as provided in Subsection (a)(1).” (Subsection (a)(1) permitted a seller of trust-funded contracts to retain up to 10% for sales expenses.) Article 548b, §5(b)(1) was codified in 1997 as part of Section 154.155 and located in Finance Code, Chapter 154, Subchapter D (subchapter entitled “General Provisions for Sales Contracts”),¹ a subchapter intended to apply to both trust-funded and insurance-funded contracts.

Article 548b, §5(b)(2) specifically distinguished a trust-funded contract from an insurance-funded contract with respect to the refund due for cancellation in the first year of the contract. Article 548b, §5(b)(2) was split into its insurance-funded and trust-funded components and codified in 1997 as Sections 154.205² and 154.254,³ respectively. Section 154.205 was located in Subchapter E (subchapter entitled “Insurance-Funded Prepaid Funeral Benefits”). Section 154.254 was located in Subchapter F (subchapter entitled “Trust-Funded Prepaid Funeral Benefits”).

Article 548b, §5(b)(3) permitted the purchaser to obtain “all funds paid to the seller and all earnings attributable to the funds” if a prepaid funeral benefits contract was canceled upon solicitation by the seller. Article 548b, §5(b)(3) was codified in 1997 as part of Section 154.155.⁴

An interpretive difficulty is immediately apparent. Article 548b, §5(b) did not explicitly address a purchaser’s refund upon cancellation of an insurance-funded contract after the first year, yet 548b, §1A(e) stated that Section 5(b) governs such refund. The “retained” amount for selling expenses mentioned in Subsection (b)(1) can only refer to a trust-funded contract. The use of the term “earnings” in Subsection (b)(3) could similarly be construed as limiting the provision to trust-funded contracts because the term is defined in Article 548b, §1(b)(4),⁵ to only apply to a trust-funded contract. The Department’s position is that the legislature intended as a matter of public policy that insurance-funded contracts should provide generally equivalent benefits to trust-funded contracts, based in part on implications of other statutory provisions. See Article 548(b), §1A(a) and (d).⁶

¹ Act of May 24, 1997, 75th Leg., ch. 1008, §1, 1997 Tex. Gen. Laws 3091, 3392.

² *Id.* at 3394.

³ *Id.* at 3395.

⁴ See *infra* note 1; see also Revisor’s Report, Finance Code, vol.2 (Texas Legislative Council 1997).

⁵ Now Finance Code Section 154.002(4).

⁶ Now Finance Code Sections 154.201(3) and 154.204(a).

However, this interpretive difficulty has previously been largely theoretical because the refund on a trust-funded contract was highly punitive, effectively limited to 90% of the original purchase price, regardless of how long the funds had been in trust. An insurance policy or annuity could easily be structured to provide equivalent or greater benefits upon cancellation. The interpretive difficulty is no longer theoretical in light of the amendment to Section 154.155(d).

Legislative history of and terminology used in the 2001 amendment

Sunset Recommendations

The Texas Department of Banking underwent review by the Sunset Advisory Commission in the last biennium, and S.B. 314 was the Sunset bill renewing the Department. The proposed amendment to Section 154.155(d) was addressed as part of Issue 8 in the Sunset Staff Report, Texas Funeral Service Commission (November 2000), pages 63-70, and the Sunset Commission Decisions, Texas Funeral Service Commission (January 2001), pages 21-23.⁷ As part of the discussion, the Sunset Staff Report distinguishes between insurance-funded and trust-funded prepaid funeral benefits contracts but focuses on the perceived unfairness to a consumer of the benefits upon cancellation of a trust-funded contract. The general character and operation of an insurance-funded contract is delegated to a sidebar. Sunset Recommendation 8.2 is to “[a]llow consumers to receive the full fair value of their investment upon cancellation of a prepaid funeral contract.” The Sunset Commission Decisions adopted Recommendation 8.2 with Modification 3, to “[p]rovide for a 50/50 split between the consumer and the contract seller of the interest earned on the investment.”

The Sunset Staff Report, in explanatory comments following Recommendation 8.2, stated that:

This recommendation would allow consumers to cancel their prepaid funeral contract and receive their original principal and the accrued interest. As part of this recommendation, the contract seller would still be permitted to retain 10 percent of the consumer’s original principal as recompense for services rendered.⁸

An insurance-funded contract is comprised of two contracts: the prepaid funeral benefits contract and the insurance contract, either a life insurance policy or an annuity. The insurance policy or annuity is regulated by the Texas Department of Insurance as to both form and content and cannot be revised without prior regulatory permission. The phrase “original principal and the accrued interest” or “interest earned on the investment” would apply awkwardly to an

⁷ In a subject matter consolidation, the Sunset Advisory Commission’s review of prepaid funeral benefits and perpetual care cemeteries regulation by the Texas Department of Banking was combined with its review of the Texas Funeral Services Commission and its regulatory programs.

⁸ Sunset Staff Report, Texas Funeral Service Commission (November 2000), page 68 (Recommendation 8.2).

insurance-funded contract. The Sunset Advisory Commission did not recommend an amendment to the Texas Insurance Code.

Legislative language and history

The enacted, amendatory language of Section 154.155(d) explicitly uses the term "earnings," a term defined in Finance Code Section 154.002(4) in such a way as to clearly invoke only a trust-funded contract.

The Senate Committee on Business and Commerce described the Section 154.155(d) amendment as entitling the purchaser "to receive the actual amount paid by the purchaser and half of all earnings attributable to that money, less the amount permitted to be retained as provided by Section 154.252...."⁹

The House Committee on Financial Institutions described the Section 154.155(d) amendment as entitling the purchaser "to receive the actual amount paid by the purchaser and half of the earnings attributable to that money."¹⁰

Conclusion

The structure of Chapter 154 and the history of Section 154.155 indicate that the provision is applicable to both trust-funded and insurance-funded contracts, and an amendment to that section should presumably also apply to both trust-funded and insurance-funded contracts. Yet credible indications exist that the proposed amendment was intended to affect only trust-funded contracts.

I would appreciate the advice and guidance of the Attorney General regarding this troublesome ambiguity. If you find that the refund provisions of Section 154.155(d) apply to insurance-funded contracts, I also need assistance in the manner in which the provision is implemented.

Immediate implementation would be impossible because new policy forms to be used with the sale of prepaid funeral benefits contracts must be designed, submitted to, and approved by the Texas Department of Insurance. Your further opinion, regarding whether insurance-funded contracts may be sold in Texas prior to the time the Department of Insurance approves a new form, would be valuable.

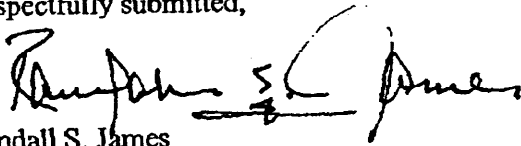
⁹ SENATE COMM. ON BUSINESS & COMMERCE, BILL ANALYSIS, Tex. C.S.S.B. 314, 77th Leg. (Mar. 22, 2001).

¹⁰ HOUSE COMM. ON FINANCIAL INSTITUTIONS, BILL ANALYSIS, Tex. C.S.S.B. 314, 77th Leg. (May 7, 2001).

John Cornyn, Attorney General of Texas
September 13, 2001
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Thank you for your attention to this matter.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Randall S. James". The signature is fluid and cursive, with a large initial "R" and "J".

Randall S. James
Banking Commissioner of Texas

Cc: Commissioner José Montemayor
Texas Department of Insurance

Joey Longley, Director
Sunset Advisory Commission

Senator David Sibley
Texas Senate

Representative Kip Averitt
Texas House of Representatives

Representative Brian McCall
Texas House of Representatives

Attached list of all permit holders for insurance-funded,
prepaid funeral benefits contracts