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Insurance -- Employee Welfare Plans

George N. Tompkins

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Insurance

EMPLOYEE WELFARE PLANS

Introduction

The increasing number of employee welfare plans, many of which are appearing in collective bargaining agreements, is causing considerable concern among insurance companies and the state officials charged with the duty of supervising insurance. This concern arises out of the fact that these welfare plans are not subjected in any substantial degree to government regulation, notwithstanding the plans are in all material respects similar to the group insurance plans which are available to employers and employees through licensed insurance companies.

The typical employee welfare plan is arrived at through negotiations between an employer and the representatives of his employees, and is generally incorporated in the collective bargaining agreement as a part of it. Thus, from the outset it must be kept in mind that these plans and their incidents are contractual in nature. The usual benefits provided under the plan for an employee and his family consist of death, hospital and surgical benefits. Some plans include in addition cash disability benefits and other medical benefits.¹

In respect of these plans the employer either agrees to provide certain benefits or to contribute to a jointly trusteeed fund on the basis of some agreed-upon formula, such as, a percentage of the total payroll, a fixed amount per employee, or a certain amount for each hour worked. Employee money contributions when required by the agreement are made by means of payroll deductions and union dues and assessments.

When the employer agrees to provide certain benefits this may be done either by purchasing insurance from a licensed insurance company or by making payments directly to the employees. When a jointly trusteeed fund is created for the purpose of providing the agreed benefits, the trustees may likewise provide benefits by purchasing insurance or by paying the benefits directly to the employees. It is only with the type of plan under which either

¹ Some of these plans also contain a provision for "pensions." As to this provision, no extended discussion appears to be necessary. Putting to one side the traditional voluntary pension paid by an employer to a retired employee and considering only the modern contractual plan calling for periodic payments conditioned upon the continuation of life, it seems clear that such a plan constitutes the writing of annuities.

the employer or the trustees pay benefits directly to the employees that this discussion is concerned. Such a plan is commonly referred to as "self-insurance."

Statutes regulating the business of insurance have been enacted in all of the forty-eight states and the District of Columbia.² The question whether the plans under discussion involve insurance within the meaning of these statutes has never been squarely presented to the courts. The purpose of this discussion is to attempt to propose an answer by examining the statutory definitions of "insurance," "insurance contract" and "insurance business," and also the judicial definitions of these terms. It goes without saying that if the plans under discussion are insurance, then the statutory regulations governing the insurance business are applicable.

Statutory Material

The statutes regulating insurance are generally very detailed in their provisions. However, the legislatures of a number of states have altogether neglected to define just what is meant by "insurance," "insurance contract" or "insurance business" within their statutes.³ The statutes of 25 states define the meaning of "insurance" or an "insurance contract" within the provisions of their insurance codes.⁴ Basically each one of these provisions

² See VANCE, *INSURANCE* 36-51 (3d ed. 1951).

³ ARK. STAT. ANN. § 66-101 (1947); CONN. GEN. STAT. § 6024 (1949); DEL. CODE ANN. tit. 18, § 101 (1953); D. C. CODE ANN. § 35-101 (1951); FLA. STAT. ANN. § 625.01 (1944); GA. CODE ANN. § 56-101 (1953); ILL. ANN. STAT. c. 73, § 614 (Smith-Hurd 1940); IOWA CODE ANN. § 505.1 (1949); KAN. GEN. STAT. ANN. § 40-101 (1949); MICH. STAT. ANN. § 24.1 (1943); MO. ANN. STAT. § 374.010 (1952); N. H. STAT. ANN. § 400.1 (1955); N.J. STAT. ANN. § 17:17-1 (Supp. 1954); N.M. STAT. ANN. § 58-1-1 (1953); OHIO REV. CODE ANN. § 3901.01 (Page 1954); PA. STAT. ANN. tit. 40, § 1 (1954); R. I. GEN. LAWS c. 156, § 1 (1938); TEX. INS. CODE ANN. art. 1.01 (1952); VT. REV. STAT. § 9023 (1947); W. VA. CODE ANN. § 3274 (1955); WIS. STAT. § 200.01 (1953); WYO. COMP. STAT. ANN. § 52-101 (1945). The statutes of Maryland and Virginia provide definitions of "insurance business," or "business of insurance," but the definitions are defective because they are cast in terms of any company issuing an "insurance contract" and this term is not defined in the statute. MD. ANN. CODE art. 48A § 1 (1951); VA. CODE § 38.1-1 (10) (1930).

⁴ ALA. CODE tit. 28, § 2 (1940); ARIZ. CODE ANN. § 61-1302 (Supp. 1954); CAL. INS. CODE ANN. § 22 (Deering 1950); COLO. REV. STAT. ANN. § 72-1-1 (1953); IDAHO CODE ANN. § 41-201(1) (Supp. 1955); IND. ANN. STAT. § 39-3203(a) (Burns 1952); KY. REV. STAT. ANN. § 304.002 (Supp. 1953); LA. REV. STAT. ANN. § 22:5(1) (1950); ME. REV. STAT. c. 60, § 1 (1954); MASS. ANN. LAWS c.175, § 2 (1948); MINN. STAT. ANN. § 60.02(3) (1945); MISS. CODE ANN. § 5633 (1942); MONT. REV. CODES ANN. § 40-101 (1947); NEB. REV. STAT. §

requires the presence of the same elements in a contract before it will be regarded as a contract of insurance, namely, an agreement, whereby one party agrees, for a valid consideration, to indemnify the other party against certain specified losses, occasioned by some fortuitous event. Perhaps the most comprehensive and extensive statutory definition of an insurance contract is that given in the New York Insurance Law, where it is provided that the term "insurance contract" shall:

. . . be deemed to include any agreement or other transaction whereby one party, herein called the insurer, is obligated to confer benefit of pecuniary value upon another party, herein called the insured or the beneficiary, dependent upon the happening of a fortuitous event in which the insured or beneficiary has, or is expected to have at the time of such happening, a material interest which will be adversely affected by the happening of such event.⁵

Applying this definition⁶ to the type of plan under consideration, the conclusion is inescapable that the plan is insurance or an insurance contract. The plan contains all the elements considered essential to the existence of an insurance contract. There is an agreement as to the terms of the plan which may be included as one part of the over-all collective bargaining agreement or may exist apart from it. This agreement contains an undertaking to indemnify the employees against certain losses occasioned by specified fortuitous events. This promise of indemnification is supported by a valid consideration. Even where the plan provides that the employer shall bear the entire cost of the plan a valid consideration on the part of the employees can be found in the services rendered. Lastly, the events which give an employee a right to receive the benefits from the fund are fortuitous, *i.e.*, substantially beyond the control of either party. The events which are usually regarded as fortuitous are death, accidents, illness and other similar unforeseen occurrences. That an employee has a material interest which is adversely affected by the happening of some such event is self-evident—his continued health or that of his family. Thus it cannot be denied that

⁴ *continued*

44-102 (Reissue 1952); NEV. COMP. LAWS § 3656.10(1) (Supp. 1941); N.Y. INS. LAW § 41(1); N.C. GEN. STAT. § 58-3 (1950); N.D. REV. CODE § 26-0201 (1943); OKLA. STAT. ANN. tit. 36, § 2 (1953); ORE. REV. STAT. § 736.005(1) (1953); S.C. CODE § 37-3 (1952); S.D. CODE § 31-0101(1) (1939); TENN. CODE ANN. § 56-1101 (1955); UTAH CODE ANN. § 31-1-7 (1953); WASH. REV. CODE § 48.01.040 (1951).

⁵ N.Y. INS. LAW § 41(1).

⁶ The New York definition is representative of similar statutory definitions.

an employee welfare plan such as that being considered here meets every requirement of the statutory definitions of "insurance" or "insurance contract." Are not these plans then subject to the same statutory regulation and control as licensed insurance companies?

Some state legislatures have seen fit to provide in their insurance statutes a provision defining the meaning of "transaction" of insurance, or "doing an insurance business" within the insurance codes.⁷ The provision in the California code⁸ is as follows:

"Transact" as applied to insurance includes any of the following:

- (a) Solicitation.
- (b) Negotiations preliminary to execution.
- (c) Execution of a contract of insurance.
- (d) Transaction of matters subsequent to execution of the contract and arising out of it.

These are the four basic requirements of all the provisions of this nature.⁹ It is important to note that any of these four activities constitutes the transaction of insurance. Referring back to the welfare plans mentioned earlier,¹⁰ it is apparent that the establishment of one of these plans is the direct result of negotiations between the employer and the union. That the executed plan is an insurance contract has already been shown.¹¹ So long as the welfare plan remains in existence there will always be some matters "arising out of it," such as, payment by the employees of their contributions where called for, payment of contributions by the employer, and payment of benefits. Thus the plan contains not only one but most of the basic requirements of an insurance transaction within the statutory meanings of that term. How then can it be denied that this type of employee welfare plan is transacting insurance and carrying on an insurance business?

On the basis of the discussion to this point, certain conclusions can be drawn. The type of employee welfare plans being considered here are established by contractual arrangement and

⁷ ARIZ. CODE ANN. § 61-1305 (Supp. 1954); CAL. INS. CODE ANN. § 35 (Deering 1950); MD. ANN. CODE art. 48A, § 1 (1951); NEV. COMP. LAWS §§ 3656.02 (j), 3656.10 (3) (Supp. 1941); N.Y. INS. LAW § 41 (3); UTAH CODE ANN. § 31-1-11 (1953); VA. CODE ANN. § 38.1-1(10) (1950); WASH. REV. CODE § 48.01.060 (1951).

⁸ CAL. INS. CODE ANN. § 35 (Deering 1950).

⁹ See note 7 *supra*.

¹⁰ See text at page 276 *supra*.

¹¹ See text at page 278 *supra*.

this contract is an "insurance contract" within the statutory definitions of that term. These plans in agreeing to provide, and providing, certain benefits to employees, for a valid consideration, and upon the happening of fortuitous events, are transacting insurance and carrying on an insurance business. These plans therefore are subject to the statutes regulating insurance in the absence of a specific exemption.¹²

¹² The correctness of this position is borne out by the fact that in Massachusetts there has been enacted a law (Chap. 636, Laws 1955) which, while it only exempts from the operation of the insurance law welfare trust funds jointly administered under the provisions of the Taft-Hartley Act, nevertheless presupposes that the use of such funds for the furnishing of benefits in the same way as the plans under consideration without the statutory exemption would be a violation of the insurance law of Massachusetts. The form of this statutory exemption, referring as it does merely to the trusts themselves, in terms of its reach and its real effect is rather ambiguous.

Likewise, legislation was introduced both in Ohio and New York (Ohio H. B. 506; N.Y. S. Int. 1924, Assem. Int. 1983 (1949), N.Y. S. Int. 308, Assem. Int. 280 (1950), N.Y. S. Int. 350 (1951)), seeking a similar result but not confined to Taft-Hartley trusts. These pieces of legislation, whose introduction obviously carried the same implications as the exemption provision enacted in Massachusetts, failed of enactment.

Similarly an action was brought recently (*Greene v. Holz*, unofficially reported in N.Y.L.J., Dec. 5, 1955) in the New York Supreme Court in New York County, by the trustees of a Taft-Hartley jointly administered trust fund, for the benefit of members of the National Maritime Union and their families, against the Superintendent of Insurance of New York for a declaratory judgment that the Superintendent should issue a ruling to the effect that, if the trustees ceased to furnish the benefits through a licensed carrier and did it on a self-operated basis, a violation of the New York Insurance Law would not be involved. The complaint in that action indicated that its genesis lay in the fact that counsel for the union had serious doubts as to whether the trustees could proceed in this manner without violating the Insurance Law. In fact, the complaint reveals that in their communication of September 6, 1955 to the Superintendent, co-counsel for the trustees said:

"At a meeting of the Board of Trustees of the NMU Pension and Welfare Plan, held on August 31, 1955, it was unanimously decided that the best interests of the beneficiaries of the fund would be served by changing by January 1, 1956 from an insured to a self-administered program, covering the welfare benefits of the Plan. *Recognizing that some legal questions may preclude this action, co-counsel were directed to take all measures necessary to resolve any doubts on this score.*" (Emphasis added). Plaintiff's complaint, p. 5, *Greene v. Holz*, *supra*.

In that action the trustees also urged the view that in any event Congress, in enacting the amendment of section 186 of the Labor-Management Relations Act in 1947 to permit jointly administered employee welfare trust funds, had pre-empted the field. The action of the trustees (opinion of Mr. Justice Eder, Supreme Court, New York County, appearing in the New York Law Journal of December 5, 1955) was dismissed as premature, as seeking an advisory opinion, and on the ground that the court, in any event, should decline to take jurisdiction.

Let us now proceed to examine the decisions of the courts to determine what the courts understand by an "insurance contract" and the "doing of an insurance business," especially in those states where the legislatures have left it to the courts to define these terms.

Case Material

As indicated earlier, no court has decided whether the type of plan being considered here is insurance.¹³ Of necessity, therefore, the following examination of court decisions will be to determine what the courts regard as insurance, and what activity they consider to be the doing of an insurance business. It is fundamental that, in construing an agreement to determine whether it is an insurance contract, the determination will be made from the agreement considered as a whole and from the ". . . conduct of the parties as a practical interpretation of the contract."¹⁴

Various definitions of an "insurance contract" and "insurance" have been enunciated by the courts but, like their statutory counterparts, they are basically the same. "Insurance" has been defined as a contract of indemnity against contingent loss,¹⁵ an agreement to indemnify against loss¹⁶ and a contract where for a stipulated consideration one party undertakes to compensate the other against loss by certain contingencies or perils.¹⁷ New Jersey has adopted the definition of insurance contained in the Mas-

¹³ A lower court in New York has decided that union welfare funds in the hands of joint trustees, to be administered solely by them in accordance with a collective bargaining agreement, are the funds of the trustees and the records of these funds are the trustees' records. Hence the New York State Superintendent of Insurance was authorized to examine these records for the purpose of determining whether an insurance business was being conducted by the trustees. The union officials contended that since unions are exempt from the insurance laws of New York, N. Y. Ins. Law § 466, the records of the welfare funds could not be reached by the Superintendent. However, the court held that the funds and the records were separate and independent from the union, and the exemption provided in the insurance law for the union did not extend to these records. *Application of Townsend*, 206 Misc. 619, 130 N.Y.S.2d 327 (Sup. Ct. 1954).

¹⁴ *National Colored Aid Soc'y v. State ex rel. Wilson*, 208 Ind. 380, 196 N.E. 240, 246 (1935) (dictum).

¹⁵ *Brock v. Hardie*, 114 Fla. 670, 154 So. 690, 697 (1934) (dictum); *Nash v. New York Life Ins. Co.*, 272 Mich. 680, 262 N.W. 441, 442 (1935) (dictum).

¹⁶ *Wolfe v. Breman*, 69 Ga. App. 813, 26 S.E.2d 633, 637 (1943) (dictum); *State ex rel. Inter-Ins. Auxiliary Co. v. Revelle*, 257 Mo. 529, 165 S.W. 1084, 1086 (1914) (dictum).

sachusetts statute.¹⁸ That statute¹⁹ provides that an insurance contract is an agreement whereby one party, for a consideration, agrees ". . . to pay money or its equivalent, or to do an act valuable to the insured, upon the destruction, loss or injury of something in which the other party has an interest." The Massachusetts court had earlier stated that this definition is essentially the same as the old common law definition.²⁰

There are no basic differences between what the courts and the legislatures regard as insurance. Hence the reasoning which was applied in attempting to show that the employee welfare plans under discussion are insurance within the statutory definitions of that term, (see the Massachusetts definition *supra*) applies equally as well here. The conclusion is therefore reached that these plans are insurance, whether that term is considered within its statutory meanings or within the meanings attached to it by the courts.

The courts insist that an insurance contract contain an element of risk and that the incidence of the risk be shifted to another. Without these factors, there can be no insurance.²¹ While it has been said by some courts that insurance also involves distribution of risk,²² when we come to the question of whether or not an insurance contract has been written, or an insurance business has or is being done, in violation of state law, it becomes clear that distribution of risk involves actuarial rather than legal considerations; for if one individual were to write insurance on another without being licensed to do so, that should involve a violation of the insurance law just as much as if many insurance contracts were issued to many individuals. These observations concerning

¹⁷ *Candell v. United States*, 189 F.2d 442, 444 (10th Cir. 1951) (dictum); *Maurer v. International Re-Ins. Corp.*, 31 Del. Ch. 352, 74 A.2d 822, 826 (1950) (dictum); *Prader v. National Masonic Acc. Ass'n*, 95 Iowa 149, 63 N.W. 601, 602 (1895) (dictum); *Chicago Bonding & Ins. Co. v. Oliner*, 139 Md. 408, 115 Atl. 592, 593 (1921) (dictum); *State ex rel. Herbert v. Standard Oil Co.*, 138 Ohio St. 376, 35 N.E.2d 437, 440 (1941) (dictum); *Denton v. Ware*, 228 S.W.2d 867, 870 (Tex. Civ. App. 1949) (dictum); *Shakman v. United States Credit System Co.*, 92 Wis. 366, 66 N.W. 528, 531 (1896) (dictum).

¹⁸ *Commissioner of Banking and Ins. v. Community Health Service, Inc.*, 129 N.J.L. 427, 30 A.2d 44, 46 (1943).

¹⁹ MASS. ANN. LAWS c. 175, § 2 (1948).

²⁰ *Attorney General ex rel. Monk v. C. E. Osgood Co.*, 249 Mass. 473, 144 N.E. 371, 372 (1924) (dictum).

²¹ *Jordan v. Group Health Ass'n*, 107 F.2d 239, 245 (D.C. Cir. 1939) (dictum); *In re Barr's Estate*, 104 Cal. App. 2d 506, 231 P.2d 876, 878 (1951) (dictum).

²² *Ibid.*

distribution of risk do not, however, need to obtain in this situation because obviously in the case of plans such as those under consideration there is distribution of risk. These additional requirements are easily satisfied by our joint trustee union welfare fund. There is an element of risk involved in the possible death, injury or illness of an employee or a member of his family; and the incidence of this risk is shifted from the employee to the welfare plan; finally, the risk is distributed over all employees covered by the terms of the agreement establishing the plan.

Now let us look at some particular types of activity which the courts regard as "insurance" or the doing of an "insurance business." Contracts providing for burial or funeral benefits, being determinable upon the cessation of human life and also dependent upon that contingency, are usually regarded as life insurance contracts.²³ Associations which issue contracts of this nature are engaged in the business of life insurance.²⁴ Mutual benefit associations, in most respects, are insurance companies and the certificates they issue are insurance policies subject to the insurance laws.²⁵ Accident and death benefit contracts issued by an association in consideration of the payment of certain dues are insurance contracts.²⁶ A corporation which sells medical protection against the hazards of injury and illness, and collects a premium from the purchasers, is performing the functions of an insurer.²⁷ In *National Colored Aid Soc'y v. State ex rel. Wilson*,²⁸ the franchise of a non-profit benevolent association was forfeited in a suit instituted by the prosecuting attorney for unlawfully engaging in the insurance business. The association

²³ *Commissioner v. W. H. Luquire Burial Ass'n Co.*, 102 F.2d 89 (5th Cir. 1939); *State ex rel. Landis v. DeWitt C. Jones Co.*, 108 Fla. 613, 147 So. 230 (1933); *Benevolent Burial Ass'n, Inc. v. Harrison*, 181 Ga. 230, 181 S.E. 829 (1935); *State v. Willett*, 171 Ind. 296, 86 N.E. 68 (1908); *Peterson v. Smith*, 188 Miss. 659, 196 So. 505 (1940); *State ex rel. Reece v. Stout*, 17 Tenn. App. 10, 65 S.W.2d 827 (1933).

²⁴ *Commissioner v. W. H. Luquire Burial Ass'n, Co.*, 102 F.2d 89 (5th Cir. 1939); *State ex rel. Landis v. DeWitt C. Jones Co.*, 108 Fla. 613, 147 So. 230 (1933); *Benevolent Burial Ass'n Inc. v. Harrison*, 181 Ga. 230, 181 S.E. 829 (1935); *State ex rel. Dist. Attorney Gen. v. Mutual Mortuary Ass'n Inc.*, 166 Tenn. 260, 61 S.W.2d 664 (1933).

²⁵ *Sovereign Camp, Woodmen of the World v. Pritchett*, 203 Ala. 33, 81 So. 823 (1919); *Cosmopolitan Life Ins. Ass'n v. Koegel*, 104 Va. 619, 52 S.E. 166, 169 (1905) (dictum); *State ex rel. Martin v. Dane County Mut. Ben. Ass'n*, 247 Wis. 220, 19 N.W.2d 303 (1945).

²⁶ *International Serv. Union Co. v. People ex rel. Wettengel*, 101 Colo. 1, 70 P.2d 431 (1937).

²⁷ *McCarty v. King County Medical Serv. Corp.*, 26 Wash. 2d 660, 175 P.2d 653, 666 (1946) (dictum).

²⁸ 208 Ind. 380, 196 N.E. 240 (1935).

issued membership certificates which provided for payments to the designated beneficiary on the death of a member and also certain disability benefits. Losses incurred were paid from a mutual fund. The holder of the contract was required to pay death assessments during the life of the insured. The promised indemnity was payable in a lump sum and a definite amount. The court held the association to be engaged in the life and accident insurance business.²⁹

In all of the above instances the courts found that the agreements, contracts or certificates were in effect insurance contracts, and that the associations or companies issuing them were thereby doing an insurance business. If the courts have little difficulty in finding that burial and funeral benefit agreements, accident and sickness agreements, and death benefit contracts, such as those mentioned above, are insurance contracts, surely it is not unreasonable or unwarranted to conclude on that basis that the courts would have little difficulty in determining that the type of employee welfare plans being considered here are insurance. These plans meet every definition, both judicial and statutory, of an insurance contract and insurance business that has been propounded. They contain every element or characteristic which distinguishes insurance contracts from all other types of agreements; the administration of these plans involves the same type of activity carried on by licensed insurance carriers.

²⁹ One of the most common arguments made in support of the proposition that, where a trust fund is established and maintained wholly or in part by contributions of an employer out of which fund benefits are paid to the employees of that employer on an agreed basis, insurance is not involved because the liability of the trustees is limited to the fund itself. A corollary argument is that insurance is not involved because there is no "guaranty" of the payment of the benefits. More particularly, it is pointed out that, in some instances, for example, pension trusts, the trustees include in the certificates issued to the employees a provision that their liability shall be limited to the fund.

This view, even in the case in which there is a provision in the contract that liability is limited to the fund, is palpably unsound as a matter of law for the reason that, in essential legal terms, the situation there involved is the same as it is in the case of a contract of insurance issued by an insurance company.

In the first place the identity, in principle, of the situation of the trustees and the trust fund on the one hand and the insurance company and its assets on the other is clear because the same contractual elements apply in both cases; there is an obligation to pay a fixed amount on the part of one to another upon the occurrence of a fortuitous or contingent event for which obligation there is a consideration moving from the employee and the employer.

In the second place there is a fund standing behind that obligation, in the case of the trustees the trust fund, in the case of the insurance company its assets; and the fact that the trust fund might some day prove to

Conclusion

It is submitted that were a court today presented squarely with the question: are employee welfare plans, such as those being considered here, insurance and are the administrators of these plans carrying on an insurance business, the answer would be in the affirmative.

George N. Tompkins, Jr.

be insufficient to pay all claims does not alter the insurance nature of the transaction any more than the fact that the insurance company could become insolvent and not pay later accruing claims in their full amount would prove that the insurance company was not writing insurance contracts.

In the third place, it can be said that nowhere in the field of insurance law, or for that matter in the field of the law of contracts in general, can be found any suggestion that ability to perform, apart from the disabilities imposed by law, is an essential legal element in the structure of a contract or one which must be taken into account in the determination of the nature of that contract. Particularly when viewed in that light, the argument being considered is obviously wrong.

Finally, in the legal sense neither a life or accident and sickness insurance contract nor an annuity contract is a guaranty. It should be observed that an insurance company issues a contract to pay a sum of money. A guaranty in the law, on the other hand, strictly speaking is an agreement to pay the debt or discharge the obligation of another made in favor of a third person (*Ollendorff Watch Co. v. Pink*, 279 N.Y. 32, 17 N.E.2d 676, 677 (1938)). Accordingly, the contract of the insurance company in this respect is identical in principle with the contract issued by the trustees.

From all of this it clearly appears that in all of their essential legal elements, in terms of whether insurance is involved or not, the contracts and the surrounding transactions of the trustees of an employee welfare trust fund and the life insurance, accident and sickness insurance, and annuity contracts issued by an insurance company and the transactions surrounding them are the same.