Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #749
October 1996
12 U.S.C. 24(7)

September 13, 1996

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Dear **[ ]**:

This responds to your letter of July 10, 1996, requesting an opinion from the Office of the Comptroller of the Currency ("OCC") confirming that 12 U.S.C. § 24(Seventh) preempts Texas insurance licensing laws that prevent or significantly interfere with a national bank's authority to act as agent in the sale of annuities.

We believe that section 24(Seventh) does preempt Texas insurance licensing laws with respect to annuities sales by national banks to the extent that those laws prevent or impair the ability of national banks to exercise their authority under section 24(Seventh) to sell annuities. We do not believe that the McCarran-Ferguson Act, 15 U.S.C. § 1012, insulates Texas law in this case for two reasons: First, annuities are not "insurance" within the meaning of the Act. Second, even if annuities were insurance for that purpose, laws that have the effect of negating or impairing the corporate powers of an entire class of entity -- in this case the authority of national banks to sell annuities -- are not laws "regulating the business of insurance" within the meaning of the McCarran-Ferguson Act. However, as we discuss below, this does not mean that all Texas law in this area is inapplicable to national banks.[1]

Background

National banks derive their authority to sell annuities from section 24(Seventh) of the National Bank Act, which provides that national banks shall have the power to exercise "all such incidental powers as shall be necessary to carry on the business of banking." The Supreme Court, in *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Company*,

[1]Please note that we recently expressed similar conclusions in a letter dated August 9, 1996, to Commissioner Bomer of the Texas Insurance Department in connection with his request for an opinion on this issue submitted to the Office of the Texas Attorney General.

__U.S.__, 130 L.Ed.2d 740, (1995) ("*VALIC*"), upheld the Comptroller's conclusion that this power includes the power to sell fixed and variable annuities as agent.

Sections 3.01, 3.75, and 21.07-1 of the Texas Insurance Code effectively prohibit national banks from selling annuities as agent in Texas. These provisions of Texas law require sellers of annuities to have a license, and a license is only available to a corporation if (1) the corporation is organized under the Texas Business Corporation Act, the Texas Professional Corporation Act, or the Texas Limited Liability Company Act, and (2) each officer, director, and shareholder of the corporation is individually licensed as an agent.

A national bank would be unable to satisfy these criteria because it is federally chartered. A subsidiary of a national bank would be unable to satisfy these criteria because its parent bank, as a shareholder, could not get a license. Thus, Texas law would prohibit a national bank even from purchasing an existing, licensed Texas annuity agency.

We also understand that the Texas Commissioner of Insurance may have considered an alternative limitation that would allow only national banks located in places with 5,000 or fewer inhabitants to sell annuities. Since the authority to sell annuities derives from section 24(Seventh), not section 92, this limitation is not imposed by federal law.[2] The proposed restriction would be an absolute prohibition for national banks not located in places of 5,000 or fewer inhabitants.

Ordinarily, when Federal law and state law so clearly conflict, the state law will be preempted by the Federal provision. Your question presents the issue, however, of whether the McCarran-Ferguson Act, 15 U.S.C. § 1012, may insulate the provisions of the Texas Insurance Code at issue, and/or the above-described limitation, from preemption by section 24(Seventh). For the reasons discussed below, it is our opinion that section 24(Seventh) does preempt these state law provisions.

Discussion

A. The McCarran-Ferguson Act

Section 2(b) of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b), protects certain insurance-related state laws from federal preemption. Section 2(b) provides that a federal law shall not be construed to "invalidate, impair, or supersede" a state law "enacted for the purpose of regulating the business of insurance," unless the federal law "specifically relates to the business of insurance."

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[2]The power to sell annuities is not subject to any geographic limitation based on the location of the *customer*. Therefore, a national bank may sell annuities to customers located anywhere.

In this case, the federal law at issue is 12 U.S.C. § 24(Seventh). As was noted above, the OCC has interpreted section 24(Seventh) to permit national banks to sell annuities as agent, and the Supreme Court has affirmed that interpretation. To the extent that the Texas Insurance Code would prohibit a national bank from exercising that power, section 24(Seventh) would "invalidate, impair, or supersede" it. Thus, the McCarran-Ferguson Act will insulate the Texas provisions from the ordinarily applicable Federal preemption standards, if the restrictions in Texas law regulate the business of insurance. We believe that the Texas licensing restrictions do not meet this test, for two reasons: First, because annuities are not "insurance" for McCarran-Ferguson Act purposes, and, second, because requirements that have the effect of negating the existing corporate authority of national banks to sell annuities, are regulating, if anything, the *powers* of a particular *class of entity*, *not* the "business of insurance."

B. Annuities as "Insurance" under the McCarran-Ferguson Act

The Supreme Court has already explicitly held in *SEC v. Variable Annuity Life Ins. Co. of America*, 359 U.S. 65, (1959) ("*SEC*") that variable annuities are *not* insurance for purposes of the McCarran-Ferguson Act. Although the Supreme Court has not specifically addressed whether *fixed* annuities are insurance for purposes of the McCarran-Ferguson Act, Supreme Court decisions in other contexts, and numerous other authorities, lead to a similar negative conclusion.

1. Annuities and Insurance are Distinct Products

The scope of the term "insurance" in the McCarran-Ferguson Act is a federal question, not controlled by Texas or other state law definitions. *SEC* at 69. Neither the statute or the legislative history of the McCarran-Ferguson Act define the term, however.[3] Nevertheless, "insurance" has a commonly-understood meaning, and, absent a contextual basis for concluding otherwise, words in statutes are presumed to have their usual meaning. This is especially true where, as here, a statute does not define a term. *See* 2A Sutherland, *Statutory Construction* § 47.28 (4th ed. 1984).[4]

Dictionary definitions of "insurance," for example, describe it as a contract for indemnification against risk of loss. In 1945, when the McCarran-Ferguson Act was enacted, the third edition of Black's Law Dictionary (1933) was in use and defined insurance as: "A contract whereby, for a

[3]*See* H.R. Rep. No. 143, 79th Cong., 1st Sess (1945), *reprinted in* 1945 U.S.C.C.A.N. 670.

[4]*See Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211-213 (1979) ("Since the [McCarran-Ferguson Act] does not define the 'business of insurance,' the question for decision is whether the [contracts at issue] fall within the ordinary understanding of the phrase, illumined by any light to be found in the structure of the Act and its legislative history.").

stipulated consideration, one party undertakes to compensate the other for loss on a specified subject by specified perils." By contrast, the definition of "annuity" from the same edition describes annuities variously as: "a yearly sum stipulated to be paid to another in fee, or for life, or years, and chargeable only on the person of the grantor;" "a fixed sum, granted or bequeathed, payable periodically but not necessarily annually;" or a contract "by which one party delivers to another a sum of money, and agrees not to reclaim it so long as the receiver pays the rent agreed upon." Thus, when Congress enacted the McCarran-Ferguson Act, an "annuity" was clearly distinct from "insurance."

That distinction continues today. For example, Black's Law Dictionary (1990) defines "insurance" as follows:

> A contract whereby, for a stipulated consideration, one party undertakes to compensate the other for loss on a specified subject by specified perils. . . . A contract whereby one undertakes to indemnify another against loss, damage, or liability arising from an unknown or contingent event and is applicable only to some contingency or act to occur in future. An agreement by which one party for a consideration promises to pay money or its equivalent or to do an act valuable to other party [sic] upon destruction, loss, or injury of something in which another party has an interest.

See also Webster's Third International Dictionary (1971) ("coverage by contract whereby for a stipulated consideration one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril"); *Random House Dictionary* (1973) ("coverage by contract in which one party agrees to indemnify or reimburse another for any loss that occurs under the terms of the contract"); *Oxford English Dictionary* (Compact ed. 1971) ("a contract by which the one party (usually a company or corporation) undertakes, in consideration of a payment (called a *premium*) proportioned to the nature of the risk contemplated, to secure the other against pecuniary loss, by payment of a sum of money in the event of destruction of or damage to property (as by disaster at sea, fire, or other accident), or the death or disablement of a person"); *Helvering v. Le Gierse*, 312 U.S. 531, 542 (1941) ("Historically and commonly, insurance involves risk-shifting and risk-distributing."). Legal encyclopedias have defined insurance similarly. C.J.S. states, "Insurance has been said to be best defined as a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from an unknown or contingent event." 44 C.J.S. § 2(a). Am. Jur. defines insurance as a contract that provides for the payment of "a certain or ascertainable sum of money on a specified contingency." 43 Am. Jur. 2d Insurance § 1. *See also* 1 Couch on Insurance 3d (1995) § 1:6 ("Essentially, insurance is a contract by which one party (the insurer), for a consideration that usually is paid in money, either in a lump sum or at different times during the continuation of the risk, promises to make a certain payment, usually of money, upon the destruction or injury of 'something' in which the other party (the insured) has an interest.").

Annuities do not involve indemnification against risk of loss. Investors who purchase annuities are not seeking to pool a catastrophic risk such as death, injury or property damage, but are instead seeking a guaranteed, long-term return on their assets. Most commonly, annuities are marketed as a tax-sheltered means of saving for retirement.[5] The element of mortality risk, which is present in some annuities, derives from the investor's willingness to price a contractual arrangement based on the length of his life in order to increase the return he will receive during his lifetime. This risk is essentially an investment risk, not an insurance risk. In upholding the Comptroller's determination that annuities are not insurance for purposes of another federal law -- 12 U.S.C. § 92 -- the Supreme Court stated,

> By making an initial payment in exchange for a future income stream, the customer is deferring consumption, setting aside money for retirement, future expenses, or a rainy day. For her, an annuity is like putting money in a bank account, a debt instrument, or a mutual fund. Offering bank accounts and acting as agent in the sale of debt instruments are familiar parts of the business of banking. . . . In sum, modern annuities, though more sophisticated than the standard savings bank deposits of old, answer essentially the same need. By providing customers with the opportunity to invest in one or more annuity options, banks are essentially offering financial investment instruments of the kind congressional authorization permits them to broker.

VALIC at 814.[6]

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[5]*See Helping Consumers Shelter Income*, ABA Banking Journal, July 1989, at 16-21 (discussing investment and tax shelter characteristics of annuities).

[6]*See also Helvering v. Le Gierse*, *supra* ("Any risk that the prepayment [premium] would earn less than the amount paid to respondent as an annuity was an investment risk similar to the risk assumed by a bank; it was not an insurance risk. . . ."); *In Re Howerton*, 21 Bankr. 621, 623 (1982) ("Both life insurance and annuity contracts may take various forms but the heart of the distinction between them is this: life insurance is a promise to pay a sum certain on the death of the insured and an annuity is essentially a form of investment which pays periodically during the life of the annuitant or during a term fixed by contract rather than on the occurrence of a future contingency."); *Daniel v. Life Ins. Co. of Virginia*, 102 S.W.2d 256, 260 (Tex. Civ. App. 1937) ("[An annuity] is essentially a form of investment, and uniformly held to be such, regardless of the fact that in its usual form payments are contingent upon continuity of the life of the grantee."); 1 J. Appleman, Insurance Law and Practice, § 84 (1981) ("annuity contracts must. . . be recognized as investments rather than as insurance"). *See also SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 207-208 (1967) ("In fixing the necessary premium [for a fixed annuity] mortality experience is a subordinate factor and the planning problem is to decide what interest and expense rates may be expected. There is some shifting of risk from policyholder to insurer, but no pooling of risks among policyholders. In other words, the insurer is acting in a role similar to that of a savings institution. . . .").

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Most authorities hold that annuities are not insurance, because they do not incorporate the element of indemnification against risk. Courts considering the status of annuities as "insurance" have held that annuities are not insurance for purposes of federal tax law,[7] several state tax laws, bankruptcy law,[8] and other laws.[9] Legal encyclopedias also agree that, because annuities do not involve this type of indemnification against risk of loss, they are not insurance. *See* 44 C.J.S. § 2(b) ("Generally an annuity contract is not a contract of insurance"); 43 Am. Jur. 2d Insurance § 5 ("Contracts for annuities differ materially from ordinary life insurance policies, and are not generally regarded as such. Consequently, a company engaged merely in selling annuities does not conduct an insurance business, and is not an insurance company unless made so by a broad statutory definition of insurance companies.")

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[7] *See Helvering v. Le Gierse*, *supra*; *Keller v. Commissioner of Internal Revenue*, 312 U.S. 543 (1941) (Under federal tax law which excludes "amounts receivable as insurance" from decedent's gross estate for tax purposes, annuities are not treated as insurance.).

[8] *See Kernochan v. U.S.*, 29 F.Supp. 860 (Ct. Cl. 1939); *In re Sothern's Estate*, 257 A.D. 574, 14 N.Y.S.2d 1 (1939); *In re Rhodes' Estate*, 197 Misc. 232, 94 N.Y.S. 2d 406 (N.Y. Surr. Ct. 1949) (Annuity contracts are not within New York tax law exemption, applicable to insurance payable to a designated beneficiary, from estate taxes.); *People v. Knapp*, 193 A.D. 413, 184 N.Y.S. 345 (1920); *Commonwealth v. Metropolitan Life Ins. Co.*, 254 Pa. 510, 98 A. 1072 (1916); *Daniel v. Life Ins. Co. of Virginia, supra*; *State v. Ham*, 54 Wyo. 148, 88 P.2d 484 (1939) (Consideration paid for annuity contracts is not subject to tax law which taxes all "premiums" paid for insurance, because annuities are not insurance.)

[8] *See New York State Association of Life Underwriters, Inc., v. New York State Banking Department*, 83 N.Y.2d 353, 632 N.E.2d 876 (1994) (Because "the great weight of authority supports the position that annuities are not insurance," New York state-chartered banks may sell annuities as agent); *In re Walsh*, 19 F.Supp. 567 (D. Minn. 1937) (Annuity policy owned by bankrupt was not within insurance exemption to Minnesota bankruptcy law and therefore trustee in bankruptcy was entitled to the cash surrender value of the policies.); *In Re Howerton*, 21 Bankr. 621, 623 (1982).

[9] *See Carroll v. Equitable Life Assurance Co.*, 9 F.Supp. 223 (W.D. Mo. 1934) (Defendant, a mutual insurance company forbidden by law to issue insurance contracts except by a "mutual plan," was nonetheless authorized to sell annuity contracts without a mutual plan because annuity contracts are investments rather than insurance.); *Succession of Rabouin*, 201 La. 227, 9 So.2d 529 (1942) (Insurance is not considered part of the decedent's estate for purposes of the law of "forced heirship," but annuities are part of the estate because they are not insurance.).

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The two leading treatises on insurance law, Couch and Appleman, also distinguish annuities from insurance. *See* 1 J. Appleman, Insurance Law and Practice, § 84 (1981) ("annuity contracts must. . . be recognized as investments rather than as insurance"); 1 Couch on Insurance 3d (1995) § 1:22 ("In consequence of the fact that annuities are not ordinarily regarded as insurance, it naturally follows that most litigation involving annuities does not present any aspect of what would ordinarily be regarded as insurance law. The subject of annuities is thus not treated in detail in this text."). The Couch treatise even has a separate section entitled "Annuity as distinguished from insurance," which states,

> An annuity contract differs materially from an ordinary life insurance contract in that it is payable during the life of the annuitant rather than upon any future contingency, and in many instances it is paid for in a single payment which is not generally regarded as a premium. Consequently, a company engaged in selling annuities is not subject to a statute applicable to 'insurers' unless the statute expressly so declares.

19 Couch on Insurance 2d (Rev. ed. 1983) § 81:2.

The recent Court of Appeals decision which found that annuities would be insurance for purposes of the McCarran-Ferguson Act, *American Deposit Corp. and Blackfeet National Bank v. Schacht*, 84 F.3d 834 (7th Cir. 1996) ("*Blackfeet*"), fundamentally mistook these essential distinctions between annuities and insurance. In that case, an Illinois statute effectively prohibited a national bank from *issuing* an annuity-like deposit instrument. A national bank challenged this prohibition on the grounds that the bank had authority under the National Bank Act, as interpreted by the OCC, to issue an annuity-like product called a "Retirement CD." In its decision, the court noted several reasons why annuities should be considered insurance.[10] All, however, have fundamental flaws.

First, the court noted that annuities involve mortality risk. However, the Supreme Court in *VALIC* rejected the notion that mortality risk is a determinative indicator that a product is insurance. For example, as the Court pointed out, a life interest in property involves mortality risk, and such an interest is certainly not insurance. *VALIC*, 130 L.Ed.2d at 751.

Second, the *Blackfeet* court reasoned that annuities should be considered insurance because they protect the insured against the risk of running out of money:

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[10]In a lengthy and comprehensive dissent, however, Judge Flaum concluded, "[A]nnuities are *not* 'insurance', and thus a national bank selling them is not engaged in 'the business of insurance.' The modern literature on insurance powerfully affirms this conclusion, and the history of insurance caselaw is in accord." 84 F.3d 834, Slip. Op. at 63, 64 (7th Cir. 1996) (emphasis in original).

> [T]he purpose of purchasing a life insurance policy on a family's breadwinner and of purchasing a lifetime annuity is essentially the same. The individual who purchases the life insurance policy insures against no longer having the money produced by the breadwinner, and the person who purchases a lifetime annuity insures against no longer having sufficient money produced by his assets.

Slip. Op. at 13. This argument, too, fails to hold up, since it would characterize any long-term income stream -- a bank account, a long-term lease, or a long-term bond -- as insurance because the holder is protected against not receiving income.[11] It is possible to describe virtually any asset as protecting against some type of "risk." Insurance is not merely protection against risk -- it is indemnification against risk of loss. *See* 1 Couch on Insurance 3d (1995) § 1:9 ("The primary requisite essential to a contract of insurance is the assumption of a risk of loss and the undertaking to indemnify the insured against such loss."). *See generally* 1 Couch on Insurance 3d (1995) §§ 1:12-23 (distinguishing various forms of risk transfer such as suretyship, guarantees, warranties, and annuities from insurance).

Third, the *Blackfeet* court contended that a fixed annuity is insurance because it

> insures the purchaser against a decline in the market--a single, contingent event. The purchaser is given the comfort that should a depression occur in the market, causing rates of interest to fall significantly, he will not suffer a "loss" of future income, but will continue to receive the rate of interest guaranteed in his Retirement CD contract.

Id. Again, the court confused indemnification against risk of loss with protection against other types of risk, in this case, investment risk. The shifting of investment risk does not make a product insurance. Treasury bonds, bank accounts, and other guaranteed obligations have no investment risk, but they are in no way considered insurance.

Thus, the *Blackfeet* court's decision was analytically flawed to a profound degree. We therefore believe that, on balance, the court's reasoning is clearly outweighed by the precedents and analysis that reach the opposite conclusion.

2. A Product Does Not Become "Insurance" Because It Is Sold by Insurance Companies

Annuities are not part of the "business of insurance" simply because they have historically been offered primarily by insurance companies. The Supreme Court specifically rejected this approach to interpretation of the McCarran-Ferguson Act, stating,

[11] Some annuities have a life term rather than a fixed term, but, as was noted above, this feature does not transform them into insurance. An interest in real property does not become "insurance" if it is divided into a life estate and a remainder interest.

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> The statute did not purport to make the States supreme in regulating all the activities of insurance *companies*; its language refers not to the persons or companies who are subject to state regulation, but to laws 'regulating the *business* of insurance.' Insurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the 'business of insurance' does the statute apply.

SEC v. National Securities, Inc., 393 U.S. 453, 459-60 (1969) ("*National Securities*") (emphasis in original).

Similarly, as the Supreme Court pointed out in *VALIC*,

> [T]he sale of a product by an insurance company does not inevitably render the product insurance. For example, insurance companies have long offered loans on the security of life insurance . . . but a loan does not thereby become insurance.

130 L.Ed.2d at 750. Insurance codes and the authority of insurance regulators will naturally address the activities that insurance companies have traditionally engaged in. *National Securities* makes it clear that the business of insurance *companies* -- what insurance companies typically do, and what insurance regulators typically regulate -- is not the same as the business of insurance under the McCarran-Ferguson Act.

Even where state insurance codes cover annuities, moreover, they generally distinguish annuities from insurance. For example, the Texas Insurance Code section at issue here, Art. 21.07-1, defines a "life insurance agent" as one who sells "insurance or annuity" contracts. The definition of "life insurance company" in Art. 3.01, Sec. 1 of the Texas Insurance Code also distinguishes between insurance and annuities.

Thus, with a few isolated exceptions, courts and other legal authorities have understood the term "insurance" to refer to a contractual obligation to indemnify the insured against a risk of loss, and have accordingly classified annuities as products that are not insurance. The Supreme Court has already addressed variable annuities and found variable annuities *not* to be insurance for purposes of the McCarran-Ferguson Act. In the absence of language in the McCarran-Ferguson Act suggesting that the context somehow requires an unusual interpretation of the term "insurance," therefore, the commonly-understood meaning must prevail, and fixed as well as variable annuities should not be considered to be insurance for purposes of the McCarran-Ferguson Act.

As discussed in more detail in section D below, this result does not mean that all Texas state laws are inapplicable to annuity sales by national banks. What it does mean, however, is that state laws that purport to apply to national banks' sales of annuities must be evaluated under longstanding, judicially developed standards of federal preemption. This is a particularly appropriate result here, since the Supreme Court has directly ruled that annuity sales are

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authorized for national banks under their corporate banking powers pursuant to 12 U.S.C. § 24(Seventh). *See VALIC*, *supra*.

C. "Regulating the Business of Insurance" under the McCarran-Ferguson Act

It is axiomatic that the McCarran-Ferguson Act shields from Federal preemption state laws enacted for the purpose of regulating the business of insurance in order to provide special status for laws that *do that*. When a state law does *something else*, as is the case here, where the effect of the law, if it regulates anything, is to regulate the *powers* of national banks as a class of entity, the state law is not within the scope of protection designed by the McCarran-Ferguson Act. State regulation that negates or impairs the existing corporate activity of an entire class of entity is regulation of that type of *entity*, not regulation of the *activity* that constitutes the "business of insurance." *See Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 125 L.Ed.2d 612, 629 (1993) ("'[T]he business of insurance' should be read to single out one activity from others, not to distinguish one entity from another.").

In fact, caselaw emphasizes that the McCarran-Ferguson Act should be construed narrowly, so as to avoid displacing other federal statutes and their underlying regulatory interests. *See Women in City Government United* v. *City of New York*, 515 F. Supp. 295, 303 (S.D. N.Y. 1981); *FTC* v. *Manufacturers Hanover Consumer Servs.*, 567 F. Supp. 992, 995 (E.D. Pa. 1983). This approach is particularly appropriate in this case, where the Supreme Court has specifically determined that the authority of national banks to conduct the "business of banking" includes the authority to sell both fixed and variable annuities.

The Supreme Court has stated that state laws enacted "for the purpose of regulating the business of insurance" under the McCarran-Ferguson Act are those laws "that possess the 'end, intention, or aim' of adjusting, managing, or controlling the business of insurance." *U.S. Dep't. of Treasury v. Fabe*, 508 U.S. 491, 113 S. Ct. 2202, 2210 (1993) ("*Fabe*"). As the Court emphasized in *Fabe*, "the focus of McCarran-Ferguson is upon the relationship between the insurance company and its policyholders." *Fabe*, 113 S. Ct. at 2212. In *Fabe*, the Supreme Court was concerned with whether an Ohio statute governing the priority of claims filed in a proceeding to liquidate an insolvent insurer was preempted by a federal priority statute, or was protected by the McCarran-Ferguson Act. In deciding to apply McCarran-Ferguson protections to the Ohio statute, the court considered the relationship between the insured and the insurer, and concluded that to the extent that the Ohio priority statute regulated the resolution of policyholders' claims against an insurer, it was a law enacted for the purpose of regulating the business of insurance. *Id*.

Fabe was not the first time that the Supreme Court has considered the relationship between the insured and the insurer in applying the McCarran-Ferguson Act. In *National Securities, supra*, the Court examined a state statute requiring an insurance commissioner to certify that insurance company mergers were equitable to stockholders in order to determine whether it was protected by the McCarran-Ferguson Act. Because the Court found that the effect of the statute was to protect the stockholders, not the policy holders, it concluded that the statute was not enacted for the purpose of regulating insurance. *National Securities, supra*, 393 U.S. at 459. In deciding the case, the *National Securities* Court, like the *Fabe* Court, focused upon the relationship between the insured and the insurer, observing that the core of the "business of insurance" is

> the relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement.

Id. In dicta, the Court gave as *examples* of activities that could constitute the business of insurance: fixing of rates, selling and advertising of policies, and licensing of companies and agents. 393 U.S. at 460.

Thus, under the standards set by the Supreme Court in *Fabe* and *National Securities*, licensing of agents could constitute regulation of the business of insurance *if* the licensing standards have the end result, intention or aim of adjusting, managing or controlling the relationship between insurer and insured, the types of policies issued, or their reliability, interpretation, and enforcement. The Texas state law provisions at issue here simply do none of that. They regulate neither the "transferring or spreading [of] a policyholder's risk," nor any other practice that is "an integral part of the policy relationship between the insurer and the insured." *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982) ("*Pireno*"); *see also Fabe*, 113 S.Ct. at 2209, 2213-216. Rather, they deprive an entire category of entity -- national banks -- of the capacity to exercise a corporate power they possess under Federal law.

Courts of appeals that have examined state insurance laws that attempt to restrict the authorized activities of national banks have generally concluded that state law restrictions on the powers of national banks to conduct those activities do not fall within the preemption shield of the McCarran-Ferguson Act.[12] *See e.g.*; *Owensboro Nat'l Bank v. Stephens*, 44 F.3d 388 (6th Cir. 1994), *cert*. *denied*, 134 L.Ed.2d 519 (U.S. 1996) ("*Owensboro*"); *First Nat'l Bank of E. Ark. v. Taylor*, 907 F.2d 775, 780 (8th Cir.), *cert*. *denied*, 498 U.S. 972 (1990) (McCarran-Ferguson Act does not immunize state insurance law restrictions from preemption because sale of debt cancellation contracts by national banks is an authorized activity of national banks and does not constitute the "business of insurance" within the meaning of the McCarran-Ferguson Act); *United Auto. Ass'n v. Muir*, 792 F.2d 356 (3d Cir. 1986), *cert. denied*, 479 U.S. 1031 (1987) ("*Muir*"); *Independent Banker's Ass'n of Am. v. Heimann*, 613 F.2d 1164, 1170-71 (D.C. Cir. 1979), *cert*. *denied* 449 U.S. 823 (1980) (Comptroller's regulation of disposition of income from sale of credit life insurance by national banks does not fall within the McCarran-Ferguson Act's protections). Although the state statutory restrictions examined by the courts of appeals differed in certain respects, the differences in specific features of the statutes were insignificant in

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[12] State courts have also examined the issue of whether the McCarran-Ferguson Act protects state anti-affiliation statutes. *See First Advantage Ins., Inc. v. Green*, 652 So.2d 562 (La. Ct. App. 1995), *cert*. *granted*, *vacated and remanded*, 64 U.S.L.W. 3656 (U.S. April 1, 1996).

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resolving the issue of whether the state's statutory prohibition or restriction fell within the protection of the McCarran-Ferguson Act. Of more significance to the courts in resolving the issue was whether the state statutes regulated the "business of insurance," or something else.

In *Owensboro*, the Sixth Circuit Court of Appeals examined a Kentucky statute that prohibited national banks from acting as or affiliating with insurance agents except in strictly limited circumstances. In specifically rejecting the claim that the McCarran-Ferguson Act protected the Kentucky statute from preemption, the Sixth Circuit concluded that the Kentucky statute was not a law that regulated the business of insurance. *Id.* at 392. In reaching its conclusion, the court relied upon the criteria used by the Supreme Court, in *Pireno* when it found that certain practices of the petitioner Union Labor Life Insurance Co. did not constitute the "business of insurance" for purposes of the McCarran-Ferguson Act. Thus, the *Owensboro* court considered *whether the practice or activity restricted by the statute had the effect* of transferring or spreading policyholder risk, was an integral part of the policy relationship between the insurer and the insured, and was a practice limited to entities within the insurance industry. *Owensboro*, 44 F.3d at 391-92. Because the court found that the Kentucky law in no way governs the manner in which the activities constituting the "business of insurance" are conducted, the court concluded that the law was "enacted for the purpose of regulating certain conduct by bank holding companies, not the business of insurance." *Owensboro,* 44 F.3d at 392.

Similarly, in *Muir*, *supra*, the Court of Appeals for the Third Circuit rejected a claim that the McCarran-Ferguson Act immunized a Pennsylvania statute prohibiting mergers between financial institutions and insurance companies. In rejecting the claim, the court emphasized that the "affiliation between insurers and banks has no integral connection to the relationship between the insured and the insurer." 792 F.2d at 364. Thus, the court concluded that laws such as Pennsylvania's "have no part in the business of insurance under McCarran-Ferguson." *Id*.[13]

The effect of the Texas provisions at issue is to exclude national banks from participating in insurance agency activities, not to regulate the relationship between the insurer and the insured. Excluding national banks as a group from even qualifying to obtain licenses to sell annuities does not transfer or spread policyholder risk; it is not an integral part of the relationship between an insurer and its insured, and it is not aimed at a practice limited to entities within the insurance industry. As the Sixth Circuit, in *Owensboro*, correctly observed:

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[13]The *Blackfeet* case briefly considered this point in the context of *issuance* by a national bank of an annuity-like product, the Retirement CD. However, in that situation, the bank's role as issuer of the instrument in question at least could be analogized to the role of an insurer in the insurance context. No such similarity exists when a bank is simply selling, as agent, an instrument issued by another entity.

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> [e]xcluding a person from participation in an activity . . . is different from regulating the manner in which that activity is conducted. The former is regulation of the person; the latter is regulation of the activity.

Owensboro, 44 F.3d at 392. Accordingly, the preemption shield of the McCarran-Ferguson Act does not apply to Texas's statutory prohibitions or to any limitation that would restrict the selling of annuities by national banks to banks located in places with 5,000 or fewer inhabitants, and those provisions must be analyzed according to traditional preemption analysis.

D. Preemption of State Laws that Conflict with a Federal Statute

To the extent that state law or other regulatory actions prohibit or impede national banks from exercising their federally-granted power to sell annuities as agent, the state action is preempted by section 24(Seventh). A state law in conflict with a federal statute is "without force," whether or not Congress has expressed an intent to preempt or has otherwise occupied the field regulated by the state. *See generally Barnett Bank of Marion County v. Nelson*, 517 U.S. ___, 134 L.Ed.2d 237 (1996); *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 113 S. Ct. 1732, 1737 (1993); *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 112 S. Ct. 2608, 2617 (1992); *MacDonald v. Mansanto Co.*, 27 F.3d 1021, 1023 (5th Cir. 1994). When such a conflict occurs, a state's claim that the area is one that it has traditionally regulated is immaterial. *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 153 (1982). A conflict between state and federal law can occur either because compliance with both state and federal law is a "physical impossibility," *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963), or because the state law stands "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). *See Barnett*, 116 S. Ct. at 1103.

The general principles of federal preemption apply with full force to state laws that affect the Federally-authorized activities of national banks. Since their creation, national banks have been recognized as appropriate "instruments designed to be used to aid the government in the administration of an important branch of public service." *Farmers' & Mechanics' Nat'l Bank v. Dearing*, 91 U.S. 29, 33 (1876). *See, e.g., First Nat'l Bank v. California*, 262 U.S. 366, 368-69 (1923); *Davis v. Elmira Sav. Bank*, 161 U.S. 275, 283 (1896). In applying federal preemption principles to conflicting state and federal laws that concern the conduct of national banks, the Supreme Court has long maintained that

> an attempt by a State to define [a national bank's] duties or control the conduct of [a national bank's] affairs is void whenever it conflicts with the laws of the United States or frustrates the purposes of the national legislation or impairs the efficiency of the bank to discharge the duties for which it was created.

Davis v. Elmira Sav. Bank, 161 U.S. at 283. *Accord Easton v. Iowa*, 188 U.S. 220, 238 (1903); *Owensboro Nat'l Bank v. Owensboro*, 173 U.S. 664, 667-68 (1899).

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Finally, state statutes that limit a national bank power conflict with federal law even if the federal law does not impose a requirement, but merely provides authority to act. *Barnett*, 113 S. Ct. at 1108; *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 155 (1982); *Franklin Nat. Bank v. New York*, 347 U.S. 373, 375-379 (1954) (federal statute permitting, but not requiring, national banks to receive savings deposits, preempts conflicting prohibitory state statute). Instruction on this point is provided by *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 155 (1982), where the Supreme Court decided that California law restricting the exercise of "due-on-sale" mortgage clauses conflicted with a federal regulation generally permitting the use of such clauses by federal thrift institutions. The Court observed that the conflict was not eliminated because the federal regulation "permits, but does not compel," the inclusion of due-on-sale clauses, because the California restriction had effectively eliminated the ability of a federal savings and loan to provide for such clauses "at its option." *Id.* at 155.

As the Supreme Court explained in *Barnett*, Congressional grants of both enumerated and incidental powers to national banks are generally interpreted in the context of national bank legislation as grants of authority "not normally limited by, but rather ordinarily preempting, contrary state law." *Barnett*, 116 S. Ct. at 1108. The Court reasoned that in defining the preemptive scope of statutes and regulations granting a power to national banks, "normally Congress would not want States to forbid, or impair significantly, the exercise of a power that Congress explicitly granted." *Id.* But, as the Court in *Barnett* recognized "[t]o say this is not to deprive States of the power to regulate national banks, where doing so does not significantly interfere with the national bank's exercise of its powers." *Id.*[14]

Under this standard, therefore, Texas state laws that interfere with national banks' exercise of their power to sell annuities would *not* be preempted if the extent of the interference is *insignificant*.[15] Clearly, that is not the case here. The state law provisions described at the outset

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[14]As examples of this principle, the court cited *Anderson National Bank v. Luckett*, 321 U.S. 233, 247-252 (1944) (State statute administering abandoned deposit accounts did not unlawfully encroach on the rights and privileges of national banks; national banks are subject to state laws unless those laws infringe the national banking laws or impose an undue burden on the performance of national bank functions.); *McClellan v. Chipman*, 164 U.S. 347, 358 (1896) (Application to national banks of state statute forbidding certain real estate transfers by insolvent transferees would not destroy or hamper national banks' functions.); and *National Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353, 362 (1869) (National banks subject to state law taxing bank shares that does not "interfere with, or impair [national banks'] efficiency in performing the function by which they are designed to serve [the Federal] Government.").

[15]This test, and the cases cited by the Supreme Court, all reflect that the extent to which state law may diminish the ability of national banks to exercise their powers is limited, e.g., state law applies if it does not "*encroach*" on the rights of national banks; if the law would not "*hamper*," "*infringe*," or impose an "*undue burden*" on national bank functions; if the applicable state law would not "*impair the efficiency*" of those functions.

of this letter would effectively prevent national banks from selling annuities. And, even if those provisions were read to allow annuities sales by national banks located in places with 5,000 or fewer inhabitants, the effect would, by any gauge, be a significant interference with the authority granted to national banks to sell annuities since some national banks (those not located in places with 5,000 or fewer inhabitants) would be prevented from selling annuities *at all*, and others would be precluded from basing their annuities sales in many locations. Accordingly, under either approach to the Texas state law at issue, the state law provisions would be preempted by section 24(Seventh) of the National Bank Act, which contains no such limitations on national banks' authority or eligibility to sell annuities.

E. Conclusion

To summarize, national banks have authority under the National Bank Act to sell annuities as agent. In our opinion, the McCarran-Ferguson Act does not shield from preemption Texas laws that wholly or partially prevent national banks from selling annuities for two reasons: (1) annuities are not "insurance" for purposes of the McCarran-Ferguson Act, and (2) the McCarran-Ferguson Act does not shield a state law that results in negating the Federally-authorized corporate power of national banks to sell annuities.

These conclusions do not, however, place annuities outside the scope of federal and state laws. Variable annuities are covered by federal securities laws, and both fixed and variable annuity sales by national banks will be subject to state laws that are not preempted under recognized standards of federal preemption.[16]

Very truly yours,

/s/
Julie L. Williams
Chief Counsel

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[16]For example, as noted in section D, a state law would *not* be preempted if it did not prevent national banks from exercising their Federally authorized powers, and if the extent to which the law actually interfered with or impaired the ability of national banks to exercise those powers was insignificant.

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