Office of the Comptroller of the Currency

Interpretive Letter #748

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12 U.S.C. 24(7)

September 13, 1996

[ ]

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. <**NOTE:** 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.>

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*, __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. <**NOTE:** 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.> 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."

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. <**NOTE:** *See* H.R. Rep. No. 143, 79th Cong., 1st Sess (1945), *reprinted in* 1945 U.S.C.C.A.N. 670.> 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). <**NOTE:** *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.").>

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 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. <**NOTE:** *See Helping Consumers Shelter Income*, ABA Banking Journal, July 1989, at 16-21 (discussing investment and tax shelter characteristics of annuities).> 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. <**NOTE:** *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. . . .").>

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,<**NOTE:** *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.).> several state tax laws, <**NOTE:** *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.)> bankruptcy law, <**NOTE:** *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).> and other laws.<**NOTE:** *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.).> 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.").

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.<**NOTE:** 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).> 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:

> [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. <**NOTE:** 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.> 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.

More of Decision