American Deposit Corp. v. Schacht: Yet Another Attempt to Limit National Banks' Powers to Sell Nondeposit Investment Products

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AMERICAN DEPOSIT CORP. v. SCHACHT: YET ANOTHER ATTEMPT TO LIMIT NATIONAL BANKS’ POWERS TO SELL NONDEPOSIT INVESTMENT PRODUCTS

I. INTRODUCTION

Recent changes in the financial services industry have threatened both the profitability and the viability of national banks in the United States. Unregulated nonbank entities provide services once offered exclusively by banks.1 New financial products, such as money market mutual funds ("MMMFs")2 and cash management accounts ("CMAs")3 have proven very successful in competing with traditional banking services. Further, many former bank customers now rely on the securities industry to meet their investment needs, because federal regulations prohibit banks from providing many underwriting and distribution services.4

1. For example, Sears opened financial centers offering insurance, securities, real estate, check cashing, and credit card services. Emeric Fischer, Banking and Insurance—Should Ever the Twain Meet?, 71 Neb. L. Rev. 726, 771 n.204 (1992). Similarly, "American Express, aside from credit card services, offered insurance, investment banking, and banking services through a Swiss bank." Id.

Congress also authorized thrift institutions to make certain consumer loans and provide negotiable order of withdrawal ("NOW") accounts, which are interest-bearing accounts. Depository Institutions Deregulation and Monetary Control Act ("DIDMCA"), Pub. L. No. 96-221, §§ 204-205, 303, 94 Stat. 132, 143 (codified at 12 U.S.C. §§ 3503-3504 (1988)). In the late 1970s, when nominal interest rates soared and banks were not allowed to pay interest on checking accounts, many bank customers transferred their money from demand deposits in banks to NOW accounts in thrift institutions. JONATHAN R. MACEY & GEOFFREY P. MILLER, BANKING LAW AND REGULATION 31 (1992). This "hemorrhage" of funds created a crisis in the banking industry, because banks were at a severe competitive disadvantage to other financial institutions. Id. Today, interest rates are effectively deregulated throughout the banking industry. Id.

2. An MMMF, although not a demand deposit, is similar to a traditional checking account because it allows check writing privileges. Fischer, supra note 1, at 772. At the time they were created, MMMFs were very popular, because they could pay higher interest rates than banks were allowed to pay on similar deposits, because banks were subject to interest rate ceilings set by Regulation Q, 12 C.F.R. pt. 217 (1992). Id. By the 1980s, however, Congress recognized that banks had been losing money to more liquid investments such as the MMMFs and enacted legislation to phase out the interest rate ceilings by 1986. See Depository Institutions Deregulation and Monetary Control Act, Pub. L. No. 96-221, §§ 204-205, 94 Stat. 143 (codified at 12 U.S.C. §§ 3503-3504 (1982)).

3. A CMA combines the features of a securities brokerage account, a money market fund, a checking account with a bank, and a debit card issued by the same bank. Fischer, supra note 1, at 772. When the owner of a CMA purchases securities, writes a check, or uses his debit card, the funds are automatically withdrawn and credited to the payee’s account. Id. at 772 n.209.

4. See infra note 7 for a discussion of Glass-Steagall’s ban on underwriting activities. In October

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In response to these competitive pressures, national banks have attempted to expand and diversify their products and activities. One such example of an innovative new bank product is the Retirement Certificate of Deposit ("Retirement CD") marketed by Blackfeet National Bank. Though named a certificate of deposit, a traditional banking product, the Retirement CD is very similar to an annuity, an insurance product. Although no federal legislation specifically prohibits national banks from engaging in insurance activities, banking and insurance have traditionally been legally separate industries.

In **NationsBank of North Carolina v. Variable Annuity Life Insurance Co.**, the Supreme Court recently held that annuities are investment products that national banks are authorized to broker. If the Retirement CD is classified as an annuity, banks will have the power to market and sell the product. However, most state insurance regulations define "insurance" to

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1995, Rep. James A. Leach introduced legislation that would repeal the Glass-Steagall Act and lift the ban on underwriting activities to ease the burden on financial institutions. See infra notes 137-45 and accompanying text (discussing this proposed legislation).

Because banks are unable to provide underwriting services, many people are placing their savings in pension and retirement plans. See William M. Isaac & Melanie L. Fein, *Facing the Future—Life Without Glass-Steagall*, 37 CATH. U. L. REV. 281, 293 (1988). The professional nonbank managers of these funds divert funds from banks to the securities markets. Id. In addition, banks have become increasingly unable to meet the modern financial needs of their large corporate customers. Fischer, supra note 1, at 773. Rather than relying on bank loans, many large corporate entities meet their credit needs by issuing commercial paper and securitizing their assets. Id. Because Glass-Steagall prohibits banks from providing underwriting services, corporate customers have looked to the securities industry to meet their financial needs. Id. at 773-74.

5. For a detailed description of the Retirement CD, see infra notes 86-92 and accompanying text.

6. For the analysis of the features of the Retirement CD, see infra notes 85-122 and accompanying text.

7. The Glass-Steagall Act strictly prohibits national banks from underwriting securities but does not regulate the insurance activities of national banks. See The Banking Act of 1933, 48 Stat. 162, 184, 188, 189, 194 (codified as amended at 12 U.S.C. §§ 24, 78, 377, 378 (1988)). Fischer explained that the separation between banking and insurance resulted from the "generally accepted view that banks should not be allowed to engage in nonbanking activities." Fischer, supra note 1, at 784; see also Saxon v. Georgia Ass'n of Indep. Ins. Agents, 399 F.2d 1010 (5th Cir. 1968) (concluding that banks should not engage in insurance-related activities). As Fischer discussed, because of the lack of comprehensive legislation, the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve, and state authorities reached conflicting decisions as to the scope of bank insurance powers. Fischer, supra note 1, at 784.


9. Id. at 817. For further discussion of NationsBank, see infra notes 51-57 and accompanying text. If the Retirement CD fell within the definition of a "security" under federal and state securities laws and regulations, national banks would have to comply with applicable securities laws. A discussion of securities laws and regulations is beyond the scope of this Recent Development.

10. In **NationsBank**, the Supreme Court granted broad deference to the Comptroller's conclusion that annuities are investment products that banks are authorized to broker. Id. at 817. However, there is some question as to whether the Court would uphold the Comptroller's determination that a national bank may underwrite products such as the Retirement CD. In footnote 4 of the NationsBank opinion, Justice Ginsburg noted that the Comptroller limited his ruling to situations where the bank "will act only as agent... will not
include annuities for purposes of state insurance regulation. Consequently, even if national banks are authorized to sell new products such as the Retirement CD, they may be subject to the full range of state insurance regulations. These onerous regulations would further strain the stability and profitability of national banks.

Using the Retirement CD as an example, this Recent Development examines the conflict between national bank powers and state insurance regulations. Part II explains federal regulation of banking activities and the powers of national banks. Part III discusses state insurance regulations and the concept of reverse preemption, which sometimes allows such regulations to preempt federal laws. Part IV examines *American Deposit Corp. v. Schacht,* a recent case in which the Seventh Circuit held that the Retirement CD is an annuity for purposes of state insurance regulation. Finally, Part V discusses the reaction to the Retirement CD and Schacht’s impact on national banks’ ability to expand and diversify.

II. THE POWERS OF NATIONAL BANKS AND FEDERAL REGULATION OF BANKING ACTIVITIES

A. Federal Regulation of Banks

1. Structure

The United States has a dual banking system. Banks may elect to seek a charter under either state or federal law. Generally, state laws regulate the

have a principal stake in annuity contracts and therefore will incur no interest rate or actuarial risks.” *Id.* at 815 n.4 (emphasis added) (citing Mar. 21, 1991 Interpretative Letter from the OCC). Thus, *NationsBank* did not address the issue of whether national banks may underwrite annuities.

The Court emphasized that it “should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute.” *Id.* at 813 (citing Clarke v. Securities Indus. Ass'n, 479 U.S. 338, 403-04 (1987) (quoting Investment Co. Inst. v. Camp, 401 U.S. 617, 626-27 (1971))). According to the Court, because the NBA is silent as to whether banks may broker or underwrite annuities, the Comptroller had discretion to authorize the activity. *Id.* at 813-14, 814 n.2. However, the Comptroller’s discretion “must be kept within reasonable grounds. Ventures distant from dealing in financial investment instruments . . . may exceed those bounds.” *Id.* at 814 n.2. Thus, the key question would be whether the Comptroller’s determination that banks may underwrite the Retirement CD is reasonable.

11. See infra note 99.
13. *Id.* at *10.
activities of state-chartered banks.\textsuperscript{14} National banks are chartered under the authority of the National Bank Act of 1864 ("NBA.").\textsuperscript{15} The NBA established the Office of the Comptroller of the Currency ("OCC" or "Comptroller")\textsuperscript{16} to screen applicants for charters, issue charters, supervise the national banks, and regulate the currency.\textsuperscript{17} Although state and national banks offer similar products and services, they may be subject to very different regulatory structures by virtue of their governing laws.\textsuperscript{18}

In addition to the NBA, nationally chartered banks are subject to other sources of federal regulation. In 1913, Congress enacted the Federal Reserve Act,\textsuperscript{19} which created a system of twelve Federal Reserve Banks, each of which operates, in effect, as a central bank for its geographic region.\textsuperscript{20} The Board of Governors of the Federal Reserve System\textsuperscript{21} (the "Fed") supervises these banks,\textsuperscript{22} and all banks operating under a national charter are required to join the Federal Reserve System.\textsuperscript{23}

\begin{itemize}
\item \textsuperscript{14} A discussion of state banking laws and the insurance powers of state-chartered banks is beyond the scope of this Recent Development.
\item \textsuperscript{16} The OCC is the federal agency within the Department of Treasury that charters and supervises the activities of national banks and is charged with interpreting the NBA. MICHAEL P. MALLOY, THE REGULATION OF BANKING 41, 62 (1992). Almost all significant actions taken by national banks, including chartering, establishment of branches, and changes in corporate control must be approved by the Comptroller. \textit{id}. at 62. The Comptroller also has supervisory authority over the day-to-day activities of national banks, such as loan and investment policies of the banks and bank trust activities. \textit{id}. National bank examiners supervise banks by conducting periodic on-site examinations. \textit{id}.
\item \textsuperscript{17} National Bank Act § 8.
\item \textsuperscript{18} Generally, national banks are also subject to the laws of the state in which they are located, unless the state law expressly conflicts with federal law or interferes with the federal regulatory scheme. MACEY & MILLER, supra note 1, at 134-35. The Supreme Court, in evaluating whether state or federal rules apply to national banks, noted that daily banking operations, such as making contracts and collecting debts, are governed more by state than federal law. National Bank v. Commonwealth, 76 U.S. 355, 362 (1869).
\item \textsuperscript{20} \textit{id}; MALLOY, supra note 16, at 66. Each Reserve Bank is a separate corporate entity, the stockholders of which are its member banks. \textit{id}. at 67.
\item \textsuperscript{21} The Federal Reserve System consists of the Fed and its staff, the Federal Reserve Banks, the Federal Open Market Committee, the Federal Advisory Council, and the member banks, which include commercial banks that are required or elect to join. MALLOY, supra note 16, at 66.
\item \textsuperscript{22} The Fed is made up of seven members appointed by the President and confirmed by the Senate. 12 U.S.C. § 241 (1988). Each member is appointed for a 14-year term, and the terms are staggered so that one member's term expires every two years. \textit{id}. The Fed supervises and examines the Federal Reserve Banks, national banks, and state-chartered member banks. MALLOY, supra note 16, at 66-67. In addition, the Fed monitors the availability of credit and administers federal laws concerning reserve requirements and interest rates applicable to bank deposits. \textit{id}. at 67. These credit and monetary functions are beyond the scope of this Recent Development.
\item \textsuperscript{23} 12 U.S.C. §§ 221-222 (1988). State banks may also elect to join the Federal Reserve System as member banks. \textit{id}. § 321. Although state member banks still derive their powers from the laws of the state of incorporation, they become subject to the jurisdiction of the Fed. 12 U.S.C. § 330 (1988) (stating that "any
Following the 1929 stock market crash, Congress enacted the Banking Act of 1933 ("1933 Act" or "Glass-Steagall Act")\(^{24}\) to effect the recovery and reform of the struggling banking system.\(^{25}\) The 1933 Act made two substantial revisions to the pre-Depression banking law. First, it strictly prohibited national banks from underwriting securities,\(^{26}\) a common practice before the Depression and a contributing factor to widespread bank failures during the Depression.\(^{27}\) Next, the 1933 Act established the Federal Deposit Insurance Corporation ("FDIC").\(^{28}\) The FDIC insures customer deposits up to a specified amount, currently $100,000.\(^{29}\)

Bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights as a State bank . . . and may continue to exercise all corporate powers granted it by the State in which it was created\(^{30}\)).

\(^{24}\) The Banking Act of 1933 §§ 16, 20-21, 32.

\(^{25}\) See MACEY & MILLER, supra note 1, at 22.

\(^{26}\) See supra note 7. Glass-Steagall’s ban on underwriting activities carries over into several sections of the NBA, most notably:

- a) Section 16 (codified at 12 U.S.C. § 24) prohibits national banks from buying or selling securities for their own account.


- c) Section 21 (codified at 12 U.S.C. § 378) prohibits national banks from underwriting or issuing securities, with exceptions.


These Glass-Steagall provisions also apply to state banks that are members of the Federal Reserve System. The language of U.S.C. §§ 78 and 377 makes them applicable to state member banks. Section 24 is applied through § 335, see 12 U.S.C. § 335 (1988) (extending section 24’s limitations on national banks to state banks), and § 378 is applicable to organizations that include state member banks.

\(^{27}\) See MACEY & MILLER, supra note 1, at 22. The Glass-Steagall Act erected a wall between commercial banking and investment banking. Id. The Act barred commercial banks that are members of the Federal Reserve System from engaging in the securities business and prohibited securities firms from accepting deposits or affiliating with deposit-taking institutions. Id.

\(^{28}\) Banking Act of 1933 § 8 .

\(^{29}\) Currently, the FDIC insures up to $100,000 of the total amount deposited by a customer at a depository institution. 12 U.S.C. § 1821(a)(1) (1988). For purposes of determining the amount of deposits insured, the FDIC will aggregate the total amount of deposits a customer makes at a depository institution, but the FDIC will not aggregate deposits that a customer holds at different institutions. See 12 U.S.C. § 1821(a)(1)(C) (1994). National banks and state member banks of the Federal Reserve System are required to obtain insurance from the FDIC. See 12 U.S.C. § 1814 (1988).

2. Protecting Depositors and Customers of National Banks

Federal banking regulations are structured to protect the depositors and customers of national banks. To effect this goal, the federal banking system relies on specific types of regulatory mechanisms. First, national banks must meet chartering and capitalization requirements. Second, banks are restricted in their use of depositors' funds. Finally, federal regulations restrict the permissible activities of national banks.

Both the NBA and the regulations promulgated by the Comptroller under the NBA govern the formation of national banks. Bank organizers must prepare articles of association and file them with the Comptroller. In addition, the NBA requires bank organizers to provide a minimum capital infusion. Once these requirements are met, the Comptroller determines which applicants will be allowed to "commence . . . business." If granted a charter, national banks must join the Federal Reserve System and obtain FDIC insurance before opening their doors.

When national banks commence business and begin accepting deposits, federal regulations restrict banks' ability to use depositors' funds. The Fed administers reserve requirements, which are designed to act as a cushion against sudden demands for withdrawal of deposits. In addition, FDIC

30. Fischer explains that consumer protection includes all policies "aimed at protecting depositors' funds, insuring competitive pricing, and insuring that banks act as relatively impartial fiduciaries for the public" and that the safety of deposits is "a primary objective" of banking policy. Fischer, supra note 1, at 739. The macroeconomic goals of federal regulation, including credit distribution and capital apportionment, and the monetary policies implemented by the Fed are beyond the scope of this Recent Development.

31. See infra notes 34-38 and accompanying text for a discussion of federal chartering requirements.

32. For an explanation of the restrictions on banks' use of deposits, see infra notes 39-41 and accompanying text.

33. See infra notes 42-46 and accompanying text (explaining the limits on banking activities).

34. MALLOY, supra note 16, at 154.

35. 12 U.S.C. §§ 21-22 (1988); MALLOY, supra note 16, at 154. Applicants must also file extensive supporting data outlining, among other things, their plans of operations and showing adequate capitalization. WILLIAM A. LOVETT, BANKING AND FINANCIAL INSTITUTIONS LAW IN A NUTSHELL 121 (3d ed. 1992). The OCC also requires information on market circumstances in order to demonstrate that the market can handle another banking institution. Id.


40. MALLOY, supra note 16, at 435.
insurance further protects customer deposits.41

Finally, federal regulations restrict certain activities of national banks. When making loans, national banks face limits on the aggregate amount of loans they can make to any one borrower, limits on certain types of loans, and prohibitions against usurious interest rates.42 Banks are also generally prohibited from guaranteeing the obligations of third parties,43 restricted as to the real property interests they may acquire,44 and regulated when they exercise trust powers.45 In addition, Glass-Steagall severely limits the underwriting and securities activities of national banks.46

B. The "Incidental Powers" Clause

Despite these limits on the activities of national banks, the NBA, in § 24 (Seventh), sets forth a specific list of enumerated powers and authorizes national banks to "carry on the business of banking."447 Specifically, § 24 (Seventh) authorizes national banks "[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking" and to "receive[e] deposits."448 Although § 24 (Seventh) specifically states that banks cannot underwrite any issue of securities or stock,49 it is silent as to the powers of national banks to sell or underwrite insurance products, such as

41. See supra note 29.
42. MALLOY, supra note 16, at 382.
43. Id. at 487 (stating that § 24 (Seventh) generally does not grant national banks the power to issue guarantees). Ironically, national banks are allowed to issue standby letters of credit, which are "in essence only guaranties." Dunn v. McCoy, 113 F.2d 587, 588 (3d Cir. 1940). A letter of credit is "[a]n engagement by a bank or other person made at the request of a customer that the issuer will honor . . . [a] demand for payment upon compliance with the conditions specified in the credit." BLACK'S LAW DICTIONARY 903-04 (6th ed. 1990). A standby letter of credit is one which commits the issuer, the bank, to honor the credit only upon evidence of a declaration of the customer's default in the underlying transaction with the beneficiary. Id. at 904.
46. See supra notes 7, 26.
48. Id. In § 24 (Seventh), the National Bank Act provides that national banks shall have power—
   To exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes . . . . The business of dealing in securities and stock by the [bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [bank] shall not underwrite any issue of securities or stock . . . .
49. Id.
annuities.\textsuperscript{50}

In 1995, the Supreme Court dramatically expanded the "incidental" powers of national banks to sell financial products not specifically enumerated in § 24 (Seventh). In \textit{NationsBank of North Carolina v. Variable Annuity Life Insurance Co.},\textsuperscript{51} the Court held that national banks may serve as agents in the sale of annuities, because such a service is incidental to the business of banking.\textsuperscript{52} Moreover, the Court expressly held that the "business of banking is not limited to the enumerated powers in § 24 (Seventh) and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated [in the NBA]."\textsuperscript{53}

In \textit{NationsBank}, the Court avoided a discussion of whether national banks have the power to sell insurance. The Court deferred to the Comptroller's conclusion that, for purposes of § 24 (Seventh), annuities are investment products rather than insurance products.\textsuperscript{54} The Court recognized that annuities might be defined as insurance products in other contexts, such as state insurance regulation, but it agreed that § 24 (Seventh) authorizes national banks to sell annuities because they "serve an important investment purpose and are functionally similar to other investments that banks typically sell."\textsuperscript{55}

\textsuperscript{50} See infra note 56 for an explanation of the "small town" provision in this rule. Even though § 24 (Seventh) does not explicitly grant national banks the power to sell annuities, many national banks do sell annuities and other insurance products. In a 1994 article, William Isaac stated that approximately 25% of national banks currently sell annuity products. William M. Isaac, \textit{Banks May Be Giving Up the War If They Don't Win Insurance Battle}, \textit{Am. Banker}, Jan. 13, 1994, at 22. Annuity sales by those banks totalled $7.7 billion in 1992 and generated fee income of $285 million. \textit{Id.} Data from the March 1994 call reports submitted to the Federal Reserve Board showed that over 1500 insured commercial banks offered annuities to their customers. Michelle A. Clarke, \textit{Call Reports Show Surprisingly Few Banks Selling Funds}, \textit{Am. Banker}, Aug. 25, 1994, at 12. To deny banks the power to sell annuities would deprive them of an important profit source and provide a boon to the insurance industry.

\textsuperscript{51} 115 S. Ct. 810 (1995).


\textsuperscript{53} \textit{NationsBank}, 115 S. Ct. at 814 n.2. The Variable Annuity Life Insurance Co. ("VALIC"), which sells annuities, brought the suit to challenge the Comptroller's decision that national banks may sell annuities. \textit{Id.} at 814. VALIC argued that the enumerated activities listed in § 24 (Seventh) after the words "business of banking" are exclusive and that national banks are confined to those activities. \textit{Id.}

\textsuperscript{54} \textit{Id.} at 817. In the 1985 Letter, the Comptroller noted that the Supreme Court had previously determined that variable annuities are securities. 1985 Letter, supra note 52 (citing SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967); SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959)); see also 1 \textbf{JOHN A. APPELMAN & JEAN APPELMAN, INSURANCE LAW & PRACTICE} § 84, at 295 (1981) (arguing that "[a]nnuity contract[s] must . . . be recognized as investments rather than as insurance"); \textbf{D. SHAPIRO & T. STREIFF, ANNUITIES} 7 (1992) (explaining that in contrast to life insurance, "[a]nnuities . . . are primarily investment products").

\textsuperscript{55} \textit{NationsBank}, 115 S. Ct. at 817. For a similar conclusion with respect to state-chartered banks, see
Because it defined annuities as investment products under § 24 (Seventh), the Court did not examine the power of national banks to sell insurance. 56 The Court also limited its holding by noting that the Comptroller's decision is limited to situations where national banks serve as agents and not as underwriters subject to interest rate and actuarial risks. 57

Further, the Court did not discuss the issue of whether national banks are subject to state insurance regulations if they sell insurance products. Presumably, if the bank acts only as an agent in the sale of insurance products, the actual underwriter of such products follows all applicable state insurance regulations. Thus, there is no need for the broker to be concerned with such regulations when selling insurance products to consumers, because the products already comply with state regulations.

New York State Ass'n of Life Underwriters v. New York State Banking Dep't, 632 N.E.2d 876 (1994) (analyzing the language of a New York statute, which is identical to the language in § 24 (Seventh) and concluding that state-chartered banks may sell annuities pursuant to their "incidental" powers).

56. The NBA is silent on the issue of whether all national banks are authorized to sell insurance. However, section 92, the "small town" provision, authorizes banks located in towns of less than 5000 inhabitants to broker certain types of insurance. Section 92 provides:

In addition to the powers now vested by law in [national banks]... any such [bank] located and doing business in any place the population of which does not exceed five thousand inhabitants...

... may act as the agent for any fire, life, or other insurance company authorized by the authorities of the State in which said bank is located to do business in said State, by soliciting and selling insurance and collecting premiums on policies issued by such company....


Although banks must be located in a city of less than 5000 inhabitants, nothing prevents banks from selling products in other markets. Independent Ins. Agents of Am. v. Ludwig, 997 F.2d 958, 962 (D.C. Cir. 1993). Thus, a bank may establish a branch in a city with less than 5000 inhabitants and sell insurance to customers everywhere. See id.

Some courts have argued that section 92, by negative implication, precludes banks in towns of more than 5000 inhabitants from selling insurance. See, e.g., American Land Title Ass'n v. Clarke, 968 F.2d 150, 157 (2d Cir. 1992), cert. denied, 113 S. Ct. 2959 (1993) (holding that section 92 precludes banks in towns of greater than 5000 from selling title insurance); Saxon v. Georgia Ass'n of Indep. Ins. Agents, 399 F.2d 1010, 1013 (5th Cir. 1968) (same).

The Supreme Court did not reach this issue in NationsBank because it determined that annuities are investment products rather than insurance products. 115 S. Ct. at 817. However, other courts have held that the powers granted in § 24 (Seventh) are supplementary to section 92 and that section 92 is not the exclusive source of banks' power to sell insurance. See, e.g., Independent Bankers Ass'n of Am. v. Heimann, 613 F.2d 1164, 1170 (D.C. Cir. 1979), cert. denied, 449 U.S. 823 (1980) (holding that section 92 does not prohibit national banks from selling credit life insurance and that this activity was authorized by the incidental powers clause of § 24 (Seventh)).

III. STATE REGULATION OF INSURANCE AND REVERSE PREEMPTION UNDER MccARRAN-FERGUSON

A. State Insurance Regulations and Mccarran-Ferguson

States have broad powers to regulate the insurance industry and the sale of insurance products. In 1945, Congress enacted the Mccarran-Ferguson Act ("Mccarran-Ferguson") to protect most state insurance regulations from preemption by federal laws. Section 1012 of Mccarran-Ferguson, which establishes a system of reverse preemption, prevents federal law from impairing state regulatory schemes unless Congress explicitly declares that the federal law preempts state insurance regulations or the federal law relates to the "business of insurance." Laws enacted "for the purpose of regulating the business of insurance" consist of those intended to adjust or control the business of insurance.

58. 19 Appleman & Appleman, supra note 54 § 10321, at 1 (1982). The state derives its right to regulate the insurance industry from its police powers, because the business of insurance affects the rights of all citizens of the state. Id. § 10321, at 8. The only limit on a state’s power to regulate insurance is that the regulations must be reasonably related to the public interest and not be arbitrary or impermissibly discriminatory. Id. § 10325, at 50.


60. See 15 U.S.C. § 1011 (1988). Mccarran-Ferguson was enacted in response to the Supreme Court’s ruling that insurance is a matter of interstate commerce subject to regulation by Congress. See United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944). Congress enacted Mccarran-Ferguson to ensure that states would retain broad regulatory authority over the “business of insurance” and to exempt the “business of insurance” from federal antitrust laws. See United States Dep't of Treasury v. Fabe, 113 S. Ct. 2202, 2210 (1993) (citing Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205, 218 n.18 (1979)).

61. 15 U.S.C. § 1012 (1976). Section 1012 states that “[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, . . . unless such Act specifically relates to the business of insurance. . . .” Id. For a definition of the “business of insurance,” see infra notes 62-63. Although Mccarran-Ferguson allows states to regulate insurance free from Commerce Clause violations, states must continue to follow other constitutional requirements. 19 Appleman & Appleman, supra note 53, § 10325, at 53.


62. Fabe, 113 S. Ct. at 2210. In Fabe, the Court relied on its decision in Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1982), in which the Court defined the “business of insurance” as being composed of practices and activities that satisfy the following criteria: “[f]irst, whether the practice has the effect of transferring or spreading a policyholder’s risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry.” Pireno, 458 U.S. at 129.
Specifically, such laws include state statutes aimed at directly or indirectly protecting or regulating the relationship between the insurance company and its policyholder. A law regulating the actual performance of the insurance contract, for example, would fall within the definition of a law "enacted for the purpose of regulating the business of insurance."  

B. Section 92 of the NBA Preempts State Anti-Affiliation Statutes

In an attempt to prevent national banks from selling insurance products such as the Retirement CD, twenty-four states enacted anti-affiliation regulations, which prohibit banks from affiliating with insurance companies or selling insurance products. Relying on McCarran-Ferguson, state insurance regulators argued that national banks could not sell insurance, because the NBA does not preempt the anti-affiliation statutes.

In Barnett Bank of Marion County v. Nelson, the Supreme Court held that section 92 of the NBA, which allows national banks in cities of less than 5000 inhabitants to sell insurance, preempts state anti-affiliation statutes.

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64. Fabe, 113 S. Ct. at 2210.

65. As of April, 1996, some 24 states had anti-affiliation regulations that might have prohibited the affiliation of depository institutions and insurance agencies. Linda Greenhouse, Ruling Backs Banks' Sales of Insurance: High Court Overturns Prohibitions by States, N.Y. Times, Mar. 27, 1996, at C1, C6. These states included Arkansas, Colorado, Connecticut, Florida, Georgia, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Mississippi, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, Ohio, Pennsylvania, Rhode Island, Tennessee, Texas, Vermont, and West Virginia. Id.


68. For the text of section 92, see supra note 56.

The state statute at issue in *Barnett Bank* prohibited insurance agents affiliated with financial institutions from engaging in insurance activities.\(^70\) In effect, the statute barred almost all banks from selling insurance.\(^71\)

The Court in *Barnett Bank* concluded that the anti-affiliation statute was in irreconcilable conflict with section 92 of the NBA, because section 92 authorizes national banks to engage in insurance activities that the statute expressly forbids.\(^72\) The Court rejected the State of Florida’s argument that section 92 grants only a very limited permission to sell insurance to the extent that state law grants such permission.\(^73\) First, the Court noted that the language of section 92 suggests a broad permission to sell insurance.\(^74\) Second, the Court explained that section 92’s grant of authority to sell insurance is an “addition to the *powers* now vested by law in national [banks].”\(^75\) According to the Court, grants of both enumerated and incidental powers to national banks ordinarily preempt conflicting state law.\(^76\) Consequently, under ordinary preemption principles, the Court concluded that section 92 preempts the anti-affiliation statute.\(^77\)

Further, the Court held that McCarran-Ferguson’s special anti-preemption rule did not apply, because section 92 “specifically relates to the business of

\(^70\) The Florida statute provided:

(2) No insurance agent or solicitor licensed by the Department of Insurance under the provisions of this chapter who is associated with, under contract with, retained by, owned or controlled by, to any degree, directly or indirectly, or employed by, a financial institution shall engage in insurance agency activities as an employee, officer, director, agent, or associate of a financial institution agency.


\(^71\) *Barnett Bank*, 64 U.S.L.W. at 4162. Under the Florida statute, banks that were not subsidiaries or affiliates of bank holding companies and were located in cities of less than 5000 inhabitants could sell insurance. *Id.* For the language of the Florida statute, see *supra* note 70. The “small town” exception comes from section 92 of the NBA, which allows banks in cities with a population of less than 5000 to sell insurance. For the language of section 92, see *supra* note 56.

\(^72\) *Barnett Bank*, 64 U.S.L.W. at 4163.

\(^73\) *Id.*

\(^74\) *Id.*

\(^75\) *Id.* (citing 12 U.S.C. § 92).

\(^76\) *Id.* (citing First Nat’l Bank of San Jose v. California, 262 U.S. 366, 368-69 (1923) (holding that national banks’ “power” to receive deposits preempts contrary state escheat law); Easton v. Iowa, 188 U.S. 220, 229-30 (1903) (concluding that the national banking system is normally “independent, so far as powers conferred are concerned, of state legislation”)). Although the cases cited were decided before the enactment of McCarran-Ferguson and its rule of reverse preemption, the Court concluded that McCarran-Ferguson does not prevent section 92 from preempting the anti-affiliation statute. See *infra* notes 78-82 and accompanying text.

\(^77\) *Barnett Bank*, 64 U.S.L.W. at 4164.
insurance.”78 Examining the language of section 92, the Court concluded that the statute specifically related to the business of insurance, because it focused directly on industry-specific selling practices and affected the relation of insured to insurer and the spreading of risk.79 Moreover, the Court explained that McCarran-Ferguson does not attempt to insulate state insurance regulations from all federal laws; it only seeks to protect state regulations from “inadvertent” federal intrusion.80 Because the Court concluded that section 92 “specifically relates to the business of insurance,” it held that section 92 is not the type of “inadvertent” federal law that McCarran-Ferguson sought to protect against.81

Thus, after Barnett Bank, state anti-affiliation statutes will not inhibit bank powers to sell insurance under section 92 of the NBA.82 However, because the Supreme Court in Barnett Bank only examined section 92 of the NBA, it is unclear whether all banks selling insurance products must comply with state regulations. As the Supreme Court recognized in NationsBank, the incidental powers clause of § 24 (Seventh) authorizes banks to sell insurance.83 Moreover, the Supreme Court recognized in Barnett Bank that grants of enumerated and incidental powers to national banks are not limited by contrary state law.84 Thus, it appears that national banks should be able to sell insurance products free from onerous state regulations. However, the Seventh Circuit, ignoring the Supreme Court’s guidance in Barnett Bank, adopted a contrary approach.

78. Id. at 4164-65. For the relevant language of McCarran-Ferguson, see supra note 61.
79. Id. at 4165. The Court rejected the State of Florida’s argument that section 92 specifically relates to banking, not insurance, because it determined that a statute may specifically relate to more than one thing. Id. at 4166. The Court explained that “[i]just as an ordinance forbidding dogs in city parks specifically relates to dogs and to parks, so a statute permitting banks to sell insurance can specifically relate to banks and to insurance.” Id.
80. Id. at 4165.
81. Id.
82. The Court’s decision will impact more than just national bank powers, because most states have laws that ensure that state-chartered banks are able to exercise the same powers as national banks. Greenhouse, supra note 65, at C6.
83. See supra note 52 and accompanying text.
84. Barnett Bank, 64 U.S.L.W. at 4163.
IV. REGULATING THE SALE OF INSURANCE PRODUCTS BY NATIONAL BANKS: AMERICAN DEPOSIT CORP. V. SCHACT

American Deposit Corporation ("ADC") developed the Retirement Certificate of Deposit ("Retirement CD") and licensed it for offering and sale to Blackfeet National Bank ("Blackfeet"). Although ADC named the product a certificate of deposit, the terms of the Retirement CD are similar to those of an annuity. The customer deposits a lump sum and selects his expected retirement date as the date of maturity. Interest on the amount is tax-deferred and begins to accrue on the date of deposit. When the maturity date arrives, the bank calculates the amount of the monthly payment by examining the account balance at that time, the customer's age, the monthly payment interest rate then in effect, and the Society of Actuaries Annuity Table. After the maturity date, the customer receives these fixed monthly payments until his death. He is assured of receiving the entire account balance regardless of his lifespan; if he has not received the full amount, the remainder is paid to his designated beneficiary or his estate at


88. Schacht, 887 F. Supp. at 1071. For a discussion of sections 72 and 1275 of the Internal Revenue Code, which allow holders of certain annuity contracts to defer taxation of interest until they begin receiving payments, see infra notes 150-55 and accompanying text. Prior to the maturity date, "withdrawals are subject to penalty and IRS treatment as taxable income." Schacht, 887 F. Supp. at 1071. For tax purposes, monthly payments are apportioned between interest and principal. Id.

89. Schacht, 1996 WL 252869, at *1. Interest is calculated under a formula tied to the then current five-year U.S. government treasury note yield. Schacht, 887 F. Supp. at 1071.

The FDIC determined that the principal amount and the accumulated interest on the Retirement CD are entitled to FDIC insurance, but it refused to insure any additional amounts. Id. at 1072. According to the FDIC, the value of the lifetime, monthly payments is uncertain and could exceed the total account balance. Id. If a bank failure occurred before the maturity date, the Retirement CD would be insured to the extent of the principal and accrued interest to the date of the failure. Id. In the event of a bank failure after maturity of the Retirement CD, the FDIC agreed to pay the customer the balance of the account at maturity date, principal plus accrued interest, minus the sum of any withdrawal and monthly payments already made. Id.


91. Id. Once determined, the monthly payments to the customer will remain fixed over the customer's lifetime. Id. If he chooses, the customer may make a cash withdrawal of up to two-thirds of the account balance on the maturity date. Id.
death.\(^{92}\)

In 1994, Blackfeet began to market the Retirement CD in Illinois.\(^{93}\) Claiming that Blackfeet was engaging in insurance activities subject to state regulation, the Illinois Director of Insurance, James W. Schacht, issued a cease and desist order against Blackfeet.\(^{94}\) ADC and Blackfeet subsequently filed a complaint in the United States District Court for the Northern District of Illinois, seeking injunctive and declaratory relief.\(^{95}\)

ADC and Blackfeet argued that the Retirement CD is a “deposit” authorized by §24 (Seventh) of the NBA\(^{96}\) and thus does not fall within the Illinois Insurance Code’s (the “Insurance Code”) definition of “insurance.”\(^{97}\) Further, they argued that even if the Retirement CD is classified as an annuity and falls within the scope of the Insurance Code, the NBA, pursuant to the “incidental” powers clause in §24 (Seventh), preempts state attempts to regulate the sale of the Retirement CD.\(^{98}\) In return, Schacht argued that the Retirement CD is an “annuity” subject to state insurance regulations\(^{99}\) and that McCarran-Ferguson immunizes state insurance regulations from preemption.\(^{100}\)

The Seventh Circuit held that Illinois insurance regulations apply to the sale of the Retirement CD, because the Retirement CD is “insurance” within

\(^{92}\) Schacht, 1996 WL 252869, at *1.

\(^{93}\) Schacht, 887 F. Supp. at 1068. Blackfeet’s marketing in Illinois was very limited; it sent informational packets to ten persons who requested them. Id. In fact, Blackfeet did not accept any deposits from Illinois residents. Id.

\(^{94}\) Schacht, 1996 WL 252869, at *1.

\(^{95}\) Schacht, 887 F. Supp. at 1068.

\(^{96}\) On May 12, 1994, the OCC issued a no-objection letter in which it determined that the Retirement CD is a deposit within the traditional banking powers under §24 (Seventh). Letter from William P. Bowden, Jr., Chief Counsel, Office of the Comptroller of the Currency, to Jack Kelly, President and Chief Executive Officer, Blackfeet National Bank (May 12, 1994), cited in David W. Roderer & William B.F. Steinman, The Authority for Banks to Sell Annuities and Insurance Related Products, 48 CONSUMER FIN. L.Q. REP. 395, 406 (1994). The OCC relied on “the express authorizations [in §24 (Seventh)] for the bank to receive deposits and enter into contracts, coupled with its powers to incur liabilities and fund its operations...” Id. In addition, the OCC explained that the fact that the Retirement CD requires actuarial calculations does not prevent it from being an “authorized bank product” because “[m]odernizing bank practices to comport with ever changing customer needs is permissible, provided that the practices remain fundamentally what is authorized by the [National Bank] Act.” Id.

\(^{97}\) Schacht, 887 F. Supp. at 1075.

\(^{98}\) Id. at 1079.

\(^{99}\) Id. at 1077. Schacht’s argument was simple; because the Retirement CD is an annuity and the insurance code lists annuities as subject to insurance regulation, the Retirement CD should be subject to insurance regulation. Id. The court noted that all fifty states regulate annuities under their insurance laws. Id. (citing Variable Annuity Life Ins. Co. v. Clarke, 998 F.2d 1295, 1300 n.2 (5th Cir. 1993), rev’d on other grounds, NationsBank of N.C. v. Variable Annuity Life Ins. Co., 115 S. Ct. 810 (1995)).

\(^{100}\) Id. at 1079.
the meaning of McCarran-Ferguson. Additionally, the court concluded that § 24 (Seventh) of the NBA does not specifically relate to the business of insurance, so the NBA, under McCarran-Ferguson, does not preempt the state regulations.

First, the court determined that the Illinois regulations were enacted "for the purpose of regulating the business of insurance." The court explained that the regulation requiring prior approval from the Illinois Department of Insurance before a company may sell any type of insurance is necessary for the State of Illinois to monitor the relationship between the insurer and its customers. Thus, because the regulations "possess the 'end, intention, or aim' of adjusting, managing, or controlling the business of insurance," they fall within the scope of McCarran-Ferguson.

Next, the court concluded that the sale of the Retirement CD falls within McCarran-Ferguson's definition of the "business of insurance." The court examined the Supreme Court's decision in NationsBank that annuities are investment products rather than insurance and determined that NationsBank was distinguishable. First, the court noted that the holding in NationsBank was limited to situations in which the bank is a broker, rather than an underwriter of the annuity. Second, the court explained that the Supreme Court in NationsBank did not consider whether a bank brokering annuities is subject to state insurance regulations. Because of these key factual differences, the Seventh Circuit in Schacht refused to follow the Supreme Court's holding that annuities are not insurance. The Seventh Circuit noted that the annuity at issue in NationsBank was a variable annuity, which offers

102. Id. at *9.
103. Id. at *3.
104. Id.
105. See supra note 62 and accompanying text.
107. Id. at *4.
108. See supra notes 54-55 and accompanying text.
110. Id. See supra note 56 for a discussion of this issue. The district court also addressed this distinction. American Deposit Corp. v. Schacht, 887 F. Supp. 1066, 1078 (N.D. Ill. 1995), aff'd, No. 95-2462, 1996 WL 252869 (7th Cir. May 13, 1996). It interpreted NationsBank to mean nothing more than "that the OCC could reasonably find the selling, as opposed to the underwriting, of annuities was an incidental power of banking." Id. (citing NationsBank of N.C. v. Variable Annuity Life Ins. Co., 115 S. Ct. 810, 815 (1995)).
112. Id. at *4-6.
no guarantee that benefits will be payable in fixed amounts.\textsuperscript{113} However, the court concluded that the Retirement CD is similar to a fixed annuity.\textsuperscript{114} Because the purchase of a Retirement CD involves both a mortality risk and a guaranteed return, the key characteristics of insurance, the Seventh Circuit concluded that the Retirement CD is insurance within the definition of McCarran-Ferguson.\textsuperscript{115}

Finally, the Seventh Circuit examined the relevant language of the NBA, presumably only the enumerated powers of § 24 (Seventh),\textsuperscript{116} and concluded that it does not preempt Illinois insurance regulations.\textsuperscript{117} Because the literal language of § 24 (Seventh) does not "explicitly" give banks the power to conduct insurance-related activities or "directly" focus on specific insurance selling practices, the Seventh Circuit concluded that § 24 (Seventh) does not "specifically" relate to the business of insurance.\textsuperscript{118} Moreover, the court examined the purposes of McCarran-Ferguson and concluded that in this case the NBA represented the type of "inadvertent federal intrusion" that McCarran-Ferguson was designed to guard against; it would allow a broad statement of federal law, of which insurance comprises only a small part, to exempt insurance activities from all state regulation.\textsuperscript{119}

In \textit{Schacht}, the Seventh Circuit adopted a misguided approach and reached an incorrect conclusion. The court's failure to consider the incidental powers clause of § 24 (Seventh) as a source of national banks' power to sell insurance was erroneous. In \textit{Barnett Bank}, the Supreme Court recognized that the NBA grants national banks the power to sell insurance in both section 92 and the incidental powers clause, and it explained that grants of incidental powers to national banks generally preempt contrary state laws.\textsuperscript{120} The District of Columbia Circuit, in \textit{Independent Bankers Association of America v. Heimann}, similarly held that section 92 is not the exclusive source of

\begin{enumerate}
\item \textsuperscript{113} \textit{Id.} at *6.
\item \textsuperscript{114} \textit{Id.}
\item \textsuperscript{115} \textit{Id.} The Seventh Circuit also noted that virtually all annuities are issued by insurance companies and that almost all state legislatures regulate annuities as a part of the insurance industry. \textit{Id.} at *7. \textit{Schacht} also made this argument at the district court level. \textit{See supra} note 99. This is a weak argument because the Court is assuming that the Retirement CD is an annuity. It has never been designated as such. If the Court chose to adopt a plain language argument, it should have called the Retirement CD a "deposit" within the definition of § 24 (Seventh) of the NBA.
\item \textsuperscript{116} Presumably, the Court based its argument only on the powers enumerated in § 24 (Seventh) and not on the incidental powers clause.
\item \textsuperscript{117} \textit{Id.} at *9.
\item \textsuperscript{118} \textit{Id.}
\item \textsuperscript{119} \textit{Id.}
\item \textsuperscript{120} \textit{See Barnett Bank of Marion County v. Nelson}, 64 U.S.L.W. 4161 (1996).
\end{enumerate}
banks' power to sell insurance.121

Moreover, there is a fundamental problem with the Seventh Circuit's holding in Schacht. If state regulations are allowed to preempt the NBA, states can effectively push banks out of the insurance market by subjecting them to such burdensome regulations that it is not cost-effective for banks to sell nondeposit investment products. This result would be contrary to the Supreme Court's decisions in NationsBank and Barnett Bank, which uphold national banks' powers to sell such products.122 Thus, the Seventh Circuit should have concluded that the state insurance regulations do not preempt the NBA. Instead, the court intensified the conflicts between the banking and insurance industries.

V. REACTION TO THE RETIREMENT CD

Although national banks hail the Retirement CD as an innovative new product, the reaction of government officials and members of the insurance industry has not been enthusiastic. Both NationsBank and Schacht indicate that national banks have the power to sell products such as the Retirement CD. However, in the wake of Schacht, federal and state legislatures and administrative officials have attempted to clarify the regulations that will govern the sale of insurance products.

A. Response at the Federal Level

1. Proposed Legislation

When national banks began to market and sell the Retirement CD, Congress attacked the product from several angles. Interestingly, legislators chose not to attack the Retirement CD head-on by amending the NBA to prohibit national banks from selling insurance products.123 Instead, proposed legislation would require national banks to comply with the full range of state insurance regulations if they choose to sell products such as the Retirement CD, and to make extensive disclosures to consumers when selling such

122. This does not mean that national banks selling insurance should be free from all regulation, but only that the source of such regulation should be federal and not left to the states.
123. In the wake of the Court's decision in Barnett Bank, some commentators expect House Republicans to amend pending banking bills to allow banks to affiliate with insurance companies. Kelley Holland, Banks Unplug a Policy Loophole, Bus. Wk., Apr. 8, 1996, at 43.
products. Finally, the proposed legislation would prevent the Retirement CD from receiving FDIC insurance.

Rep. Thomas J. Bliley introduced the Insurance State’s and Consumers’ Rights Clarification and Fair Competition Act (“Insurance Rights Act”) on March 24, 1995. The Insurance Rights Act would require that anyone who sells, underwrites, or solicits the purchase of insurance must comply with all applicable state insurance regulations. According to Rep. John D. Dingell, everyone selling or underwriting insurance, including banks, must at least meet state insurance standards in order to protect consumers and ensure that insurance products are financially sound. The Insurance Rights Act would essentially codify the holding in Schacht, allowing national banks to market and sell products such as the Retirement CD, subject to state regulation.

On March 28, 1995, Senator David Pryor introduced the Bank Customer Confidentiality and Protection Act of 1995 (“Customer Protection Act”). The Customer Protection Act would limit banks’ ability to advertise nondeposit investment products and would require banks selling such products to provide specific disclosures to customers.

When banks advertise nondeposit investment products, they would be unable to mislead consumers by implying that the products are insured or guaranteed. In addition, banks could not use bank letterheads, logos, or names when advertising or selling the products. The Consumer Protection

124. See infra notes 126-36 and accompanying text.
125. See infra notes 126-36 and accompanying text.
127. Id.
128. 141 CONG. REC. E693 (daily ed. Mar. 24, 1995) (statement of Rep. Dingell). Interestingly, Rep. Dingell is a strong supporter of federal regulation of the insurance industry, because he believes that current state regulatory schemes are inadequate and incapable of controlling the “interstate and international” insurance industry. Id.
130. Id. § 2(a)(3), (6). In February, 1994, the OCC announced that a section dealing with the sale of retail nondeposit investment products would be added to the Comptroller’s Handbook for National Bank Examiners. OCC Examination Procedures for Nondeposit Investment Sales, 6 Fed. Banking L. Rep. (CCH) ¶70-113, at 82,585 (Nov. 10, 1995) [hereinafter OCC PROCEDURES]. This section replaced the OCC Banking Circular on National Bank Retail Non-Degposit Investment Sales Activities. Id. The OCC PROCEDURES, which are very similar to Senate Bill 633, provide guidelines for national banks to follow when marketing and selling products such as the Retirement CD. See id.
131. S. 633, supra note 129, § 2(a)(2). Similarly, the OCC PROCEDURES require that banks disclose to consumers that the products are not FDIC insured, are not deposits or other obligations of the bank or guaranteed by the bank, and that they involve investment risks. OCC PROCEDURES, supra note 130, at 82,589. Additionally, the OCC PROCEDURES explain that banks could be liable under the antifraud provisions of federal securities laws if they mislead consumers about the nature of nondeposit investment products. Id. at 82,586.
Act would further require that the place where nondeposit investment products are sold be physically separated from the banking activities of the bank and be readily distinguishable by the public as separate and distinct from the bank.\textsuperscript{133} Finally, only qualified brokers whose responsibilities are limited to the sale of nondeposit investment products would be able sell the products.\textsuperscript{134}

When a customer opens an investment account or purchases a nondeposit investment product, FDIC-insured banks would have to disclose, in writing, that the product is not a deposit, not FDIC-insured, not guaranteed by the bank, and carries a risk of loss of principal.\textsuperscript{135} After providing the disclosure, banks would have to obtain written acknowledgements of customer disclosure.\textsuperscript{136}

The Customer Protection Act would impose substantial costs on national banks. If a national bank had to develop separate advertising schemes, hire new employees to sell the products, and maintain physically separate facilities for those employees, banks would be deterred, and in some cases incapable, of selling nondeposit investment products.

Finally, on May 3, 1995, Rep. Marge Roukema introduced the Bank Insurance Fund and Depositor Protection Act of 1995 ("Insurance Fund Act"),\textsuperscript{137} which would exclude bank products such as the Retirement CD from the definition of a "deposit" under the Federal Deposit Insurance Act.\textsuperscript{138} Senator Alfonse D'Amato introduced a companion bill in the Senate on May 12, 1995.\textsuperscript{139} The Insurance Fund Act would add 12 U.S.C. § 1813(l)(5)(C) to clarify that "any liability of an insured depository institution that arises under

\textsuperscript{133} Id. § 2(a)(7). The OCC PROCEDURES contain similar requirements. See OCC PROCEDURES, supra note 130, at 82,587-88.

\textsuperscript{134} S. 633, supra note 129, § 2(a)(8). The guidelines of the OCC PROCEDURES are more lenient. They simply require that individuals selling investment products "have an understanding of securities industry customer protection and control systems and have an adequate knowledge of the products being offered" and that banks instruct the sellers "as to the specialized obligations of selling investment products in a retail banking environment." OCC PROCEDURES, supra note 130, at 82,591.

\textsuperscript{135} S. 633, supra note 129, § 2(a)(3)(B). A bank would also have to disclose the nature of its relationship to the broker. Id. § 2(a)(3)(A)(ii). The disclosure provision of Senate Bill 633 is very similar to the requirements in the OCC PROCEDURES. See supra note 131 for a discussion of the guidelines.

\textsuperscript{136} S. 633, supra note 129. The OCC PROCEDURES merely suggest that banks obtain signed acknowledgements. OCC PROCEDURES, supra note 130, at 82,589.


\textsuperscript{138} Id. § 2.

an annuity contract, the income of which is tax deferred under section 72 of the Internal Revenue Code of 1986" is not a deposit qualifying for FDIC insurance.140

The Insurance Fund Act would take away a key feature of the Retirement CD—government insurance. As long as the Retirement CD is treated as an annuity for tax purposes and earned income is deferred until payments are received, the Insurance Fund Act is fair. However, if the Retirement CD is denied both government insurance and tax deferral, as regulators have proposed,141 the product would be rendered completely unmarketable. This would unfairly disadvantage national banks selling products such as the Retirement CD that the NBA authorizes them to sell.

2. The OCC Moratorium

As part of the Financial Services Competitiveness and Regulatory Relief Act of 1995 ("Regulatory Relief Act"),142 which would repeal the Glass-Steagall Act143 and reduce the regulatory burden on financial institutions, Rep. James A. Leach introduced144 a provision that would impose a five-year moratorium on the authority of the OCC to authorize new insurance activities for banks.145 The Regulatory Relief Act excluded a provision previously introduced by Rep. Richard Baker, which would have allowed banks to affiliate with insurance firms where state law permits such links.146

140. S.799, supra note 139.
141. See infra notes 150-60 (discussing proposals to prevent the Retirement CD from receiving the benefits of tax deferral).
143. The provisions of the Glass-Steagall Act were originally included in the Banking Act of 1933. See supra notes 24, 26 and accompanying text for further discussion of these provisions.
Both the Clinton administration and the American Bankers Association ("ABA") opposed the OCC Moratorium provision.147 Similarly, the ABA opposed the proposed limits on the OCC’s authority to authorize new bank insurance activities, stating that the Regulatory Relief Act would “roll back current bank insurance powers.”148 Rep. Leach stated that there is “some chance” of passing the Regulatory Relief Act, but he indicated that there would be a “substantially stronger chance” of passing the bill if the controversial insurance provisions were removed.149

3. Proposed Tax Regulation to Deny Tax-Deferred Status

Section 72 of the Internal Revenue Code ("the Code") allows the holder of an annuity contract to which the section applies to defer all earned income until distributions on the contract are made.150 Once distributions under the contract begin, the holder includes the earnings in income on a pro rata basis.151 Under these provisions, the holder of a Retirement CD could defer taxation of earned income until she begins receiving monthly payments.

Section 1275(a)(1)(B) of the Code specifically excludes section 72 annuity contracts from the original issue discount ("OID") requirements in section 1272 of the Code.152 OID refers to the unstated interest in a deferred payment.153 The OID provisions, which treat OID as ordinary interest income,154 require the holder of a debt instrument to include OID in his

148. Id.
149. Id.
151. Id.
152. Subsection (B) of section 1275(a)(1) provides:

Exception for certain annuity contracts

The term “debt instrument” shall not include any annuity contract to which section 72 applies and which—

(i) depends (in whole or in substantial part) on the life expectancy of 1 or more individuals, or

(ii) is issued by an insurance company subject to tax under subchapter L—

(I) in a transaction in which there is no consideration other than cash or another annuity contract meeting the requirements of this clause,

(II) pursuant to the exercise of an election under an insurance contract by a beneficiary thereof on the death of the insured party under such a contract, or

(III) in a transaction involving a qualified pension or employee benefit plan.

current income on a constant yield basis, regardless of the holder’s overall accounting method.\textsuperscript{155} Thus, if the Retirement CD is not classified as a section 72 annuity, the holder must include an imputed amount of interest in his yearly income.

On April 7, 1995, the Internal Revenue Service published a notice of proposed rulemaking in the \textit{Federal Register}.\textsuperscript{156} The proposed rule would significantly reduce the number of annuity contracts qualifying for the section 1275(a)(1)(B)(i) exception, which currently protects all annuity contracts that depend “on the life expectancy of [one] or more individuals.”\textsuperscript{157} Under the proposed regulation, an annuity may avoid the OID provisions only if it provides periodic payments that “(A) [a]re made at least annually for the life (or lives) of one or more individuals, (B) [d]o not increase at any time during the term of the contract; and (C) [a]re part of a series of payments that begins within one year of the date of the initial investment in the contract.”\textsuperscript{158} Because the payments must begin within one year of the initial deposit, the proposed rule would effectively deny holders of the Retirement CD the benefits of tax deferral and subject them to the OID provisions.

Although the proposed rule would strip tax benefits from bank-issued annuities maturing more than one year beyond the initial deposit, the rule would not affect annuities issued by insurance companies, because it would not amend section 1275(a)(1)(B)(ii), which specifically protects annuities issued by insurance companies.\textsuperscript{159} The inequity of the proposed rule is readily apparent: bank annuities subject to OID rules would be unable to compete with functionally identical annuities issued by insurance companies that would enjoy the benefits of tax deferral.\textsuperscript{160}

\textsuperscript{155} 26 U.S.C. § 1272 (1988). Forcing the taxpayer to declare income based on a constant yield is intended to provide a more economically accurate reflection of income and to prevent disparity between issuer deductions and holder inclusions. This mismatch would occur because the issuer could declare deductions immediately but the holder could defer all earned income until the years when payments actually begin. \textit{See H.R. REP. NO. 432 (Part II), 98th Cong., 2d Sess. 1242-43 (1984); H.R. REP. NO. 413 (Part I), 91st Cong., 1st Sess. 109 (1969).}


\textsuperscript{157} \textit{See supra} note 152.

\textsuperscript{158} 60 Fed. Reg. 17,731, 17,733 (1995) (to be codified at 26 C.F.R. pt. 1) (proposed Apr. 7, 1995) (emphasis added). The IRS determined that the section 1275(a)(1)(B)(i) exception should not apply to annuity contracts that provide for a significant deferral of income. \textit{Id.} at 17,732. Presumably, the IRS reached this conclusion because the longer a taxpayer may defer recognition of income, the wider the gap becomes between the issuer’s deduction and the taxpayer’s inclusion in income.

\textsuperscript{159} \textit{See supra} note 152.

\textsuperscript{160} The proposed regulation is particularly unfair when one considers that the Retirement CD is presumably an “annuity” for purposes of state regulation. If the Retirement CD is to be regulated as if it is an annuity, it should also be taxed as an annuity. To treat the product otherwise provides a boon to the insurance
Immediately upon release of the proposed rule, Blackfeet sought an injunction against the proposed regulation because sales of the Retirement CD had ground to a halt. In Blackfeet National Bank v. Rubin, the District Court of the District of Columbia granted Rubin’s Motion for Summary Judgment, holding that the bank had not been denied administrative due process and that the issue was not ripe for judicial review. The Court of Appeals for the District of Columbia Circuit affirmed, indicating that the case warranted summary action. Currently, the Internal Revenue Service has not issued a final regulation.

B. Reaction at the State Level

As banks’ powers to sell nondeposit investment products expand, some states have amended their state banking codes to explicitly allow banks to sell these products. Presumably, state legislatures would not want banks in their states to be at a competitive disadvantage to banks in other states allowed to sell products such as the Retirement CD. However, states that allow the sale of nondeposit investment products generally require banks to comply with state insurance regulations or impose extensive disclosure requirements.

industry, because Retirement CDs issued by banks could never compete with products issued by the insurance industry if they lack similar tax benefits.

The American Bankers Association, in its July 17, 1995 comment letter to the Internal Revenue Service (“IRS”), recognized this unfairness, stating that “[t]here is no logical justification or policy rationale for the disparity of treatment between annuity contracts issued by insurance companies and those that are not and depend (in whole or substantial part) on the life expectancy of one or more individuals.” Commentators Weigh in on IRS Proposal to Change Tax Treatment of Annuities, 65 Banking Report (BNA), at 250 (Aug. 7, 1995).

Similarly, at the August 8, 1995 hearing on the proposed regulation, Dennis Gingold, who represented American Deposit Corporation of Colorado, the company that initially developed the Retirement CD, argued that “[t]he proposal perpetuates a monopoly by discouraging competition among financial institutions that essentially are offering the same product.” Government Panel Offers Limited Comment at IRS Hearing on Proposed Annuity Rules, 65 Banking Report (BNA), at 289 (Aug. 14, 1995).


162. id. at 55.

163. 67 F.3d 972 (D.C. Cir. 1995) (unreported table decision).

164. As of June 24, 1996, the Internal Revenue Service has not published a final rulemaking notice in the Federal Register incorporating the proposed change.

165. See, e.g., ARK. CODE ANN. § 23-64-203(b)(2)(B) (Michie Supp. 1995) (providing that “a lending institution . . . may be issued a license . . . to sell fixed or variable annuities”); IOWA CODE, § 524.802(8) (Supp. 1995) (authorizing state banks to “[e]ngage in the brokerage of insurance . . . subject to the prior approval of the superintendent”).

166. Florida’s rule concerning the sale of annuities is very similar to the Consumer Protection Act, supra note 129, in that it restricts the advertising activities of banks, requires banks to maintain physically separate facilities for the sale of nondeposit investment products, and requires banks to provide written disclosures to customers to inform them that the annuity products are not insured or guaranteed. FLA.
VI. CONCLUSION

Products such as the Retirement CD would allow national banks to increase profits and compete with other institutions in the financial services industry. After NationsBank and Barnett Bank, it seems clear that national banks have the power, under § 24 (Seventh), to sell nondeposit investment products such as the Retirement CD. However, Schacht indicates that innovative products may be unfairly subjected to new forms of regulation. Until the Supreme Court resolves this issue, if national banks choose to sell products such as the Retirement CD, they will probably be subject to all insurance regulations applicable to the sale of annuities. By the same token, as long as products such as the Retirement CD are treated as annuities for purposes of state regulation, Congress and the states must accord bank products the same treatment as annuities marketed by the insurance industry.

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Admin. Code Ann. r.3C-100.960 (1996).