

GRAMM-LEACH-BLILEY: WHAT'S GOOD FOR THE FEDERAL GOOSE IS GOOD FOR THE STATE GANDER – DEBT CANCELLATION AGREEMENTS

Hugh Alexander, Esq.
Kevin Kuznicki, Esq.
(303) 825-7307

The authority of national banks to offer debt cancellation agreements (“DCAs”) is clearly stated in numerous cases and OCC opinion letters and rulings, and most recently, in the Gramm-Leach-Bliley Act (“GLBA”). This article addresses the issues related to the offering of DCAs by state-chartered banks. In order to address this issue, it is necessary to discuss the following:

1. To what extent are opinions of state insurance authorities or attorneys general controlling or binding upon a nationally-chartered bank engaged in issuing DCAs;
2. Whether a national bank is likely to be found to be engaging in the business of insurance with respect to the offering of DCAs; and
3. Whether or not the same analysis applies to state-chartered banks, particularly whether and to what extent a finding by a state insurance regulator or attorney general that debt cancellation constitutes insurance would preclude a state-chartered bank from offering such, alleging that the bank is conducting the “business of insurance.”

Are the Opinions of State Regulatory Bodies Controlling?

Opinions of the state government bodies are subject to the general tenets of federalism. Pursuant to the Supremacy Clause, federal law must prevail over any contrary state measure. The McCarran-Ferguson Act is an exception to this general rule and provides that:

- (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
- (b) No 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, or which imposes a fee or tax upon such business, *unless such Act specifically relates to the business of insurance . . .*¹

Thus, in order for a state insurance department to have jurisdiction over the offering of DCAs by banks, a court would have to find that (1) the offering of DCAs fell within the “business of insurance,” and (2) Congress has not otherwise specifically superseded the matter. Neither of these are likely to be found. First, case law expressly provides that the offering of DCAs is not within the “business of insurance.” Second, GLBA specifically relates to the business of insurance and removes DCAs from the pre-emption application of McCarran-Ferguson.

Case law has specifically stated that the determination of what constitutes insurance is a federal issue and whether a certain product or business practice constitutes insurance should be decided pursuant to federal law.²

In *SEC v. VALIC*, the court stated that it was “reluctant to disturb state regulatory schemes that are in actual effect, either by displacing them or superimposing federal requirements on *transactions that are tailored to meet state requirements*.”³ Thus, whether the transaction in question is subject to state insurance regulation will be determined in part to what extent states have expressly regulated the transaction, thereby causing the transaction to be tailored to meet state regulations. The *VALIC* court took note of the fact that there was not uniformity among the states’ regulation of annuities in that some states denied “annuity” contracts the status of “insurance” and others accepted them under their “insurance” statutes. Consequently, the court reasoned that since the states had not clearly exercised authority over annuity regulation, the transactions in question (annuities) could not have been tailored to meet state requirements.⁴

As with the sale of annuities, a review of the states’ treatment of DCAs shows an inconsistent and non-uniform pattern

of regulation. While some states have indicated that DCAs are considered “insurance,” the majority have not ruled on the issue, and even other states have taken the opposite position. Thus, as with the treatment of annuities under *VALIC*, a consistent and uniform state regulatory scheme over DCAs does not exist among the states such that the states have clearly exercised authority over the treatment of DCAs. Consequently, banks have not had to tailor DCAs to meet state insurance requirements. Accordingly, as with the *VALIC* case, a federal court would not be faced with disturbing existing state regulatory schemes over DCAs. Therefore, although state insurance opinions will carry some weight, a court should not be reluctant to subject DCAs, and the offering thereof, to banking regulation as opposed to insurance regulation. This conclusion is further supported by the fact that prior federal court rulings on DCAs have found them to specifically not be insurance.

Does the Offering of DCAs Constitute the Business of Insurance?

In *Manasen v. California Dental Services*, the court provides that first, the practice in question must be found to be the “business of insurance,” and, second, if so, under McCarran-Ferguson Act, should the challenged conduct then be regulated under state law.⁵

The offering of DCAs does not constitute the “business of insurance,” whether offered by a state bank or a federal bank. As stated above, the issue will be decided under federal law and case law has found that the offering of DCAs by federal banks is not considered to be the “business of insurance,” but rather is the “business of banking.”⁶ Second, GLBA expressly removes from insurance regulation those products expressly authorized by the OCC prior to January 1, 1999. Third, the OCC has issued clear directions, as have a few state banking authorities, that DCAs fall within the business of banking and not insurance.

Case Law. In *First Nat’l Bank v. Taylor*,⁷ the Eighth Circuit concluded that a bank, engaged in the business of issuing DCAs, was not subject to state insurance regulation.⁷ In *Taylor*, First National Bank (“FNB”) issued DCAs to its borrowers which would cancel the unpaid balance of the loan in the event of the borrower’s death.

The *Taylor* court noted that the Comptroller had declared the issuance of DCAs to be an incidental power of banks under the National Bank Act, and further remarked that the Comptroller’s view was to be accorded significant deference by the reviewing court.⁸

More recently, *Steele v. First Deposit National Bank et al.*,⁹ found in favor of the offering of DCAs as outside state insurance regulation. The *Steele* Court looked at three issues: “(1) whether the pertinent sections of [Alabama’s insurance code] were enacted ‘for the purpose of regulating the business of insurance;’ (2) whether [credit protection] is properly considered ‘the business of insurance;’ and (3) whether the pertinent provisions of the Bank Act ‘specifically relate to the business of insurance.’”¹⁰ The court took note of prior case law which provides that the question whether a product is insurance for the purposes of the McCarran-Ferguson Act is a federal question.¹¹ After concluding that DCAs did not constitute “the business of insurance,” the court then gave great weight to the OCC determination and its interpretation of the National Bank Act.¹²

Clearly, credit protection products such as DCAs have been found to not constitute the “business of insurance,” and therefore, the McCarran-Ferguson Act does not apply. Therefore, jurisdiction with respect to state banks would lie, not with the state insurance regulator, but with the state banking authority. In addition, even if DCAs were considered to be an insurance product, Congress specifically removed the application of McCarran-Ferguson to DCAs with the passage of GLBA.

Gramm-Leach-Bliley Act. The McCarran-Ferguson Act provides that insurance is to be regulated by the states except when Congress has enacted statutes specifically relating to the business of insurance. Numerous statutes have been enacted by Congress which clearly impact and address the business of insurance, including the Employee Retirement Income Security Act,¹³ and the Title III of the Americans With Disabilities Act.¹⁴ Most recently, Congress enacted the Gramm-Leach-Bliley Act.¹⁵ Under GLBA, the prohibition on national banks and their subsidiaries against providing insurance in a State as principal does not apply to “authorized products.”¹⁶ The definition of “authorized products” includes products which, as of January 1, 1999, the Comptroller of the Currency had determined, in writing, national banks may provide as principal, or that national banks were in fact lawfully providing such product as principal.¹⁷ As shown below, not only were banks offering DCAs as principal prior to January 1, 1999, but the OCC clearly authorized the offering of such by banks in writing prior to January 1, 1999. Thus, McCarran-Ferguson does not pre-empt GLBA

so as to grant authority over DCAs to the state insurance agencies, but rather the opposite is true.

OCC Opinions. The OCC has clearly stated that DCAs may be offered by national banks and are not considered to be insurance products.

A national bank may provide for losses arising from cancellation of outstanding loans upon the death of borrowers. *The imposition of an additional charge and the establishment of necessary reserves in order to enable the bank to enter into such DCAs are a lawful exercise of the powers of a national bank and necessary to the business of banking.*¹⁸

Numerous written opinions have been issued by the OCC prior to January 1, 1999 which clearly permit national banks to provide DCAs as principal. Pursuant to OCC Interpretative Letter 640, January 7, 1994, the Comptroller of the Currency provides that “pursuant to 12 U.S.C. § 24(Seventh), national banks may offer DCAs that cancel debt upon a borrower’s disability and/or unemployment, as well as a borrower’s death.” The Comptroller states further that while Interpretive Ruling 7.7495, 12 C.F.R. § 7.7495 only addresses DCAs that cancel debt upon the death, the same rationale underlying the ruling that DCAs are incidental to bank’s express loan-making authority applies to DCAs involving borrower’s disability or unemployment. In OCC Interpretative Letter 827, dated April 3, 1998, the OCC approved the offering by national banks of debt suspension contracts which would “freeze” the cardholder’s account “in the event that the cardholder becomes involuntarily unemployed, is unable to work due to disability, goes on an approved family leave, is hospitalized for more than a specified number of days, or becomes temporarily unable to continue to make payments on the account for certain other reasons;” (emphasis added). Not only does this opinion specifically authorize DCAs which protect against events other than death, disability or unemployment, but it also confirms that the OCC has considered any DCA product which protects against the credit risk undertaken by banks in making a loan, regardless of the event, as an inherent part of a bank’s express authority to make loans, and is not “insurance” for purposes of Section 92 of the National Bank Act.

Given the clear legal authority for offering of DCAs by national banks outside of insurance regulation, the question then turns to the offering of such by state-chartered banks and whether a state-chartered bank’s offering of DCAs would be considered to be insurance activities.

Will a State Bank’s DCA Activities Be Deemed the Business of Insurance?

As stated above, federal courts must interpret federal law in deciding whether the bank’s activities will be deemed the business of insurance, rather than the business of banking. McCarran-Ferguson only grants jurisdiction to the states over those laws enacted by Congress which do not specifically relate to insurance. GLBA clearly relates to insurance and expressly permits banks to offer DCAs as the principal, not subject to preemption by state insurance laws. This same reasoning should apply to state level determinations. This conclusion is supported by *Humana Inc. v. Forsyth*.¹⁹ In *Humana*, the U.S. Supreme Court states that Congress did not, under McCarran-Ferguson, intend to cede the entire field of insurance regulation to the states. Rather, when federal law does not directly conflict with state regulation and when application of the federal law does not frustrate any declared state policy or interfere with a state’s administrative regime, McCarran-Ferguson does not apply.²⁰ Given the non-uniform treatment of DCAs by the states, the express declaration by federal courts that DCAs are not insurance, and the clear declaration by the OCC that DCAs are “authorized products” under GLBA, permitting the offering of DCAs by state-chartered banks, subject to the jurisdiction of the state banking authorities would not directly conflict with state insurance regulation or an uniform declared state policy.

Also relevant to this analysis is to look at how states have interpreted state banking laws which provide *incidental* powers to banks as part of their general banking authority. In the matter of *New York State of Life Underwriters, Inc. et al. v. New York State Banking Department, et al.*²¹ the court discusses the authority of a state bank under a state law which specifically provides that a state-chartered commercial bank, as part of its general powers, has the ability to “exercise all such incidental powers as shall be necessary to carry on the business of banking.” In that case, the New York State Bankers Association requested an opinion from the New York State Banking Department as to whether state chartered commercial banks had comparable authority to broker financial investment instruments under New York state law, as the OCC had found in Interpretive Letters No. 494 and No. 499 for federal banks. The State Banking Department found that such authority existed under New York bank law § 96(1) which includes the ability to “exercise all such incidental powers as shall be necessary to carry on the business of banking.” The court concluded that the state-chartered commercial banks had the authority to purchase and sell annuities, directly or through a subsidiary. The court further

stated that the bank agency's determination that the sale of annuities by state-chartered banks was within its incidental powers of the business of banking was not unreasonable or irrational. This case clearly establishes precedent for giving deference to the ability of a state-chartered bank to exercise its "incidental" authority consistent with the interpretation given by federal courts to the exercise by a federal bank of its "incidental" authority under similar statutory language.

In addition to case law and the passage of GLBA as grounds in favor of finding that the offering of DCAs falls within a state bank's banking authority, further support can be found in state statutory schemes. Numerous states have enacted statutes which give banks parity authority of national banks in order to permit the state banks to remain competitive with the federal charters.²² In such states, clearly the argument, as followed in *New York State of Life Underwriters*, exists that state banks have the authority to offer debt cancellation under its *incidental powers* to the same extent that federal banks have that ability.

In summary, given that federal law must be followed in determining whether a product is insurance, that case law has found DCAs to be within a bank's incidental powers, that GLBA preempts the application of McCarran-Ferguson to "authorized products" as determined by the OCC, and that numerous states have enacted parity statutes granting the same authority for state banks as exists for federal banks, the authority for offering of DCAs by state-chartered banks outside of insurance regulation clearly exists.

Endnotes

1. 15 U.S.C. § 1012.
2. *SEC v. Variable Annuity Life Insurance Co.*, 359 U.S. 65, 69, 3 L. Ed. 2d 640, 79 S.Ct. 618 (1959); *see also Manasen v. California Dental Services*, 424 F. Supp. 657 (N.D. Cal. 1976), *rev'd. on other grnds.*, 638 F.2d 1152 (9th Cir. 1979) ("The interpretation of what constitutes the "business of insurance" as that term is used in the McCarran Act is a federal question and federal interpretations supersede those of state courts."), citing *SEC v. VALIC*, 359 U.S. 65 (1959), *Fry v. John Hancock Mutual Life Insurance Company*, 355 F. Supp. 1151 (N.D. Tex. 1973), and 7 Von Kalinowski, *Antitrust Laws and Trade Regulation* P47.02(2)(b) at 47-32.
3. 359 U.S. 65, 68-69 (emphasis added).
4. *Id.*
5. 424 F. Supp. 657, 659, citing *Mitgang v. Western Title Insurance Company*, *CCH Trade Regulation Reports* P75, 322 (N.D. Cal. 1974).
6. *First National Bank v. Taylor*, 907 F.2d 775 (8th Cir. 1990); *Steele v. First Deposit National Bank et al*, 732 So. 2nd 301 (1999 Ala. Civ).
7. *Id.*
8. *Id.*, at 777-778.
9. *Steele v. First Deposit National Bank et al*, 732 So.2d 301, (Oct. 1999, AL. Ct. of App.).
10. 732 So.2d 301, 303, citing *American Deposit Corp. v. Schacht*, 84 F.3d 834, 838 (7th 1996).
11. *Id.*, citing *OCC Interpretative Letter No. 623* (May 10, 1993); *SEC v. VALCI.*, 359 U.S. 65 (1958); and *First Nat'l Bank of Eastern Arkansas v. Taylor*, 907 F.2d 775, 780, n.8 (8th Cir. 1990) ("[S]tate law defining insurance is not controlling on the issue of whether an activity falls within the 'business of insurance' as that term is used in the McCarran-Ferguson Act.").
12. *Id.*, at 303-304.
13. 29 USC § 101(a), et seq.

14. 42 USC § 12181, et seq.
15. PUB. L. No. 106-102 § 103(a), 121, 113 stat. 1338, 1342-50, 1373-81(1999).
16. Title III, Insurance, Subtitle A--State Regulation of Insurance, § 302.
17. *Id.*
18. 12 C.F.R. § 7.1013 (emphasis added).
19. 525 U.S. 299 (1999).
20. *Id.*, at 308.
21. 83 N.Y. 2d 353; 6632 N.E. 2d 876 (March 30, 1984).
22. States which have parity or “wild card” statutes are: Alabama, Alaska, Arizona, Arkansas, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Oklahoma, Ohio, Oregon, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming