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No. 8269

This opinion is issued in response to a question from Nancy Ellison, Deputy Commissioner of the Insurance Division of the Department of Consumer and Business Services.

QUESTION PRESENTED

Must national banks comply with Oregon insurance laws when offering debt cancellation programs?

ANSWER GIVEN

Debt cancellation programs offered by national banks in accordance with applicable federal law do not constitute insurance subject to regulation under Oregon's insurance laws.

DISCUSSION

Under Oregon law, no person may be an insurer without first obtaining a certificate of authority. ORS 731.354. Only an insurer in possession of such a certificate may enter into policies (contracts) of insurance. *Id.* An insurance contract occurs where "one undertakes to indemnify another or pay or allow a specified or ascertainable amount or benefit upon determinable risk contingencies." ORS 731.102(1). The question concerns debt cancellation programs, which have been described as follows:

The essence of the debt cancellation contract is the imposition of an additional charge by the bank when a loan is made. Such a charge is subsequently used for the establishment of reserves to cover the bank's interest in the loan should it be canceled by the contract before being paid. * * * The primary purpose of a debt cancellation contract is to protect the bank from the risk of a loan loss when a contingency occurs that is covered by the contract. Because of this function, the debt cancellation contract has been called the equivalent of underwriting credit life insurance.

Moore & Smith, *Debt Cancellation Contracts: A Neglected Asset*, 112 Banking LJ 918, 920 (1995). "Credit life insurance" is statutorily defined as "insurance on the life of a debtor pursuant to or in connection with a specific loan or other credit transaction." ORS 743.371(1). In Oregon, a national bank may not enter into policies of insurance, including credit life insurance, if it does not have the required certificate of authority.

In 1964, we opined that national banks that engaged in writing debt cancellation contracts in Oregon were engaging in the business of insurance subject to state regulation. 32 Op Atty Gen 59 (1964). Specifically, our opinion concluded that debt cancellation contracts fell within the statutory definition of credit life insurance. *Id.* at 60. In 1964, state law expressly prohibited anyone other than an authorized insurance company from writing credit life insurance. *Id.* (citing former ORS 739.603). Former ORS 739.603 was renumbered as ORS 743.585 and, again in 1989, as ORS 743.379. The current statute no longer contains this specific prohibition. The prohibition in ORS 731.354 against a person transacting insurance without first obtaining a certificate of authority, however, remains applicable to credit life insurance.

To determine whether national banks may offer debt cancellation contracts without regard to state insurance laws, we must answer two questions under federal case law developed since 1964. First, does a national bank have the authority to offer debt cancellation contracts, and, second, if a national bank does have this authority, do debt cancellation programs offered by such a bank constitute "insurance" that is subject to regulation under state insurance laws?

I. A National Bank's Authority to Offer Debt Cancellation Programs

The United States Comptroller of the Currency (comptroller) is responsible for enforcing national banking laws. 12 USC § 1. The National Bank Act, in addition to enumerating specific powers, grants national banks the power to exercise "all such incidental powers as shall be necessary to carry on the business of banking." 12 USC § 24 (Seventh). Since 1964, the comptroller has interpreted "incidental powers" to include the offering of debt cancellation contracts. Moore & Smith, 112

Banking LJ at 919-920. The comptroller's current Interpretative Ruling states:

A national bank may enter into a contract to provide for loss arising from cancellation of an outstanding loan upon the death or disability of a borrower. The imposition of an additional charge and the establishment of necessary reserves in order to enable the bank to enter into such debt cancellation contracts are a lawful exercise of the powers of a national bank.

12 CFR § 7.1013.

In our 1964 opinion, we quoted from an earlier comptroller statement, which concluded that national banks had the authority to enter into debt cancellation contracts, stating:

"The use of debt cancellation contracts * * * is a lawful exercise of the powers of a National Bank. The exercise of such powers is necessary to and is a part of the business of banking. Such activities may not therefore, properly be considered as engaging in the life insurance business."

32 Op Atty Gen at 60 (quoting March 10, 1964 letter addressed to the presidents of national banks from the Comptroller of the Currency, James J. Saxon). Our opinion, however, gave no authoritative weight to the comptroller's decision. Instead, the opinion focused upon federal statutes and case law, finding no authority in the National Bank Act for national banks to offer debt cancellation contracts, and no federal case law holding that debt cancellation contracts were "incidental" and "necessary" to banking. In light of this absence of federal statutory and common law authority, we concluded that national banks that wrote debt cancellation contracts in Oregon would be engaged in the business of insurance. 32 Op Atty Gen at 61.

Several federal appellate courts have interpreted the National Bank Act's "incidental powers" provision since 1964. In 1990, the Eighth Circuit Court of Appeals analyzed the particular question that you have raised in deciding whether the Arkansas Insurance Commissioner had acted lawfully in directing First National Bank of Eastern Arkansas (FNB) to cease offering debt cancellation contracts. *First National Bank of Eastern Arkansas v. Taylor*, 907 F2d 775, 777 (8th Cir 1990), *cert den* 498 US 972 (1990). The court concluded that the National Bank Act authorizes national banks to enter into debt cancellation contracts. *Id.* at 778-79. The court specifically cited the comptroller's interpretation of "incidental powers" as including debt cancellation contracts and noted that the comptroller's interpretation of the National Bank Act is entitled to "great weight." *Id.* at 777 (quoting *Clarke v. Securities Indus. Assn.*, 479 US 388, 403-04, 107 S Ct 750, 93 L Ed2d 757 (1987) ("[C]ourts should give great weight to any reasonable construction of a regulatory statute [regarding enforcement of banking laws] adopted by the [comptroller].").

In construing the National Bank Act, the *Taylor* court reasoned that the "incidental powers" of national banks are not limited to activities deemed essential to the exercise of express powers. 907 F2d at 778. Rather, "incidental powers" include activities closely related to an express power that are useful in carrying out the business of banking. *Id.* The court supported its conclusion that the act of making debt cancellation contracts was directly related to FNB's expressly authorized lending power with the following rationale. First, debt cancellation contracts were sold only in connection with loans to FNB borrowers. *Id.* Second, debt cancellation contracts "provide borrowers with a convenient method of extinguishing debt in case of death, and enable FNB to avoid the time, expense, and risk associated with attempting to collect the balance of the loan from a borrower's estate." *Id.*

The Ninth Circuit Court of Appeals has adopted the following test to determine whether an activity falls within the purview of a national bank's "incidental powers":

[F]or an activity to be pursuant to an incidental power "necessary to carry on the business of banking" it must be "convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act."

M&M Leasing Corp. v. Seattle First National Bank, 563 F2d 1377, 1382 (9th Cir 1977), *cert den* 436 US 956 (1978) (quoting *Arnold Tours, Inc. v. Camp*, 472 F2d 427, 431-32 (1st Cir 1972)). In determining the scope of incidental powers, the Ninth Circuit stated its belief that "the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking." *Id.* at 1382.

The rationale provided by the *Taylor* court for concluding that offering debt cancellation contracts is within the "incidental" powers of national banks and therefore authorized by the National Bank Act fits well into the test established by the Ninth Circuit in *M&M Leasing Corp.* It cannot be seriously questioned that lending money constitutes an

established activity carried out pursuant to a national bank's express powers under the National Bank Act.¹ The Ninth Circuit requires that an activity be either "convenient" or "useful" in connection with the performance of an established activity, such as lending money, to be pursuant to an "incidental power." As noted above, the *Taylor* court found that debt cancellation contracts were offered only in relation to the bank's lending of money and that they offered a "convenient method" for a borrower to extinguish a debt in case of death and allowed the bank to "avoid the time, expense and risk" of trying to collect from a deceased borrower's estate. *Taylor*, 907 F2d at 778. These qualities establish debt cancellation contracts as both convenient and useful to a national bank's established function of lending money. Consequently, we believe that the Ninth Circuit would conclude that issuing debt cancellation contracts is within the "incidental" powers of national banks and is therefore authorized by the National Bank Act.

II. Debt Cancellation Programs and State Insurance Laws

Normally, concluding that the National Bank Act authorizes debt cancellation contracts would end our inquiry. "Because national banks are considered federal instrumentalities * * * states may neither prohibit nor unduly restrict their activities." *Taylor*, 907 F2d at 778 (citations omitted). One would expect, in other words, that the National Bank Act would preempt a state's requirement that a national bank obtain a certificate of authority from state insurance regulators before offering debt cancellation contracts.¹ However, a second federal statute, the McCarran-Ferguson Act, protects a state's regulation of insurance against conflicting federal law.¹ Section 2(b) of the McCarran-Ferguson Act states:

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 * * * unless such Act specifically relates to the business of insurance * * *.

15 USC § 1012(b).

The National Bank Act specifically relates to the business of banking, not insurance. The court in *Taylor*, however, found that the McCarran-Ferguson Act did not prevent the National Bank Act's preemption of state insurance laws because, the court concluded, the offering of debt cancellation contracts by banks falls within the incidental powers granted by the National Bank Act and therefore does not constitute "the business of insurance." *Taylor*, 907 F2d at 779. The court offered two reasons in support of this conclusion. The first (and primary) reason was that "the McCarran-Ferguson Act was not directed at the activities of national banks." *Id.* The *Taylor* court explained that Congress passed the McCarran-Ferguson Act in response to the Supreme Court's decision in *United States v. South-Eastern Underwriters Assn*, 322 US 533, 64 S Ct 1162, 88 L Ed 1440 (1944).

[The Court] held that the insurance industry was subject to regulation by Congress under the Commerce Clause, and that insurance company activities were subject to federal antitrust laws. * * * The McCarran-Ferguson Act was designed to preserve traditional state regulation and taxation of insurance companies, and to provide insurance companies with a partial exemption from federal antitrust laws.

Taylor, 907 F2d at 779 (citations omitted). Concluding that the McCarran-Ferguson Act was not designed to provide states with authority broader than that which they enjoyed prior to the decision in *South-Eastern Underwriters*, the *Taylor* court found the fact that national banks were exclusively regulated by the federal government before *South-Eastern Underwriters* to be a strong indication "that Congress did not intend the 'business of insurance' to encompass lawful activities of national banks." *Id.* at 780. (citations omitted).

The second reason the *Taylor* court concluded debt cancellation contracts did not constitute "the business of insurance" focused on the difference between such contracts and traditional insurance with regard to transferring or spreading risk. The court found that debt cancellation contracts issued by banks in connection with loans differ significantly from traditional insurance contracts with respect to risk, stating:

Although debt cancellation contracts may * * * transfer some risk from the borrower to the bank, the contracts do not require the bank to take an investment risk or to make payment to the borrower's estate. The debt is simply extinguished when the borrower dies. Thus, the primary and traditional concern behind state insurance regulation — the prevention of insolvency — is not of concern to a borrower who opts for a debt cancellation contract.

Id. (footnote omitted).

We believe that the Ninth Circuit, like the *Taylor* court, would find that debt cancellation contracts are not subject to state insurance regulation pursuant to section 2(b) of the McCarran-Ferguson Act. The Ninth Circuit has adopted a four-part

inquiry to determine, under section 2(b) of the McCarran-Ferguson Act, whether a federal law will give way to a state's insurance requirements. *Merchants Home Delivery Service v. Hall*, 50 F3d 1486, 1489 (9th Cir) (1995). Under the Ninth Circuit test, whether an activity, such as offering debt cancellation contracts, constitutes "the business of insurance" is one of the four factors to be considered. The Ninth Circuit will preclude the application of a federal statute only if:

1. the federal statute does not "specifically relate to the business of insurance,"
2. the challenged acts "constitute the business of insurance,"
3. "the state has enacted a law or laws regulating the challenged acts," *and*
4. "the state law would be superseded, impaired or invalidated by the application of the federal statute."

Id. Unless all four factors of the test are satisfied, the Ninth Circuit will permit the federal statute to preempt the state insurance law.

With respect to debt cancellation contracts, the first factor of the Ninth Circuit test is satisfied because the provisions of the National Bank Act addressing a national bank's "incidental powers," which authorize the banks to offer such contracts, do not "specifically relate" to the business of insurance. The third factor may also be met; to the extent that our 1964 opinion concluded that debt cancellation contracts fall within the statutory definition of credit life insurance, one could argue that Oregon has enacted laws regulating the writing of debt cancellation contracts, although there are no state statutes that specifically regulate this activity by name. If a court concluded that Oregon's insurance laws regulate debt cancellation contracts, those laws would be superseded by the National Bank Act to the extent that the latter authorizes national banks to write debt cancellation contracts, thus satisfying the fourth factor of the test.

All four prongs of the Ninth Circuit's test must be met; however, to prevent the National Bank Act from preempting Oregon's insurance laws. Unless the offering of debt cancellation contracts constitutes "the business of insurance," the second factor of the test is not satisfied and the National Bank Act preempts state insurance laws with respect to this activity.

A debt cancellation contract may be viewed as very similar to credit life insurance under Oregon law, where the latter is defined as "insurance on the life of a debtor pursuant to or in connection with a specific loan or other credit transaction." ORS 743.371(1). United States Supreme Court precedent, however, indicates that the federal judiciary will not look to state insurance laws to determine whether a practice actually constitutes "the business of insurance" when applying the McCarran-Ferguson Act. In determining whether federal securities laws applied to the offering of annuity contracts, the Supreme Court stated that conflicting state treatment of annuities was not of consequence to the case because "the meaning of 'insurance' or 'annuity' under these Federal Acts [Securities Act of 1933 and McCarran-Ferguson Act] is a federal question." *SEC v. Variable Annuity Life Ins. Co.*, 359 US 65, 69, 79 S Ct 618, 3 L Ed2d 640 (1959). The *Taylor* court cited to the Supreme Court's decision in *Variable Annuity Life* when discounting the relevance of state law to determining whether offering debt cancellation contracts constituted "the business of insurance."

We acknowledge that in addition to the Commissioner [in Arkansas] a few state appellate courts have found debt cancellation contracts to fall within their states' definitions of "insurance." However, state 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.

Taylor, 907 F2d at 780 n 8 (citations omitted).

The Ninth Circuit applies the following test to determine whether an activity constitutes "the business of insurance":

1. whether the practice has the effect of transferring or spreading the policyholders' risks,
2. whether the practice is an integral part of the policy relationship between the insurer and the insured, and
3. whether the practice is limited to entities within the insurance industry.

Merchants Home Delivery, 50 F3d at 1490 (citing *Union Labor Life Ins. Co. v. Pireno*, 458 US 119, 129, 102 S Ct 3002, 73 L Ed2d 647 (1982)). The Ninth Circuit observed that "[t]he U.S. Supreme Court has made it clear that the transfer or spreading of the risk is the primary or even 'indispensable' characteristic of the business of insurance." *Merchants Home Delivery*, 50 F3d at 1490 (citing *Pireno*, 458 US at 127). With regard to the transferring or spreading of risk, *Taylor* concluded that, while some risk may be transferred to the bank under a debt cancellation contract, the risk taken on by the bank is much different (and less) than that taken on by an insurance company. *Taylor*, 907 F2d at 780. Because offering a debt cancellation contract does not necessitate the bank taking an investment risk or making payment to the borrower's

estate, the court explained, "the primary and traditional concern behind state insurance regulation — the prevention of insolvency — is not of concern to a borrower who opts for a debt cancellation contract." With regard to the second component of the *Pireno* test, so long as the contracts are optional, rather than a term or condition of taking a loan, it would be difficult to construe the practice of offering debt cancellation contracts as an "integral part" of the relationship between the bank and the borrower. For example, the debt cancellation contracts offered by the bank in *Taylor* were "additional-cost options to customers borrowing \$10,000 or less." *Id.* at 776. As to the third component of the *Pireno* test, the fact that national banks offer debt cancellation contracts shows that the practice is not limited to entities within the insurance industry.

We conclude that the offering of debt cancellation contracts does not constitute "the business of insurance" under the *Pireno* test used by the Ninth Circuit. This conclusion means that, under the Ninth Circuit's interpretation of section 2(b) of the McCarran-Ferguson Act, the National Bank Act preempts Oregon insurance laws with respect to debt cancellation contracts.

In our 1964 opinion, we stated that, in the absence of applicable federal court decisions, if a national bank engaged in writing debt cancellation contracts in Oregon it would be engaged in the business of insurance in violation of state law. 32 Op Atty Gen 59. Since that opinion, federal law has developed in the Ninth Circuit and other jurisdictions which leads us to reverse our 1964 opinion and conclude that a national bank issuing debt cancellation contracts in Oregon, in conformance with requirements of the National Bank Act and regulations issued by the comptroller, is not engaging in the business of insurance by conducting such activities. A national bank's offering of debt cancellation contracts, therefore, is not subject to regulation under Oregon's insurance laws.

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