Should Banks Sell Insurance - The Relationship of Section 92 of the Banking Act, the McCarran-Ferguson Act and State Laws Restricting Bank Activity

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There is an ongoing civil war within the nation's banking and insurance communities that promises to turn both worlds upside-down. That war centers on whether banks should be permitted to sell insurance. Obviously, the banks favor permitting their entry into the lucrative insurance market. Just as obviously, the agents and some insurers oppose such a move. The war is being fought on a variety of fronts: in Congress, in both the state and federal courts, and in the state legislatures.

The stakes are huge. The three largest organizations of insurance agents represent almost 600,000 members nationwide. The market for commercial property/casualty insurance alone amounts to over $100 billion annually. The banking industry would like to share in that market and the insurance industry would like to protect its traditional turf.

The policy arguments over the advisability of banks selling insurance are also substantial. The banks claim that the competition between banks and independent agents will lower prices and increase availability, thus aiding consumers. Insurance agents, on the other hand, point to a number of economic arguments and antitrust-like considerations to argue that the banks may in fact endanger competition. A number of statutes with differing provisions have been introduced and are pending in Congress at this writing. Very little research has been done on the issue, and only a few articles touch on the problem.

It is also clear that both commentators and courts do not have a clear perception of the very real distinction between banks acting as insurers and banks acting as insurance agents. There are very different concerns with each function and confusion of the two functions results in erroneous premises and faulty argumentation.

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1. The National Association of Life Underwriters has 138,000 members; the Independent Insurance Agents of America has 280,000 members; and the Professional Insurance Agents (PIA) has more than 180,000 members. Source: Letter from seven insurance organizations to Hon. Newt Gingrich, (April 4, 1995) and made available to the author through the Professional Independent Insurance Agents of Illinois (PIIA).

2. Letter to Hon. Newt Gingrich from seven insurance organizations (April 4, 1995) and made available to the author through the Professional Independent Insurance Agents of Illinois (PIIA).

The results of a number of federal cases and the discussions in Congress will create vast changes in the financial services industry. This article is an attempt to bring some order out of the chaos and to organize the discussion. The first section will provide a broad overview of some of the legal issues to be discussed. Part II concentrates on the repeal and revival of section 92 of the Banking Act, which purports to permit banks to sell insurance in towns of 5,000 or less. Part III discusses the complex relationship of section 92, the McCarran-Ferguson Act, state laws forbidding banks from selling insurance, and the split in the circuits on the complex issue of reverse pre-emption. Part IV deals with the related issue of the definition of the term “insurance” within the McCarran-Ferguson Act in a changing financial landscape. Part V outlines pending legislation, and Part VI deals with the politics and policies surrounding this financial civil war. The article concludes that, at a minimum, states should be allowed to experiment with the sale of insurance by banks, even if Congress does choose to regulate the banking industry’s underwriting of this insurance.

I. BACKGROUND AND OVERVIEW

In 1916, Congress passed an amendment to the National Bank Act ("section 92") that permitted banks to sell insurance in communities with fewer than 5,000 people. In 1918 some changes were made to that statute, but that provision remained intact through the 1926, 1934, 1940 and 1946 versions of the United States Code. In the 1952 edition, the compilers of the Code omitted section 92, with a note that it had been repealed in 1918.

Section 92 reads as follows:

In addition to the powers now vested by law in national banking associations organized under the laws of the United States any such association located and doing business in any place the population of which does not exceed five thousand inhabitants, as shown by the last preceding decennial census, may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, 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; and may receive for services so rendered such fees or commissions as may be agreed upon between the said association and the insurance company for which it may act as agent: Provided, however, that no such bank shall in any case assume or guarantee the payment of any premium on insurance policies issued through its agency by its principal: And provided further, That the bank shall not guarantee the truth of any statement made by an assured in filing his application for insurance.

In 1986, the Comptroller of the Currency found that section 92 had in fact not been repealed. In 1993, the Supreme Court affirmed that the statute was alive and well and had been in place continuously since 1916.

Most states have statutes which prohibit banks from selling insurance (except title and credit life insurance). These state laws work a kind of “reverse pre-emption” under the terms of the federal McCarran-Ferguson Act. This Act gives states the right to regulate “the business of insurance” and provides that state laws governing insurance take precedence over federal laws in many instances.

The question then became whether section 92 or the various state laws governing insurance was effective. Currently, there is a split in the circuits over the effect of section 92. One case holds that section 92 governs in spite of the McCarran-Ferguson Act’s provisions permitting the states to regulate insurance. A second case holds that the state laws pre-empt section 92 under the provisions of McCarran-Ferguson. A petition for certiorari has been granted in one of these cases.

In January of 1995, the Supreme Court opened a second front in the war between insurers and banks. In Nationsbank v. VALIC, the Court held that variable annuities are properly classified as “investments,” not insurance, within the meaning of section 92. Thus, the case sidestepped the preemption issue, but permitted banks to enter the business of selling variable annuities. Those annuities are closely analogous to insurance, often sold by insurance brokers and agents, and are created and initially offered by insurance companies. The result of the Nationsbank case is that banks have a foot in the door, that insurance brokers and agents would like to shut, lock and securely bar.

II. SECTION 92 OF THE BANKING ACT: REPEAL AND REACH

In the 1920 compilation of the U.S. Code, the provision quoted above appeared as section 92 of Title 12. The provision was reprinted in the 1926, 1934, 1940 and 1946 revisions of the Code. The 1952 edition omitted the provision, with a note indicating that Congress had repealed the act in 1918. The provision was left out of all subsequent editions of the Code.

A. Was the Repeal of Section 92 Effective?

Evidently the omission was troublesome to legislative bodies throughout the years. Hearings were held in 1957, but no action was taken. In 1965, Congressional staffers again reviewed the matter and concluded that Congress had indeed repealed the statute in 1918. At no time did Congress try to reenact what the staff thought had been repealed. Congress seemingly assumed that section 92 was still in force, even amending the statute on one occasion in 1982. Regulators, including the Comptroller

11. Id.
of the Currency and the Federal Reserve Board, also acted on the understanding that section 92 remained in full force.\(^6\) A number of courts have also assumed the validity of section 92.\(^7\)

In 1986, the United States National Bank of Oregon—a national bank with its principal place of business in Portland, Oregon—requested permission from the Comptroller of the Currency to sell insurance nationwide through its branch in the aptly-named municipality of Banks, a small town of 489 people. The Comptroller approved the request under the authority of section 92.

The respondents, a trade association of independent insurance agents, challenged the Comptroller's decision in the U.S. District Court for the District of Columbia, claiming that the ruling was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" under the Administrative Procedure Act (APA).\(^8\) The respondents argued that section 92 only permits banks to sell insurance only in the locality of under 5,000 people. The respondents for some reason declined to argue that section 92 was not valid law.\(^9\) The issue of the repeal of section 92 was considered by the Court of Appeals on its own motion,\(^10\) and the Court of Appeals held that section 92 had indeed been repealed in 1918.\(^11\)

The Supreme Court first dealt with the issue of whether the repeal was properly before the Court, since the respondents had refused to raise the issue. The Court held that a court "need not render judgment on the basis of a rule of law whose nonexistence is apparent on the face of things, simply because the parties agree upon it."\(^12\)

The Court then considered the more substantive question of whether the repeal of the statute had actually occurred. The Court reviewed the legislative history of the entire National Bank Act with its beginnings in 1863, the creation of the Federal Reserve in 1913, and the enactment of section 92 in 1916. The Court found that section 92 had not been repealed in 1918 based on the simple issue of the placement of quotation marks. After exhaustive analysis, the Court said that "we are convinced that the placement of the quotation marks in the 1916 Act was a simple scrivener's error, a mistake made by someone unfamiliar with the law's object and design. Courts, we have said, should 'disregard the punctuation or re-punctuate, if need be, to render the true meaning of the statute.'"\(^13\) The Court reversed the judgment of the Court of Appeals.

### B. Where May Banks Sell Insurance?

The decision of the court in Independent Insurance Agents left a critical point undecided, however. The issue which began the case in the first place—whether banks in towns with populations of 5,000 or less could sell insurance anywhere—went unanswered. Following this "chaotic and muddled history,"\(^14\) the U.S. Court of Appeals

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\(^6\) Nat'l Bank of Oregon, 113 S. Ct. at 2176 n.1.
\(^7\) Id. at 2176 n.2.
\(^9\) Nat'l Bank of Oregon, 113 S. Ct. at 2177.
\(^10\) Id. at 2178.
\(^12\) Nat'l Bank of Oregon, 113 S. Ct. at 2179 (citing United States v. Burke, 112 S.Ct. 1867, 1877 (1992)) (Scalia, J., concurring in judgment)).
\(^13\) Id. at 2186 (citing Hammock v. Loan and Trust Co., 105 U.S. 77, 84-85 (1881)).
\(^14\) King, supra note 3, at 841.
for the District of Columbia finally decided the issue in Independent Insurance Agents of America v. Ludwig ("Ludwig"), which was the Bank of Oregon decision on remand.

The Court of Appeals in Ludwig affirmed the district court’s ruling that a bank (or branch) located in a town with 5,000 or less people may sell insurance to persons located outside of that town. The court specifically addressed the Independent Insurance Agents of America’s arguments that the Comptroller’s interpretation of section 92 was (1) contrary to Congressional intent; (2) contrary to the Comptroller’s prior interpretations of section 92; and (3) contrary to parallel interpretations of the Bank Holding Company Act. The end result was that there was no geographic limit on the persons to whom banks could sell insurance when operating under section 92.

It would thus appear that banks may now enter the insurance market, even though they may be required to establish a branch in a small town to do so. Once entered, banks may sell anywhere, not just within the small town in which they have located. However, the story is not that simple.

III. PRE-EMPTION AND REVERSE PRE-EMPTION OF SECTION 92 UNDER THE MCCARRAN-FERGUSON ACT

The resurrection of section 92 presented some basic problems for regulation of insurance throughout the United States. The problem centers around the McCarran-Ferguson Act of 1945, which provides in part:

§ 1011. Declaration of policy
Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948
(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 . . . unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

In 1945, following the Supreme Court’s ruling in United States v. South-Eastern Underwriters and as a result of lobbying by the National Association of Insurance

26. See King, supra note 3, at 841-44 (discussing these three arguments and King’s agreement with the result).
28. United States v. South-Eastern Underwriters, 322 U.S. 533 (1944) (holding, contrary to prior decisions, that the business of insurance was indeed “commerce,” and
Commissioners ("NAIC"), Congress passed the McCarran-Ferguson Act. The concerns that prompted the enactment of the McCarran-Ferguson Act appear to have been three-fold. First, that the application of the antitrust laws to the insurance industry was wholly inappropriate and that an exemption from those laws was required to protect insurers from criminal antitrust liability. Second, that state schemes taxing and regulating insurance would be found to violate the Commerce Clause as the Court had interpreted it in South-Eastern Underwriters. Third, that legislation was needed to erect a barrier against the perceived threat that the "activist" Roosevelt administration would federalize insurance regulation and wrest control from the states.

Following the enactment of McCarran-Ferguson, all states have passed comprehensive legislation regulating insurance. Many, if not most of those state laws prohibit banks from selling insurance, or at least place substantial roadblocks in the way of banks selling insurance.

Under the terms of McCarran-Ferguson, section 1012(b), above, federal law cannot "invalidate, impair, . . . supersede" or preempt any state law "regulating the business of insurance." Obviously section 92 directly conflicts with state laws that provide that banks may not participate in insurance sales. There have been two cases directly dealing with the effect of such conflicting legislation, and their results are opposite. It is to those cases to which we now turn.

A. The Barnett Bank Case

The first case involved a Florida statute prohibiting banks from selling insurance or conducting insurance activities. The Florida statute read in part:

The purpose of this part is to regulate trade practices relating to the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945 (Pub.L. No. 15, 79th Congress)[McCarran-Ferguson], by defining, or providing for the determination of, all such practices in this state which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined.

(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 agent activities as an employee, officer, director, agent, or associate of a financial institution.

Barnett-Marion is a national bank subsidiary of a bank holding company, Barnett Banks, Inc. Barnett-Marion's principal place of business is Ocala, Florida, but it maintains a branch office in Belleview, Florida, which has a population of under 5,000. Barnett purchased an insurance agency in Belleview. The former owner, a licensed insurance agent, became an employee of Barnett-Marion and maintained her office inside the bank.

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29. See, e.g., ILL. ANN. STAT. ch. 215 (Smith-Hurd 1993).
32. FLA. STAT. ANN. § 626.988. (West 1984).
33. Barnett Bank, 43 F.3d at 632-33.
On the day of the purchase, Barnett sought a declaration allowing it to use the branch office to “market insurance to existing and potential customers regardless of where the insurance customers are located.” Four days later, the Florida Department of Insurance issued an Immediate Final Order (“IFO”) ordering the former owner and the Barnett bank to cease insurance agency activities other than selling credit life and credit disability insurance. Barnett moved for a temporary restraining order (“TRO”) against the Department restricting it from acting on the IFO. The district court denied Barnett’s motion for the TRO, and Barnett appealed.

The first question before the Court of Appeals was whether the Florida statute regulated insurance. While at first blush this seems to be a nonsense question, the court reviewed United States v. Fabe, which held in part that the key determinant to whether a statute regulates insurance is not title and location of a statute, but rather whether the statute’s aim is to regulate “an essential part of the ‘business of insurance.’” Barnett-Marion had argued that the sole purpose of the statute was to protect independent insurance agents from competition. The court disagreed:

While appellant Barnett-Marion argues that the statute exists only to protect “independent insurance agents from competition by financial institutions,” we disagree. The danger in these situations, as the trial court correctly points out, is the loss of arms-length transactions and objectivity when the bank becomes involved with insurer and insured. “The maintenance of this relationship is for the protection of the solvency of the insurance industry, and the prevention of coercion, which in turn protects all potential, present and future policyholders.”

Based on that analysis, the court held that the Florida statute regulates insurance, and that “under the terms of the McCarran-Ferguson Act, therefore, the federal law must yield to the extent the [state] statute furthers the interests of policyholders.”

Fabe also held that “[s]tate laws enacted ‘for the purpose of regulating the business of insurance’ do not yield to conflicting federal statutes unless a federal statute specifically requires otherwise.”

Although Nat’l Bank of Or. did not address whether section 92 relates to insurance, it did emphasize at length the relation between section 92 and both the National Bank Act and the Federal Reserve Act, neither of which suggests section 92 relates specifically to insurance or was a specific attempt to preempt state insurance laws. Both Acts concern banking, not insurance. Moreover, Congress enacted section 92 “at a time when the business of insurance was believed to be beyond the reach of Congress’ power under the Commerce Clause.” As the trial court pointed out, “[e]ven South-Eastern Underwriters, which briefly altered the preemption landscape, noted that prior to 1944 Congress ‘at no time’ had attempted to control the business of insurance.” Before 1944, both Congress and the Supreme Court understood Paul v. Virginia to place insurance outside the Commerce Clause power.

34. Id. at 633.
36. Fabe, 113 S. Ct. at 2204.
37. Barnett Bank, 43 F.3d at 636.
38. Id. at 636 (quoting Fabe, 113 S. Ct. at 2208).
39. Id. (quoting Fabe, 113 S. Ct. at 2211).
cordingly, when Congress enacted section 92 in 1916—nearly 30 years before *South-Eastern Underwriters*—Congress could not have been attempting to regulate a business that it believed it had no power to regulate. Congress was concerned with banking, not insurance.40

The *Barnett Bank* Court held that section 92 neither specifically related to insurance nor specifically required that apparently conflicting state laws be pre-empted. As a result, the court held that the Florida statute was not pre-empted by section 92. Since the Florida statute was paramount under McCarran-Ferguson, the Court held that it need not reach the question of whether banks could sell insurance nationally or anywhere outside of the town where the bank is located. As mentioned earlier, petition for certiorari has been granted.41 The result under *Barnett Bank* is that banks may not sell insurance, at least in the Eleventh Circuit, if there is a state law that forbids it.

B. The *Owensboro* Case

A month before the *Barnett Bank* case was decided, the Sixth Circuit, dealing with virtually identical facts, came to the opposite result. In *Owensboro National Bank v. Stephens*,42 the court dealt with a Kentucky statute that read as follows:

No person who after July 13, 1984, owns or acquires more than one-half (1/2) of the capital stock of a bank shall act as insurance agent or broker with respect to any insurance except credit life insurance, credit health insurance, insurance of the interest of a real property mortgage in mortgaged property, other than title insurance.43

Plaintiffs submitted requests for applications for licenses to act as life and general line insurance agents in Kentucky. The Commissioner denied the requests, but scheduled a hearing. Before the hearing the plaintiffs filed these actions, seeking declaratory and injunctive relief. A Kentucky state court granted a stay of the administrative proceedings. Meanwhile, a number of insurance industry associations intervened on the side of the Commissioner, and the United States intervened on behalf of the plaintiff. The district court granted plaintiff's motion for summary judgment and held in favor of the plaintiffs. The defendant-Commissioner appealed.

The *Owensboro* court affirmed the judgment and ruled in favor of the bank, albeit not unanimously. The court held that the McCarran-Ferguson Act did not immunize the state statute from pre-emption, since the state statute did not regulate "the business of insurance." The court argued that the statute only regulated *who* could enter the business, not *how* the business would be conducted.

Excluding a person from participation in an activity, however, is different from regulating the manner in which that activity is conducted. The former is the regulation of the person; the latter is the regulation of the activity. Section 287 only regulates persons owning "more than one-half (1/2) of the capital stock of a bank"; it in no way governs the manner in which the activities constituting the "business of

40. *Id.* at 637 (citations omitted).
41. *Id.*
insurance” are conducted.44

The court relied on the criteria established in *Union Labor Life Insurance Company v. Pireno*45 to determine whether a state statute was enacted “[f]or the purpose of regulating the business of insurance.” Those criteria are:

*first,* 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 insured; and *third,* whether the practice is limited to entities within the insurance industry.46

In anticipation of the dissent, the *Owensboro* court specifically distinguished the opinion in *Fabe* from the *Pireno* opinion on this point. As a result, the court held that the Kentucky statute did not regulate insurance, but rather regulated the activities of certain bank holding companies instead. The court then held that it did not need to reach the question of whether section 92 “specifically relates to the business of insurance” for, without regard to whether section 92 so relates, McCarran-Ferguson could not save the statute.47

Justice Batchelder filed a dissenting opinion on the issue of McCarran-Ferguson Act pre-emption.48 His decision is quite similar to the opinion in *Barnett Bank.* His analysis argued that *Fabe* applies, thus requiring a different result than the *Pireno* decision relied upon by the majority.

C. *Fabe* and *Pireno* Pre-emption Theory and the McCarran-Ferguson Debate

The debate centers around differing approaches taken by the court in the *Pireno* and *Fabe* decisions. The issue in both cases was whether a state statute was enacted “for the purpose of regulating the business of insurance” under section 1012(b) of the McCarran-Ferguson Act.

The *Pireno* decision involved a New York statute requiring health insurance policies to cover certain claims for chiropractic services. Some policies issued by the Union Labor Life Insurance Company limit the company’s liability to “the reasonable charges” for “necessary medical care and services.” In making these determinations, Union Labor arranged with the New York State Chiropractic Association (“NYSCA”), a professional association of chiropractors, to use the NYSCA’s Peer Review Committee, which had been established for the express purpose of reviewing procedures and charges for insurance purposes.49

The plaintiff, a chiropractor, filed an antitrust action on the grounds that many of his bills had been turned down by the Peer Review Committee. The NYSCA and the insurance company argued that the McCarran-Ferguson Act permitted the states to regulate the area, and contrary antitrust statutes would not apply and were effectively “reverse-pre-empted” by the act.50 The district court ruled for the defendants, and the

44. *Owensboro,* 44 F.3d at 392.
46. *Owensboro,* 44 F.3d at 391.
47. *Id.* at 392.
48. *Id.* at 393-99.
50. *Id.* at 124.
Court of Appeals reversed. That court relied on the opinion in *Group Life & Health Insurance Company v. Royal Drug Company*, and found that the statute involved was not a regulation of "the business of insurance." The Supreme Court granted certiorari.

The Supreme Court affirmed, holding that the use of the peer review committee does not constitute the "business of insurance" within the meaning of the McCarran-Ferguson Act. Relying on *Royal Drug*, the Court found "three characteristics of the business of insurance that Congress had intended to exempt through § 2(b)." Those characteristics are: 1) the "spreading and underwriting of the policyholder's risk," 2) the "contract between the insurer and the insured," including the "relationship between insurer and insured, the type of policy which would be issued, its reliability, interpretation, and enforcement—these were the core of the 'business of insurance,'" and 3) the "cooperative rate-making process" which permits intra-industry cooperation in underwriting risks. The Court noted that none of these criteria is "necessarily determinative in itself."

The Court found that the peer review system played no part in the first and second criteria. It did find some relationship to the third criteria—at least through the involvement of third parties—but that involvement was not sufficient to move the regulation into the exempt category created by the McCarran-Ferguson Act. It is important to note that the opinion was written in 1982 by Justice Brennan, and that Justice Rehnquist dissented, joined by Justices O'Connor and Burger. A number of changes have taken place on the Court in the intervening thirteen years, casting some doubt on the future viability of the decision.

In *United States Department of Treasury v. Fabe*, the Court dealt with an Ohio statute that conferred fifth priority status on claims of the United States in proceedings to liquidate an insolvent insurance company. The federal priority statute accords first priority to the federal government. That statute would pre-empt the inconsistent Ohio law, unless the Ohio law was considered exempt from pre-emption under the McCarran-Ferguson Act.

The district court in *Fabe* had cited *Pireno's* three-part test, holding that the Ohio statute did not involve the business of insurance and that federal law governed. A divided Court of Appeals reversed. That court held that the Ohio statutory scheme regulates the "business of insurance" because it protects the interests of the insured. The court also applied *Pireno*, but found that the statute: 1) transfers and spreads the risk of insurer solvency, 2) involves an integral part of the policy relationship because it is designed to maintain the reliability of the insurance contract, and 3) focuses upon

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51. See *Pireno v. New York State Chiropractic Ass'n*, 650 F.2d 387 (2d Cir. 1981).
55. *Id.* at 127.
56. *Id.* at 127-28 (citing *Royal Drug*, 440 U.S. at 211-12).
57. *Id.* at 128 (citing *Royal Drug*, 440 U.S. at 215-16).
58. *Id.* at 128 (citing *Royal Drug*, 440 U.S. at 221).
59. *Id.* at 131.
63. *Fabe v. United States Dep't of Treas.*, 939 F.2d 341 (6th Cir. 1991).
the protection of policyholders by diverting the scarce resources of the liquidating entity away from other creditors.64

The Supreme Court granted certiorari65 and held that the statute—to the extent that it regulates policyholders—was enacted for the purpose of regulating the business of insurance, and thus not pre-empted by the federal priority statute. The Court relied on SEC v. National Securities, Inc.66 The Court distinguished Royal Drug and Pireno from National Securities on the ground that the former cases dealt with the scope of the antitrust immunities conferred in the second clause of section 2(b), while the first clause of section 2(b)—never considered by the court until the Fabe case—“is not so narrowly circumscribed.”67

The distinction in Fabe is both subtle and critical. “To equate laws enacted... for the purpose of regulating the business of insurance with the business of insurance itself, ... would be to read the words out of the statute.”68 The Court refused to do so. The Fabe Court found that the performance of an insurance contract was an essential part of “the business of insurance.”69 As a result, the protection of shareholders created by the priority statute were not pre-empted by federal law because of the doctrines in the McCarran-Ferguson Act.

The subtle distinction in Fabe is important to the current discussion. Based on Fabe, it would appear that the Barnett Bank case—and Justice Batchelder’s dissenting opinion in Owensboro—are the better reasoned. Moreover, since Fabe is the newer case, one would also assume that the Court would follow that case more closely than Pireno. On the other hand, Fabe involved a dissent by four justices (Kennedy, with Scalia, Souter and Thomas joining),70 and Justice Blackmun, the author of the Fabe decision, has retired. Again, the future viability of Fabe is in question.

The Fabe distinction centers on the fact that there are two separate clauses in section 1012(b) of the McCarran-Ferguson Act. For ease of reference, that clause reads as follows:

(b) No act of Congress shall be construed to invalidate, impair, or supersedes 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: Provided, That after January 1, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.71 [emphasis added]

Fabe clearly distinguishes the first clause—dealing with general regulation of “the business of insurance”—and the second “proviso” clause—dealing specifically with antitrust laws.

The broad category of laws enacted “for the purpose of regulating the business of

64. Id. at 351-52.
67. Fabe, 113 S. Ct. at 2209.
68. Id. at 2209-10.
69. Id. at 2212.
70. Id.
"insurance" consists of laws that possess the "end, intention, or aim" of adjusting, managing, or controlling the business of insurance. This category necessarily encompasses more than just the "business of insurance." For the reasons expressed above, we believe that the actual performance of an insurance contract is an essential part of the "business of insurance." Because the Ohio statute is "aimed at protecting or regulating" the performance of an insurance contract, ... it follows that it is a law "enacted for the purpose of regulating the business of insurance," within the meaning of the first clause of § 2(b).

Our plain reading of the McCarran-Ferguson Act also comports with the statute's purpose. As was stated in Royal Drug, the first clause of § 2(b) was intended to further Congress' primary objective of granting the States broad regulatory authority over the business of insurance. The second clause accomplishes Congress' secondary goal, which was to carve out only a narrow exemption for "the business of insurance" from the federal antitrust laws.72

Justice Batchelder adopted the Fabe analysis in a very closely worded and well-reasoned dissent in the Owensboro case. He noted that the majority opinion in Owensboro cited Fabe as approving of the Pireno three-part test.73 However, he pointed out that "this quotation appeared ... before the [Fabe] Court actually analyzed Pireno and distinguished it from the Ohio statute then being considered. In its subsequent analysis of Pireno, the Court clearly limited the scope and application of Pireno's tripartite test ... ."74

Justice Batchelder went on to argue that the very purpose of McCarran-Ferguson was to allow states to regulate the insurance contract.

In enacting McCarran-Ferguson, Congress intended for the contract between an insurer and its policyholder to be controlled and regulated by the state. The legislation was aimed at:

The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly are laws regulating the "business of insurance."75

Batchelder went on to argue that the Kentucky statute prohibiting banks from selling insurance was enacted to regulate "the business of insurance" within the meaning of

73. Owensboro, 44 F.3d at 392.
74. Id. at 395.
75. Id. at 396 (quoting Securities and Exch. Comm'n v. National Sec., Inc., 393 U.S. 453, 460 (1969)).
the first clause of the McCarran-Ferguson Act. He cited Barnett Bank and argued that the purpose of both statutes was "to protect and regulate the relationship between insurer and insured at its most basic level." He argued that the Kentucky legislature's legitimate concern was with the continued solvency of insurance companies, and that legislation need not be located only within the Insurance Code.

Justice Batchelder then went on to the second question in this analysis—namely, whether section 92 "specifically relates to the business of insurance" within the meaning of the exception phrase of the first clause of the McCarran-Ferguson Act.

However, there is little doubt that as the district court determined below, § 92 does not specifically relate to the business of insurance. Rather, § 92's "primary intent was to strengthen small national banks by providing them with an additional source of revenue." Id. (citations omitted). As the district court further stated, the mere fact that "the power granted to the national banks involves insurance does not transform this section into a regulation of the business of insurance." Id. at 36. On this issue, the district court's analysis is sound and should be followed by this Court.... The context of § 92 has always been within the regulation of banking rather than insurance. In United States Nat'l Bank of Oregon v. Independent Insurance Agents of America, in which the Court upheld the viability of § 92, the Court emphasized that § 92 was part of the Federal Reserve Act. The court in Barnett Bank relied on the language of Independent Ins. Agents stating that § 92 was to be read in context with the other paragraphs around it and the fact that neither the Independent Ins. Agents Court nor Congress ever suggested that § 92 was specifically related to the business of insurance. Therefore, § 92 was found not to specifically relate to the business of insurance.

It is submitted that among Owensboro, Barnett Bank, and Fabe, Justice Batchelder has the better of the argument. While the majority in Owensboro and the dissent in Fabe rely on the Pireno case and the idea that the same words used in the two clauses of the McCarran-Ferguson Act should be read identically, it is also clear that the term "business of insurance" was not intended as a term of art when it was used in the McCarran-Ferguson Act. It is also clear that Congress was well aware that exemptions from the antitrust laws were to be treated strictly. The result seems to be that the McCarran-Ferguson Act was dealing with two very different issues in the two clauses.

On one hand, Congress was dealing with a pre-emption issue for general state regulations of insurance. As a general rule, the states were to be left alone in regulating insurance. State laws pre-empted all but the most specific federal laws dealing with insurance. Thus, a federal law dealing with banking must be pre-empted by a state law dealing with insurance. However, a federal law dealing specifically with insurance would pre-empt a state law on the same topic.

On the other hand, Congress was dealing with antitrust issues in the second clause. If state law was silent on antitrust issues, the federal antitrust laws would govern. State exemptions from the antitrust laws would be given deference, but under existing federal law, would be treated very narrowly and strictly.
IV. THE NATIONSBANK DECISION AND THE DEFINITION OF INSURANCE

A complicated issue surrounds the Supreme Court's decision in *NationsBank of North Carolina v. Variable Annuity Life Insurance Company.* That case dealt with the problem of whether national banks may serve as agents in the sale of annuities. NationsBank—a national bank based in Charlotte, North Carolina—sought permission under 12 C.F.R. section 5.34 from the Comptroller of the Currency for its brokerage subsidiary to act as an agent in the sale of annuities.

The Comptroller granted NationsBank's application, and respondent, the Variable Annuity Life Insurance Company ("VALIC") challenged the decision in the United States District Court for the Southern District of Texas. The district court granted summary judgment in favor of the Comptroller and NationsBank. The Fifth Circuit Court of Appeals reversed. That court relied on its decision in *Saxon v. Georgia Association of Independent Insurance Agents,* which held that section 92 bars banks not located in small towns from selling insurance, and rejected the Comptroller's view that annuities are not insurance for purposes of section 92. Four judges dissented from the *NationsBank* court's failure to grant rehearing en banc. Their dissent argued that the court had not accorded due deference to the Comptroller's reasonable statutory interpretations. The Supreme Court granted certiorari.

The Court first considered whether the "business of banking" included the power to sell annuities. The National Bank Act provided that national banks shall have the 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 . . . .

The Comptroller's authorization to NationsBank to sell annuities noted the "power [of banks] to broker a wide variety of financial investment instruments." The Comptroller construed the authorization to conduct incidental powers as an independent grant of authority, and the specific powers noted as "exemplary, not exclusive." VALIC argued that the words in the statute are designed to completely describe the "business of

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82. See *Variable Annuity Life Ins. Co. v. Clarke,* 998 F.2d at 1298-1302.
87. *Id.*
banking." Thus, there would be—using the Court's verbiage—"no independent significance" to the words "business of banking." The Court disagreed.

The Court found that the limitation on dealing in securities made sense only if banks had such authority in the first place. "Congress' insertion of the limitation decades after the Act's initial adoption makes sense only if banks already had authority to deal in securities, authority presumably encompassed within the 'business of banking' language which dates from 1863."88 [emphasis added]. In an important footnote, the Court stated

[W]e expressly hold that the "business of banking" is not limited to the enumerated powers in Sec. 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated. The exercise of the Comptroller's discretion, however, must be kept within reasonable bounds. Ventures distant from dealing in financial investment instruments—for example, operating a general travel agency—may exceed those bounds.89

The Court also looked at the character of annuities and their relationship to the business of banking. The Court defined annuities as contracts under which the purchaser makes one or more premium payments to the issuer in exchange for a series of payments. That series of payments may continue for either a fixed period or for the life of the purchaser or a designated beneficiary. When a purchaser invests in a variable annuity, the purchaser's money is invested in a designated way and payments to the purchaser vary with investment performance. In classic a fixed annuity, payments do not vary. Issuers are ordinarily insurance companies.90

The Court found that annuities of both sorts were analogous to the activities of savings banks:

By making an initial payment in exchange for a future income stream, the customer is deferring consumption, setting aside money for retirement, future expenses, or a rainy day. For her, an annuity is like putting money in a bank account, a debt instrument, or a mutual fund. Offering bank accounts and acting as agent in the sale of debt instruments and mutual funds are familiar parts of the business of banking....

In sum, modern annuities, though more sophisticated than the standard savings bank deposits of old, answer essentially the same need. By providing customers with the opportunity to invest in one or more annuity options, banks are essentially offering financial investment instruments of the kind congressional authorization permits them to broker. Hence, the Comptroller reasonably typed the permission Nationsbank sought as an "incidental powe[r]... necessary to carry on the business of banking."91

89. Id. at n.2.
90. Id. at 815.
91. Id. In a telling footnote to this passage, the Court stated "Assuring that the brokerage in question would not deviate from traditional bank practices, the Comptroller specified that NationsBank 'will act only as agent... will not have a principal stake in annuity contracts and therefore will incur no interest rate or actuarial risks.'" Id. n.4. This note indicates the Court's willingness to differentiate between the agency and underwriting functions of a bank in the sale of insurance.
More to the point, VALIC also argued that section 92 barred NationsBank from selling annuities as an agent. That section permits banks to sell insurance in localities of less than 5,000 persons. VALIC argued that, by negative implication, that section prohibits banks from selling insurance in localities of greater population. Therefore, according to VALIC, banks cannot sell annuities in towns with a population of 5,000 or more.

The Court refused to take the bait. VALIC’s argument presupposed that annuities were insurance, and the Court refused to so hold, and classified annuities as “investments,” not insurance. While annuities are often sold by insurance companies, and often classified as insurance by state law for the purpose of regulating insurance companies, the Court found that those classifications are not based on function, but rather on convenient groupings based on similar marketing.

The Court instead held that the tax deferral and investment features of annuities made a classification as “investments” to be “at least reasonable.”

A key feature of insurance is that it indemnifies loss . . . . As the Comptroller observes, annuities serve an important investment purpose and are functionally similar to other investments that banks typically sell . . . . And though fixed annuities more closely resemble insurance than do variable annuities, fixed annuities too have significant investment features and are functionally similar to debt instruments . . . . Moreover, mindful that fixed annuities are often packaged with variable annuities, the Comptroller reasonably chose to classify the two together.92

The Court then agreed with the Comptroller’s conclusion that brokerage of annuities is an incidental power of the business of banking, and affirmed the judgment of the Court of Appeals.93 The decision was based in large part on the Court’s deferral to the decisions of the administrator.

The NationsBank decision does not bear directly on the issues of whether section 92 provides a basis for banks to sell insurance. The Court sidestepped the issue of whether section 92 prohibited banks from selling insurance in towns of more than 5,000 persons by negative implication. Similarly, the Court defined variable annuities in a way to make section 92 irrelevant to the issue, by holding that annuities were not “insurance” but rather “securities.” However, the decision is important to our present inquiry in a number of ways. First, the decision indicates a tolerance for the decisions of the Comptroller of the Currency. The Court appears willing to defer to a substantial degree to the decisions of the Comptroller with regard to the interpretation of the National Banking Act. Second, footnote 2—noted above94—clearly states that the “business of banking” is not limited to the enumerated powers. This indicates a broad acceptance of the notion that banks may expand their activities substantially beyond traditional banking activities. Finally, the Court neatly sidestepped the question of whether section 92 prohibited banks from selling insurance in towns larger than 5,000. While a reading of section 92 would seem to make such an interpretation self-evident, the Court even refused to take the step of stating that section 92 prohibited insurance sales in large towns through negative implication. That decision was made in Ludwig in 1993 at the Court of Appeals level. The Court did not mention or cite Ludwig but

92. Id. at 817.
93. Id. at 817.
94. Ludwig, supra note 86. In fact, this doctrine of “implied powers” of banks opens the door to a host of new issues.
merely stated that it did not reach the issue.

It is sobering to realize that this decision was unanimous—without a concurring opinion in this age of separate opinions. The VALIC decision indicates a sympathetic attitude on the part of the Court toward expanded bank power. While it is not at all certain that this attitude would extend to attempts by banks to sell insurance—by the Court’s definition insurance was not at issue in the case—the decision seems to indicate a rather clear tolerance of and dependence on the Comptroller’s interpretation of the Banking Act.

V. PENDING LEGISLATION AND PROPOSED CHANGES

A number of bills have been introduced in Congress which address both the issues raised by section 92 and current bank efforts to legalize the sale of insurance. This gamut of proposals illustrates the wide range of choices and policy decisions to be made, as well as the extent to which banking and insurance industry regulation is being reevaluated in Congress generally.

Representative Leach’s bill\(^95\) would replace bank holding companies with “financial services holding companies,” permitted to engage in banking and securities underwriting and dealing. The bill creates firewalls between the two entities and permits creation of “investment bank holding companies” that can control both a financial institution uninsured by the FDIC and a securities affiliate. The bill would grandfather unitary thrift holding companies, which generally are specialized housing lenders.

Leach’s staff has said that the only purpose is to eliminate the Glass-Steagall separation between banking and securities businesses and not encroach upon other forms of commerce. However, the bill amends the Bank Holding Company Act to provide that bank holding companies can acquire entities engaged in any activity the Federal Reserve Board has determined to be financial in nature or incidental to such financial activities. Leach’s staff has also said that the new language would not expand insurance-related powers, but the Supreme Court’s deference in the NationsBank decision to the Comptroller’s view that annuities are investment instruments and not insurance casts some doubt on that conclusion.\(^96\)

Chairman D’Amato’s bill\(^97\) permits well-capitalized companies of any nature to acquire and affiliate with insured depository institutions. The bill creates Finance Services Holding Companies (“FSHCs”), which can own commercial banks, securities brokerages, insurance companies and agencies, and other commercial or industrial companies. The proposed law clearly contemplates cross-marketing and coordinated activities between diversified affiliates. D’Amato’s bill pre-empts state laws that interfere with affiliation structure. Therefore, state laws that prohibit the affiliation of lending institutions and insurance companies or agencies would be pre-empted in the case of an FSHC.

The bill does contain some insurance-related restrictions: 1) FSHCs cannot enter into new insurance agency activity except by acquiring an existing agency; 2) No depository institution affiliate of an FSHC can directly engage in insurance underwriting

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96. See, e.g., NationsBank, supra, note 88 (upholding the Comptroller’s decision to permit banks to sell annuities).
and underwriting must be through an affiliate other than the bank itself; and 3) FSHCs are subject to the same restrictions currently imposed on bank holding companies, which are prohibited from tying together banking and nonbanking products.

The Administration has also offered a proposal not yet offered in the form of a bill. The administration would permit affiliations between well-capitalized FDIC-insured depository institutions and companies engaged in “financial activities”—meaning securities and insurance underwriting and sales. The proposal would allow the affiliated companies to be subsidiaries of either the insurance depository institution or the institution’s parent company.

The administration proposal would maintain the prohibition against affiliations between insured banks and companies engaged in nonfinancial activities, and erect certain restrictions and firewalls to ensure safety and soundness of the banks.

A seven-member National Council on Financial Services would be established to be made up of federal banking and securities regulators. The Council would act as an inter-agency policy forum, not a hands-on regulator, and would determine what activities are “financial” within the meaning of the proposed Act.

Finally, Rep. Bliley of the House Commerce Committee has also produced a bill. This proposal would solidify the States’ authority to regulate the business of insurance and clearly provide that state law controls. Every entity that sells, solicits or underwrites insurance would be required to comply with applicable state insurance laws, including licensing and consumer protection laws. Prospective agents and underwriters must qualify under state law in order to engage in the business. State law governs who may and who may not sell and underwrite insurance within a state’s borders. “Insurance” is defined solely by state law; if a state regulates or defines a product as insurance, a seller or underwriter of that product would be subject to this legislation. No new substantive requirements are imposed.

VI. POLITICAL AND POLICY ISSUES: SHOULD BANKS SELL INSURANCE?

The sole article to deal with the issue of the economic costs and benefits associated with banks entering the insurance market deals exclusively with competition between banks and insurance companies.

The article considered the Federal Deposit Insurance Corporation Improvement Act of 1991, which provided that no insured state-chartered bank or subsidiary may engage in any activity that is not permissible for its national bank counterpart unless the FDIC determines that the activity is not risky and the bank complies with the applicable federal capital standards. The FDIC’s authority to make even that determination is withdrawn in the case of insurance underwriting.

100. Sarch, supra note 3, at 247-51.
In this context, the author notes three problems caused by this legislation: 1) no effort was made to permit experimentation in new markets (i.e., insurance) by allowing the states to act as laboratories for testing innovative ideas in banking, 2) Congress may have included the above restriction in order to restore a competitive advantage to the insurance industry, and 3) the possibility of anti-competitiveness.104

It is critical to consider the competitive aspects of banks operating at two very different levels. If banks operate as *insurers*, creating an in-house or subsidiary insurance firm, it raises entirely different concerns than if banks simply act as agents for sale of insurance.

A. Economic and Policy Considerations of Banks as Insurers

While the focus of section 92 is the sale of insurance, most of the arguments considering banks selling insurance deal with the problems of banks acting as insurance underwriters. For example, in the *Barnett Bank* case, the Florida Department of Insurance argued that an issue was the threat of instability to banks caused by the risks assumed by banks acting as underwriters.

[The Director of Legal Services for the Florida Department of Insurance ... testified about the need to protect policyholders by regulating the financial stability of insurance companies so that they remain solvent and able to pay claims upon demand, which could be threatened by pressures to make improper insurance decisions. This pressure could force an insurer to assume a bad risk to quickly consummate a bank loan, or could push a bank customer to take out unnecessary insurance where the bank’s only motive is profit.105

That, of course, is not an issue if the only activity of the bank is to sell insurance underwritten by other insurance companies.

The threat to bank financial stability is more realistic if banks enter directly into insurance underwriting. Insurance companies accept risks by definition. All states impose reserve requirements on insurers to provide protection to policyholders, assuring that assets will be available to pay claims. Occasionally, and fortunately rarely, reserves are insufficient or are secured by assets that are overvalued or insecure, and an insurance company becomes insolvent.106

If a bank becomes an insurer it will likely do so through a holding company or subsidiary arrangement. The issue then becomes whether it is feasible to erect some kind of “firewall” between the assets of the bank *qua* bank and the assets of the bank *qua* insurer. This appears to be the principle issue of most of the federal legislation now pending.

It seems both necessary and appropriate to erect these “firewalls.” The spirit of state and federal banking laws and state insurance reserve requirements all would seem to demand that there be protection for banking customers (and the FDIC) from the vicissitudes of the insurance market. The same is true for insurance claimants, who in rarer cases may need protection from the vagaries of the banking industry. These

106. The most notorious contemporary failures involved Mutual Benefit Insurance Company and Executive Life Insurance Company, both insurance companies that purportedly invested their assets in risky investment schemes.
firewalls seem to exist in some, but not all, of the proposed federal statutes.

B. Economic and Policy Considerations of Banks as Insurance Agents

It has been argued that banks' entry into the business of insurance sales would benefit both consumers, by lowering their costs of insurance, and banks, by increasing their profitability by expanding their product lines. On the other hand, this would clearly affect independent insurance agents negatively, and the effect on insurance companies will vary with the company's product lines and methods of doing business.

There have been a number of reasons put forth for allowing banks to sell insurance. It is asserted that banks need the added revenue because of shrinking profits and increased competition. This argument seems to fail prima facie. There seems to be no logical reason to choose between banks, insurers and insurance agencies as a preferred industry. If banks are permitted to sell insurance in order to increase their profits at the expense of insurers or insurance agencies, there seems to be no net increase in utility. The argument presupposes that the market favors banks over insurance agencies, large businesses over small, or the banking industry over the insurance industry.

A second set of reasons advanced in support of permitting banks to sell insurance revolves around lower customer cost. Lower customer cost is presumably a function of two factors: (1) that banks will be able to absorb operating costs into their larger organization and thereby lower customer prices; (2) that banks will provide competition for remaining insurance agents, thus lowering prices for all agents' services.

These two factors are not independent. It is likely true that banks will be able to lower the costs of selling some kinds of insurance. There will be less—or even nonexistent—overhead costs for insurance sold over the counter or over an existing desk in the lobby of today's banks (or even through an automated teller machine). Banks will probably be able to cut the costs of insurance by reducing their commissions because of the lowered costs of sale. This, in turn, will probably cause a number of independent insurance agents to cut their commissions in order to compete. Marginal agents will certainly go out of business, and others will be operating closer to the margin themselves. This will cause those newly-marginal agents to become more efficient and cut services now provided. At least in the short run consumers will probably benefit from lower commission costs.

The problems with banks entering the insurance agency field are substantial: (1) a loss of the education function of insurance agents; (2) potentially "tying" other bank services to insurance sales; (3) potential cross-subsidization of insurance services and resultant monopolization of local insurance markets; and (4) potential concentration of the insurance sales field and the loss of large numbers of small businesses. All present troubling counterpoints to the "lower-cost, greater efficiency" arguments of the banks and consumer groups.

1. Loss of Education Function

It is difficult to conceive of a business in which the direct sales marketer—here, the insurance agent—plays a larger education function. Consumers are often confused

108. King, supra note 3, at 847.
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by even the simplest insurance transaction. In automobile insurance, for example, it is
difficult for even sophisticated customers to choose between the myriad of options and
coverages available. The same is even more true of residential property coverages, life
and accident insurance, and umbrella coverage.

The insurance agent provides a valuable education service by enlightening the
consumer about the various coverages and by helping to analyze the consumer's needs.
It is sometimes argued that agents may "oversell" or work in their own best interest
instead of that of the customer. But most insurance agents are attempting to establish a
lifetime "book" of customers, and gross overselling and sharp practices work against
such a long view. Many insurance agents undertake long and arduous training courses
and embark on related careers as financial planners in order to serve both their careers
and their clients better. Some proposals would require that banks only sell insurance
through licensed agents associated with their banks which may resolve some of the
problem (and also by implication eliminate any possibility of selling insurance through
ATMs).

2. Tying

Tying one product to another involves selling one product or service only on
condition that another product or service is also purchased. In the current discussion
over banks selling insurance, tying would most likely occur if banks were to sell mort-
gage services, for example, only if the consumer were to purchase property insurance
through the bank. The same effect would occur if a bank agreed to loan money on a
car only on condition that the consumer purchase auto insurance through the bank.109

"Tying" is, of course, a traditional per se violation of section 1 of the Sherman
Antitrust Act. In 1984 the Supreme Court ruled that tying would no longer be a per se
violation unless the seller had "market power" in the market for the tying product.110
This would mean that for banks to be accused of tying, they must have power in the
market for mortgage services or car loans, thus producing a forcing effect and an un-
earned competitive advantage for property or automobile insurance.

For antitrust purposes, the question becomes whether the market for financial
services—real estate mortgages, auto loans, etc.—involves "market power." The banks
would likely argue that it does not, simply because consumers are free to seek out
mortgages and auto loans from a variety of sources, including other banks and other
financial institutions such as savings and loans, state chartered banks, credit unions, or
from national banks that do not sell insurance.

Prior to the Jefferson Parish Hospital case in 1984, such market power was not
even required for per se treatment of tying contracts, at least not in express terms.111
More importantly, the issue is not one of guilt or innocence for antitrust purposes, but
one of whether as a policy matter, competition in the insurance market should be sub-
verted in this way. The issue is whether the transaction is in fact a true arm's length

109. In Ohio, the Director of Insurance proposed regulations that would have prohibit-
ed banks selling insurance from requiring that borrowers also purchase insurance. After
substantial lobbying, the regulation was voted down by the legislature's joint committee
on agency rule review. An Uneven Playing Field in Ohio, FC&S (Publication of the National
Underwriter Company), Jul. 1995. See also Dave McDaniel, Agents' Worst Nightmare: Banks are
Gaining the Edge to Sell Insurance in a Big Way, BEST'S REVIEW, May 1995, at 34.
A loan transaction, whether for mortgages or auto loans, can be one of the most stressful and insecure times in a consumer's life. It seems obvious that consumers will feel pressure to agree to purchase insurance from the potential lender. Consumers who have doubts about their own credit-worthiness or who are less than sophisticated about the lending process will undoubtedly see their agreement to purchase insurance as either a requirement of obtaining the loan, or an inducement to the lender to give the loan. This would be true irregardless of whether the lender tells the borrower that "you do not have to purchase insurance from us."112

This friction in the competitive system would provide banks with the opportunity to sell insurance with either higher premiums or lower benefits (or both). If consumers enter into these transactions because of some extraneous motive—convincing the lender to make the loan, for example—then more than low price and quality are the determining factors for the purchase. The result is a reduction in competition in the insurance market. At a minimum, this means that any law permitting banks to sell insurance should include substantial safeguards to consumers about the transaction. Banks should be required to tell consumers that they do not have to purchase insurance as a condition of the transaction, and that their refusal to purchase insurance from the bank will have no effect on their eligibility for the loan. This would likely require auditing of loan records to make sure that banks are not, in fact, conditioning loans on the purchase of insurance.

3. Cross-Subsidization

Another problem that arises in this context is the possibility of cross-subsidization and resultant predatory pricing. Cross-subsidization involves an integrated seller—one with more than one line of products—cutting the price on one of its products below cost in order to subsidize the sales of that product by the profit made in the seller's other businesses. This permits the seller to undercut single product competitors—who cannot subsidize by other products—and can in extreme cases force them out of business through predatory pricing. In our current case, the argument is that banks could cut the price of insurance products, perhaps even below "cost" by foregoing agency fees, thereby undercutting local insurance agents. Once banks gain the market, the fees could be reimposed and the prices raised.

Cross-subsidization has been used as evidence of monopolization under section 2 of the Sherman Act.113 Similar doctrines exist in the area of price discrimination, though again simple price competition does not amount to a violation.114 Again, the issue is not an antitrust one, but one built on antitrust analogies. The issue is whether banks should have the ability to undercut competitors who do not have other lines of business on which to fall back. Theorists have argued that while predatory practices against existing competitors occur, it is rarely for the purpose of eliminating a competitor; the discipline of smaller rivals is a more plausible motive.115

112. Nobody really believes such statements, anyway. For example, most people believe that you have to purchase magazines in order to qualify for the sweepstakes—even if they tell you that it is not necessary.
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Predatory pricing aimed at existing competitors need not be intended to destroy them but merely to warn or discipline those whose pricing strategies undercut either an oligopolistic consensus or an outright conspiracy. Even if these actions hurt the disciplinarians more than the errant competitors, they may still make sense as intimidating demonstrations, designed to warn all firms in the market against future transgressions. At times, appearing to be indifferent to the harm one inflicts on oneself may be a perfectly rational business strategy.\(^6\)

It has been theorized that any price below marginal cost can be deemed predatory because no firm would make such a sale other than to harm a competitor.\(^7\) The problem in the instant situation is that marginal cost is quite low. Banks selling insurance will incur very little in the way of new overhead, utilizing existing space, utilities, and even personnel. The result is that marginal cost is likely to be lower than that of most independent agents.

4. Concentration of the Insurance Sales Market

Because of the likelihood of at least informal tying and cross-subsidization (even in the absence of predatory pricing), it is likely that banks will enter into the insurance market with substantial advantages. Those same advantages may result in cost savings for consumers, at least in the short run. It may also provide advantages for some insurers who are able to make arrangements with banks to sell their products, rather than depending on more numerous but lower volume independent agents.

The drawback is that many small business people are likely to be put out of business, or their business will be greatly restricted. Independent insurance agents will be forced to compete, not just against each other, but against the banks. Banks, in turn, have substantial competitive advantages through both informal tying and cross-subsidization, and will at least drive marginal independent agents from the market.

The end result may be a more concentrated local market for insurance. There will be fewer, but larger sellers of insurance. Some banks may even sell through mail order, others through an ATM network. Face-to-face sales (and service) may decline. If the market continues to concentrate, consumers will likely face restricted choices and in the long run higher prices. The result is that the benefits of lower costs may come at a price. Costs may decline—at least in the short run—but at the expense of service and the education function. However, costs may not decline in the long run since, as the insurance market becomes more concentrated and more vertically aligned, a number of insurance competitors may be forced from the market and fewer competitors generally means higher prices.

Safeguards are certainly necessary in order to obtain lower consumer costs.\(^118\) But safeguards against tying, cross-subsidization and concentration may not address the problems of reduced service and concentration of the agency market for the products of insurance companies.

\(^6\) Id. at 208.
\(^7\) Id. at 428 (citing Phillip Areeda and Donald F. Turner, Predatory Pricing and Related Practices Under Section 2 of the Sherman Act, 88 HARV. L. REV. 697 (1975)).
\(^118\) Sarch, supra note 3, at 251.
VII. POLITICS AND CONCLUSIONS

The politics of the banking/insurance controversy are convoluted. One might expect that banks would favor entering the insurance market. But, upon inspection, banks' motives prove to be more complex. Banks located in small communities prefer that banks located in large communities be precluded from entering insurance markets—through section 92, or at all—in order to preserve that market for themselves. Conversely, banks in large communities prefer an expansive definition of section 92, which would permit them to open in small communities through a branch, and then sell insurance nationwide. The best of all worlds for such large banks is to avoid section 92 entirely, and allow banks to sell directly as part of their incidental power.

Some insurance companies, particularly those that currently distribute through independent agents, would seem to be the banks' natural allies. On the other hand, companies that have exclusive or employee agents have a large investment in the current system and may see banks entering the field as a threat. And of course the independent agents see the change as a threat to their very existence.

It is interesting to note that even the various groups representing insurance agents are not of one mind. When the Insurance Director of the State of Ohio proposed regulations prohibiting banks from making loans which required that borrowers also purchase insurance from them (and implicitly recognizing the right of banks to sell insurance), the Independent Insurance Agents argued against the regulations on the ground that no controls could be strong enough to "level the playing field." On the other hand, the Professional Insurance Agents Association of Ohio and the Ohio Association of Life Underwriters—accepting what they perceived as the inevitable, but seeking to apply the strongest possible controls—supported the proposal. The result was a mixed message to legislators, resulting in no controls at all.

Because so much is at stake, the story can hardly be said to be over. The intricate problems of the relationship between section 92, state insurance regulations, and the McCarran-Ferguson Act provide a fertile field for litigation. The pending Supreme Court decision in Barnett Bank will certainly resolve some—but probably not all—of these issues. Many other states can expect cases like Owensboro and Barnett Bank. While the latter seems to be more reasonably decided, it is not at all certain that future cases will have similar results.

Legislation is clearly needed to resolve the intricate legal and policy dilemmas created by the interplay of section 92, the McCarran-Ferguson Act, and the various state statutes. Courts can only react to the legislation and should not perform what is essentially a legislative function. That function should, at a minimum, treat banks' entry into the insurance sales market and into the insurance underwriting market separately.

While the approach of that legislation is problematical and highly politicized, a strong argument in favor of state experimentation remains unanswered. The business of insurance sales is a highly personal and inevitably local matter. It would seem both within the spirit of the McCarran-Ferguson Act and within the philosophy of decentral-

119. See Frankel, supra note 3, at 1692-93.
120. See FC&S, supra note 109.
ization and state experimentation to permit each state to decide for itself whether banks should be permitted to enter the market for insurance sales.

For banks to enter the insurance underwriting market is a somewhat different matter. Insurance companies are largely national or regional firms, though there are large numbers of smaller companies as well. Banks and banking are becoming increasingly national or regional as well. It is a much more difficult task for individual states to regulate those areas simultaneously and in a coordinated fashion. The concerns here are broader in scope, and it may be necessary to erect the "firewalls" at a federal level to assure the safety of both banking and insurance customers. The point is that both issues should not be viewed through the same glass. A creative and tailored approach can more logically resolve the issues.