Bank Powers to Sell Annuities

By Tamar Frankel*

INTRODUCTION

The conflict over turf between the banking industry and the insurance agents has heated up again. In the 1993 case Variable Annuity Life Ins. Co. v. Clarke,1 the Fifth Circuit held banks have no power to sell fixed annuities issued by insurance companies in cities with more than 5,000 inhabitants.2

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2. Id. at 1303. The results and rationale of Variable Annuity Life Ins. Co. v. Clarke are contrary to the holdings of the D.C. Circuit in Indep. Ins. Agents v. Ludwig, 997 F.2d 958 (D.C. Cir. 1993), in which the court approved the Comptroller's interpretation of § 92 of the National Bank Act, 12 U.S.C.S. § 92 (1978) (allowing banks in small communities to sell insurance products) which permitted banks to sell insurance products anywhere else. Ludwig, 997 F.2d at 958 (“The Comptroller determined that § 92 imposes no geographic limits on the insurance market so that, as long as it is located in a small town, a bank is free to solicit and serve insurance customers everywhere. We uphold the Comptroller's interpretation as permissible”).

Although the Comptroller's petition for a rehearing and a suggestion for rehearing en banc were denied on January 13, 1994, a dissenting opinion by Judge Jerry E. Smith raises interesting procedural and substantive points. Variable Annuity Life Ins. Co. v. Clark [sic], 13 F.3d 833 (5th Cir. 1994) (Smith, J., dissenting), cert. granted, NationsBank v. Variable Annuity Life Ins. Co., 62 U.S.L.W. 3806 (U.S. June 6, 1994). First, owing to the recusal of six of the Fifth Circuit's 13 active judges, the original three-judge panel was able to override the four dissenters because “recused judges are counted as members of the court” and a request for an en banc rehearing must be approved by a “majority of the active judges.” Id. at 834. Judge Smith opines that “[r]ecusal seems to be a particular problem in cases involving large banks and their regulatory agencies (and the attorneys of both) with whom several active judges are likely to have relationships that require them to recuse.” Id. at 835.


On June 6, 1994, the Supreme Court granted certiorari to review the decision. Both the Clinton Administration and members of Congress are considering steps toward resolving this issue. Concerned that the flight of high-quality borrowers from the banking system has rendered bank lending increasingly risky, the Comptroller of the Currency has stated that unless banks diversify into other safe lines of business, banks’ safety and soundness is in jeopardy. His remarks are believed to represent the Clinton Administration’s policy concerning the structure of the banking industry. For the insurance industry, long-time supporter Senator Christopher Dodd (D—Connecticut) recently abandoned efforts to repeal section 92 of the National Bank Act, which served as one legal basis for bank powers to sell insurance products such as annuities. Whether banks have or should have

4. The Office of the Comptroller issued a no objection letter in response to a bank seeking to offer a “retirement CD” which is similar to an annuity. Letter from William P. Bowden, Chief Counsel, Office of the Comptroller of the Currency to Jack Kelly, Chairman, Blackfeet National Bank (May 12, 1994). This approval was interpreted as evidence of the Comptroller’s “commitment to restore the competitiveness of national banks with other financial intermediaries, particularly non-bank purveyors of alternative investment products such as mutual funds and annuities.” FDIC Says Deposit Insurance Will Cover New Retirement CD, with a Key Limitation, 62 Banking Rep. (BNA) 915 (May 23, 1994).
5. Kenneth H. Bacon, U.S. Comptroller favors Letting Banks Sell Insurance, Other Financial Services, Wall St. J., Sept. 14, 1993, at A20; Barbara A. Rehm, Ludwig Plans Legislation On Banking This Year, Am. Banker, Sept. 21, 1993, at 1. See also Martin Sarch, A Game of Three Card Monte, Anyone? Banks Find Nothing But Trouble Seeking Expanded Insurance Powers, 24 Rutgers L.J. 207 (1992). Sarch argues that, given proper safeguards, banks’ entry into insurance business would benefit: (i) consumers, by lowering their costs of insurance; (ii) banks, by increasing their profitability through product line expansion; and (iii) the existing insurance industry (especially its weaker members), not at all. Id. at 250 n.126.

The Office of the Comptroller and the Federal Deposit Insurance Corporation ("FDIC") recently decided to allow a bank to offer a "retirement CD" which is similar to an annuity. Consequently, lobbyists representing the insurance industry have offered to concede legislation that would allow banks to sell annuities in exchange for a regulation which would forbid the "retirement CD." As a result, banks would be forbidden to underwrite annuities. Banks that favor bank power to sell annuities, however, are reluctant to compromise and are hoping instead the Supreme Court will reverse the Variable Annuity Life Ins. Co. v. Clarke case. Insurance Industry Cries Uncle in Bank Annuity Sales Battle, 1 Bank Mutual Fund Rep. 1 (June 1, 1994).
the power to sell annuities is but one of many currently debated issues involved in the major reshaping and restructuring of our financial system. Consensus is slow to emerge. Even the banking and insurance industries do not represent a united front, and each is divided into factions that favor or disfavor banks' power to sell annuities.\textsuperscript{7} The airing of conflicting views, however, helps to better understand and guide the progress of the financial system.

This Article deals with two questions involving banks' powers to issue and sell annuities. One question relates to the domain of insurance companies and their regulators. Are annuities "insurance contracts" exclusively reserved to insurance companies or are annuities "insurance business" in which insurance companies as well as other institutions may engage? The second question relates to banks' powers to engage in annuities business. Even if annuities are insurance business, in which not only insurance companies but also others may engage, are annuities the type of instruments which banks have the power to issue? Further, even if banks may issue these annuities, may they buy and sell annuities issued by other banks?\textsuperscript{8}

Answers to these two questions are complicated because annuities are complex and varied instruments, with different components, designed to meet different needs, issued by different financial institutions, and, most importantly, offered under different names. This Article suggests that essentially identical instruments can appear in different forms under different names, even though they are traditionally issued by different financial

\textsuperscript{7} The issue can be viewed as raw political controversy between the powerful insurance agents' lobby and the larger banks. See, e.g., Charles R. Babcock, Political Donations by NRA, UPS and Dentists Rise Sharply: Guess Who's Coming to Dinner?, WASH. POST, May 4, 1993, at A19 (among 34 lobbyists invited to dine with President Clinton was Paul Equale of the Independent Insurance Agents of America).


Banks located in small communities prefer the D.C. Circuit's interpretation precluding banks in large communities from selling insurance products, thus limiting competition from such large banks. Those banks in large communities interested in marketing annuities would prefer the Comptroller's legal basis and rationale that such activity is allowed to all banks as part of their incidental powers. Insurance companies that are interested in distributing their annuities are natural allies of such banks while insurance companies with a captive sales force and the independent insurance agents are aligned on the other side of the barricade.

\textsuperscript{8} The question of whether banks may buy and sell annuities issued by other institutions (including insurance companies), and the interpretation of § 92 of the National Bank Act, 12 U.S.C.S. § 92 (1978) (allowing banks in small communities to sell insurance products) are outside the boundaries of this paper. Section 92 is also codified at § 13 of the Federal Reserve Act.
institutions. Banks can design and issue annuities in the form of deposits, in competition with insurance annuities. Such an instrument was recently offered by Blackfeet National Bank—a retirement certificate of deposit.  

Part I of this Article defines, dissects and classifies annuities. Part II discusses insurance annuities and identifies those annuities that are “insurance contracts” exclusively reserved to insurance companies and those annuities that are not “insurance contracts,” but constitute “insurance business.” This part also describes the regulatory systems that apply to different types of annuities. I conclude that most annuities fall within the “insurance business” category, not exclusively reserved to the insurance industry or its sales force. Part III of the Article discusses bank powers to issue instruments that function like certain types of annuities (bank annuities) and concludes that banks have express powers to issue and sell these types of annuities and “incidental powers” to sell such annuities issued by other banks. Because tax treatment would be crucial to successful marketing of annuities, Part III explores this area and shows that the tax treatment does not depend on the nature of the issuing institution. Therefore, bank annuities sold by the issuing banks and by other banks will receive the same tax treatment as insurance issued annuities. I conclude that without changing the policies underlying the current regulations, banks may design, issue and sell certain annuities (without life contingencies), even in the Fifth Circuit’s jurisdiction.

**WHAT ARE ANNUITIES?**

Annuities are flexible savings tools. They can also be used as source of income. A saver can accumulate substantial amounts by small monthly or weekly payments. At the end of the “accumulation” or “pay-in” period the annuity agreement may entitle the saver to receive a lump sum (that he will invest directly or through other money managers, or consume). Annuities are often used to provide retirement income. A person who has accumulated money by saving or other means (inheritance) may use the money to buy a life annuity or an annuity for a certain period.

10. See infra notes 17-20 and accompanying text.
11. See infra notes 21-30 and accompanying text.
12. See infra notes 32-49 and accompanying text.
13. See infra notes 23-30 and accompanying text.
14. See infra notes 50-56 and accompanying text.
15. See infra notes 46-49 and accompanying text.
16. See infra notes 64-65 and accompanying text.
17. See Kalen Holliday, *Fidelity Annuity to Feature Immediate Flow of Income*, AM. BANKER, Oct. 12, 1993, at 14 (annuitants pay for this annuity by a lump sum, and it is used for retirement).
The legal form of annuities constitutes an agreement by which one party ("annuitant") pays money to another party ("institution") in exchange for a promise to be repaid the contributed amounts plus a return at a certain date or dates. Annuities can be distinguished by periods and income-return.

Annuities can be divided into two periods: the pay-in period, in which the annuitant pays money to the institution, and the pay-out period, in which the institution repays the annuitant. The length of the pay-in and pay-out periods can vary greatly, ranging from very short (lump sum payment) to decades (numerous installment payments). Thus, the annuitant can pay the institution in a lump sum and start receiving period payments, or the annuitant can pay the institution in installments, and the institution can repay the annuitant in a lump sum or installments. Rarely does the annuitant pay and receive a lump sum simultaneously (although theoretically possible) because in such a case the annuitant will receive a very small return on his payment and the transaction costs would probably exceed the return. Usually, the pay-in period terminates on an ascertainable date (e.g., annuitant reaches a certain age or dies). Similarly, the pay-out period terminates on ascertainable dates (e.g., the annuitant, or a designated beneficiary dies).

It is important to note at the outset that the pay-in period does not involve any contingent obligations on the part of the issuing institution. The amount which the institution would owe the annuitant is ascertainable. If the pay-out period terminates upon the death of the annuitant or his beneficiary, however, the institution's obligations are based on a contingency; it undertakes to pay an amount that depends on the annuitant's longevity.18 There is widespread consensus that the contingent risk which an institution undertakes in promising a life annuity is relatively very small.19 In fact, the institution usually undertakes to continue payments to the estate or beneficiaries and complete a promised number of payments even if the annuitant expires before the amount is paid. Therefore, the value of the contingency in an annuity is relatively insignificant, and can be eliminated without reducing the attractiveness of the annuity to the annuitants. In any event, the pay-in period of annuities does not involve any contingency.

18. In such a case, the institution pools and distributes the risk of longevity. Although the institution does not know which annuitant is going to die, it knows with a high degree of certainty what percentage of annuitants are going to die in a particular year. That knowledge (and anticipated income from the remaining amount that the institution holds) enables the institution to promise the annuitant certain payments throughout his life. Life insurance companies issued annuities to diversify their business.

19. Insurance companies diversify this risk further by issuing life insurance policies. Losses to the companies from annuitants' longevity are offset by gains from life insurance policyholders' longevity, and vice versa.
The income-return that the institution pays the annuitant can vary with the type of the annuity. Fixed annuities promise the annuitant a fixed return on the amount that he has paid to the institution. The issuing institution bears the investment risk and enjoys the chance of investment gain. Variable annuities promise the annuitant an amount that varies with the performance of a fund invested in different investments, such as stocks, short-term instruments or government securities. The annuitant holding a variable annuity bears the investment risk and enjoys the chance of investment gain.

In sum, annuities constitute flexible savings devices that offer savers investment risk (and gain) and longevity risk- (life contingency) transfers. The longevity risk-transfer (the life contingency), is fairly small and appears only in the pay-out period of the annuities.\(^\text{20}\)

**POWERS OF INSURANCE COMPANIES TO ISSUE ANNUITIES**

Annuities can be divided into insurance contracts and insurance business. They differ in the applicable regulatory regimes and in the powers of non-insurance issuers to issue them.

**INSURANCE CONTRACTS**

Some annuities fall under the definition of insurance contracts. Insurance contracts are contracts that contain life contingencies.\(^\text{21}\) These life contingency risks are covered by an insurance scheme, pooling and distributing the risk. The measure of premiums of these insurance contracts and the required reserves that cover them are regulated by insurance laws and their government administrators. Therefore, the distinction between contingent and non-contingent risks is the historic earmark of insurance. Contracts that cover such risks are reserved for the insurance industry. Non-insurance institutions may not issue such insurance contracts.\(^\text{22}\)

**INSURANCE BUSINESS**

In addition to issuing and selling insurance contracts, insurance companies may also engage in numerous other businesses. Although these other businesses are "insurance business," in which insurance companies may engage, they are outside the monopoly of insurance companies. Among others, these businesses include investment advisory services, real estate development, lending, brokerage services, sponsorship and management of investment companies, and management of pension funds.

\(^{21}\) NY Ins. Law § 1101(a) (Consol. 1985).
Annuities not containing contingencies are of the insurance business kind and may be issued by insurance companies and others. Further, in the pay-in period, no annuity contains actuarial calculations, and that portion of the annuity is neither exclusively an insurance contract nor reserved exclusively to insurance companies. In this context, annuities are merely contracts insurance companies as well as other institutions are allowed to issue and sell. In fact, such annuities may be the products offered primarily by financial intermediaries other than insurance companies.

Further, there are numerous other contracts and arrangements that are annuities issued and sold by non-insurance financial institutions and regulated by non-insurance regulators. For example, variable annuities (including variable annuities involving contingencies) are regulated by the Securities and Exchange Commission. Pensions represent another example of annuities outside the insurance domain. There is little difference between annuities and pensions: annuities represent the annuitants’ savings; pensions usually represent savings payments for the same purpose (to provide for retired employees), except that the payments are made by employers, or by employers and employees. Pension funds have historically been managed by banks, insurance companies, investment managers, and investment companies. It is true that banks were expressly authorized to manage pension funds by ERISA in 1974. However, for decades before ERISA, banks and other advisers were engaged in managing pension funds and trust funds.

Face-amount certificates are annuities issued and sold by investment companies and were very popular during the 1940’s. They are annuities by another name, serving as savings mechanisms. Guaranteed Investment Contracts ("GICs") are another example of an annuity known by another name. GICs are "wholesale" annuities under which an institution accepts pension contributions by or for numerous employees, and undertakes to pay a fixed return and to repay pension payments to numerous employ-

23. For this reason such annuities are subject to dual regulation by insurance commissioners and by the Securities and Exchange Commission. See Tamar Frankel, Variable Annuities, Variable Insurance and Separate Accounts, 51 B.U. L. Rev. 173 (1971).
25. Section 2(a)(15) of the Investment Company Act of 1940 defines a face-amount certificate as:

any certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums at a fixed or determinable date or dates more than twenty-four months after the date of issuance, in consideration of the payment of periodic installments of a stated or determinable amount . . . .; or any security which represents a similar obligation on the part of a face-amount certificate company, the consideration for which is the payment of a single lump sum. . . .

ees.27 GICs do not involve contingent payments but only fixed-period payments. In fact, New York insurance companies sought a classification of GICs as insurance business rather than insurance contracts to allow the issuance of such contracts without contingencies because that is what clients wanted.28 Banks have recently begun to issue GICs for savings as well as other uses.29

All of the instruments described above demonstrate that annuities which do not contain contingencies are not insurance contracts, but rather insurance business, in which other financial institutions are permitted to engage. Arguably, even annuities that contain contingencies should not be classified as insurance contracts. The pay-in period payment is independent of the life of the annuitant. Life contingencies can appear only during the pay-out period of the contracts, and might not appear at all, if annuitants can choose to receive a lump sum at the end of the pay-in periods. In addition, the contingencies in the pay-out period are usually insubstantial, and the cost of insurance in annuities also is relatively small.

Annuities are not typical insurance contracts. If there are countervailing reasons to allow government agencies other than insurance commissioners to regulate annuities, these agencies are allowed to do so.30 Perhaps by analogy, if there are good reasons for allowing non-insurance institutions to issue annuities, they should be allowed to do so.

THE REGULATORY REGIME APPLICABLE TO ANNUITIES

One of the rationales of the Fifth Circuit's decision is that annuities have been historically viewed as insurance contracts, regulated as such under state insurance laws.31 This statement should be qualified. Banks and other institutions have offered similar instruments; annuities were not viewed as insurance contracts exclusively reserved to the insurance companies.32

Historically, annuities—even annuities that contain contingency obligations—were not entirely within the exclusive domain of insurance laws

27. Id. at 367.
28. Id. at 368.
29. Id.
32. Recognizing banks' growing role in marketing annuities, the Office of the Comptroller (in concert with the Office of Thrift Supervision and the Federal Deposit Insurance Corporation) is preparing guidelines for banks and thrifts that sell "non-insured products such as annuities and mutual funds through their investment centers." Amy S. Friedman, Fed Guidelines Due Soon for Bank Annuity Sales, NAT'L UNDERWRITER, LIFE & HEALTH/FIN. SERVICES Ed., Feb. 21, 1994, at 20.
or insurance companies. For example, section 3(a)(8) of the 1933 Act exempts from registration: "Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, or any State or Territory of the United States or the District of Columbia."  

Professor Loss suggested long ago that this exemption demonstrates an over-cautious attitude by Congress. Presumably, even without this explicit exemption no one would view insurance contracts as securities. However, the exemption of insurance contracts from registration does not necessarily mean that only insurance companies may issue or have issued such contracts. On the contrary, other species of financial institutions have issued such contracts, and the section makes clear that they, too, are exempt from registering such contracts. The language of the section is quite broad. Issuance of the enumerated insurance contracts is not limited to insurance companies subject to the supervision of insurance commissioners. Rather, the exempt issuer is "a corporation subject to the supervision of the insurance commissioner, [and] bank commissioner."  

That the Securities Act of 1933 exemption did not identify annuities or even insurance contracts with insurance companies is also demonstrated by section 24 of the Investment Company Act of 1940. This section suggests not only that investment companies issued annuities before 1940, but also that Congress recognized and did not prohibit the practice. Instead, Congress allowed investment companies to continue to offer insurance products but applied to them the Securities Act of 1933. Section 24 of the Investment Company Act of 1940 requires investment companies to register securities they issue. Section 24(d) states: "The exemption provided by paragraph (8) of section 3(a) of the Securities Act of 1933 shall not apply to any security of which an investment company is the issuer." Section 24 of the 1940 Act is not limited to annuities. It eliminates the exemption of insurance contracts in the 1933 Act, so that investment companies issuing insurance contracts—all the contracts listed in section 3(a)(8) of the 1933 Act, including annuities—must register these contracts under the 1933 Act. 

The provisions of the 1940 Act and the 1933 Act must be interpreted to allow for two possibilities: first, that the instruments listed in section 3(a)(8) can be issued by companies that are not insurance companies (such as investment companies); and second, that the instruments listed in section

34. Louis Loss, Fundamentals of Securities Regulation 204 (1988) ("in effect § 3(a)(8) of the Securities Act of 1933 is supererogation").
37. Id.
3(a)(8) can constitute securities, but for the exemption in that section. Unless section 24 allows for these two possibilities, it would not make sense. If these instruments are not covered by the 1933 Act, why eliminate their exemption from the 1933 Act?

Furthermore, in the 1930's and 1940's, face-amount companies issued contracts very similar to annuities. These companies were regulated under section 28 of the Investment Company Act of 1940, which contains many provisions that appear in insurance statutes. The section requires face-amount companies to maintain reserves and imposes mandatory provisions in the certificates, such as the cash surrender value, surrender rights and borrowing rights for the certificate holders, among others. Moreover, Congress imposed on face-amount certificate companies the investment limitations imposed by the Insurance Code of the District of Columbia.

For regulatory purposes, variable annuities can be classified as securities as well as insurance. Such annuities can and have been issued by both insurance companies and investment companies. In fact, when first issued, insurance companies and their state regulators fought long and hard to exclude the applicability of the securities laws to such annuities. The result of the judicial battle, however, was to impose the securities acts, including the Investment Company Act of 1940, on insurance companies issuing variable annuities. Classification of variable annuities as securities allowed banks to sell (but not underwrite) such annuities as agents for their customers, without recourse, under an exception from the Glass Steagall Act.

Section 72 of the Internal Revenue Code strengthens these arguments. The section regulates the taxation of annuities under the heading: "Annuities; certain proceeds of endowment and life insurance contract." Clearly, annuities were distinguished from the payment of proceeds of

39. TAMAR FRANKEL, THE REGULATION OF MONEY MANAGERS (INVESTMENT COMPANIES AND INVESTMENT ADVISERS) XXX § 1, at 183 (1980) [hereinafter REGULATION OF MONEY MANAGERS].


42. 15 U.S.C. §80a-28(a)-(b); REGULATION OF MONEY MANAGERS, supra note 39, § 12 at 212.


44. Frankel, supra note 23, at 180.


47. Id.
endowment and life insurance. Furthermore, section 72 specifically deals with face-amount certificates.\(^{48}\)

Therefore, it is inaccurate to say that only insurance companies have historically issued annuity contracts. Other financial institutions have historically issued such contracts. The most that can be said is that annuities containing contingent obligations are insurance contracts, subject to insurance laws if issued by insurance companies and to the Investment Company Act, if issued by investment companies. Even this assertion, however, is weak because the contingency in annuities is very slender.\(^{49}\)

**BANK POWERS TO ISSUE AND SELL ANNUITIES**

**POWERS OF BANKS TO ISSUE AND SELL BANK ANNUITIES: DEPOSITS THAT FUNCTION LIKE ANNUITIES**

To assert the power to issue and sell annuities, banks must show: (i) annuities are not insurance contracts exclusively within the turf of insurance companies; and (ii) banks have express or incidental powers to issue annuities. I argue that banks have *express* powers to issue and sell non-contingent annuities.

The main business of banks and similar depository institutions is to accept deposits. Deposits include savings accounts and other arrangements under which banks receive money and promise to repay the money under certain conditions. Within certain limits, all such institutions may pay returns on their deposits. Deposit accounts are equivalent to annuities without contingent obligations. There is nothing to preclude banks from offering such annuities: depositors will be invited to periodically make certain payments into an account until a particular date. The bank will credit the account with an agreed-upon interest rate. At the end of the pay-in period, the savers may demand and receive a lump sum. Alternatively, the bank may start paying the depositors periodic payments with a promised return. The bank may not, however, promise the depositor payment for his or someone else's life.

Blackfeet National Bank of Browning, Montana recently introduced a deposit instrument similar to an annuity.\(^{50}\) A customer depositing money in a Blackfeet National Bank Retirement CD is promised an agreed-upon rate (3.75 percent for an initial three-year term) and the customer may

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\(^{48}\) I.R.C. § 72 provides: "For the purpose of this section, the term 'endowment contract' includes a face-amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940. ..." I.R.C. § 72(0) (1988). As of February 21, 1994, there was no clear confirmation that the Internal Revenue Service agreed to recognize a tax-deferred treatment to interest on a bank deposit that serves as annuity. *See* Friedman, *supra* note 32, at 34.


\(^{50}\) Friedman, *supra* note 9, at 1.
either withdraw up to two-thirds of the balance at a pre-determined maturity date or opt for monthly withdrawals that must begin between ages 59 1/2 and 70. Withdrawals prior to age 59 1/2 are subject to a government penalty.\footnote{Id.} On May 12, 1994, the Office of the Comptroller of the Currency issued a "no-objection" letter approving the Retirement CD, subject to seventeen conditions pertaining to, among other things, disclosures and representations to consumers.\footnote{Letter from William P. Bowden, Chief Counsel, Office of the Comptroller of the Currency to Jack Kelly, Chairman, Blackfeet National Bank (May 12, 1994). The approval was also based on the bank's contention that it would pay Federal Deposit Insurance Corporation (FDIC) insurance assessments on the customer contributions plus interest. On May 13, the FDIC stated it would insure the CD up to $100,000 but would insure only the customer contributions and interest and not the monthly withdrawals. \textit{FDIC Says Deposit Insurance Will Cover New Retirement CD, with a Key Limitation}, \textit{62 Banking Rep. (BNA) 915} (May 23, 1994).}

Deposits are equivalent to annuities, with a number of exceptions. First, as compared to annuitants, savers have greater freedom to pay into the accounts and draw from the accounts. Consequently, most deposits do not function as "forced savings" to the extent that is true of annuities. However, there is no reason why banks cannot offer deposits that would provide this "forced savings" feature (especially if the payments are automatically deducted from employees' salaries).\footnote{Annui ties and certificates of deposit (CDs), traditional bank savings vehicles, already share one important feature which contributes to the instruments' stability— a penalty for early withdrawal. Although annuities ordinarily "front-load" the penalty (declining annually during the pay-in period), Security First Life Insurance, a subsidiary of Los Angeles-based Holden Group, recently designed an annuity with penalties that resemble that of a bank CD. Karen Talley, \textit{Holden Enlists Bankers to Help Design Annuity}, \textit{Am. Banker}, Nov. 4, 1993, at 22. Security First's "Bankers' Choice" annuity imposes an early-withdrawal surrender charge (in effect for the life of the annuity) equal to the preceding six months' interest. \textit{Id.} This penalty imitates that imposed on early withdrawal of a bank CD and was designed to make the product more attractive to customers familiar with bank products. \textit{Id.}}

Like traditional annuities, bank annuities will pose far lower liquidity risk to the issuing institution than traditional deposits. Both deposits and annuities pose market interest risks for institutions. Yet insurance and banking institutions have learned to hedge their market interest risks through swaps and other instruments. Bank annuities, like insurance annuities, offer various returns under varying terms. When annuitants desire variable annuities, such as annuities bearing a return measured by the performance of a stock fund, both insurance companies and banks (as well as investment companies and investment advisers) may issue such annuities because the institutions are allowed to manage stock funds and sell securities as agents.\footnote{The difference between the institutions is that banks may not act as securities and insurance underwriters while insurance companies may engage in both activities.} In sum, assignment of market risks between institutions and annuitants can be allocated similarly in bank annuities and insurance
annuities, in much the same way banks currently allocate risks with depositors.

I conclude that banks have express powers to issue deposits that function like annuities. At most, instead of naming the instruments annuities, banks would call the instruments "bank account" annuities, or "bank annuities."\textsuperscript{55} If, at the end of the pay-in period or during the pay-out period, the bank promises to pay the annuitant a lump sum, the account is similar to any other bank savings account. If the bank promises the annuitant periodic payments rather than a lump sum, such payment will also fall within the definition of a deposit or savings account so long as the amount and date of payment is certain and not contingent.\textsuperscript{56} Arguably, once characterized as deposits, such annuities are within the exclusive domain of banks.

**BANK POWERS TO SELL BANK ANNUITIES**

Banks' power to issue annuities does not necessarily encompass banks' power to sell annuities. The power to sell can be divided into three kinds: (i) banks' power to sell the annuities that they issue; (ii) banks' power to sell annuities that other banks issued; and (iii) banks' power to sell annuities issued by other institutions, such as investment companies or insurance companies. This section examines banks' powers to sell instruments they issue and instruments other banks issue.

**Sale of Instruments That the Banks Issue**

The Fifth Circuit did not decide whether banks have the power to sell instruments that the banks issue.\textsuperscript{57} This power has been implied in other instances as incidental to express powers.\textsuperscript{58} Thus, on the assets side, banks have the explicit power to make loans.\textsuperscript{59} The power to sell loans, however, has been implied solely from the incidental powers clause.\textsuperscript{60} In the opinion of the Comptroller, national banks' incidental powers include the power to sell assets. Bank assets include loans and the rights under loans, such as cash flow from loans.\textsuperscript{61} Similarly, on the liabilities side, banks were granted the explicit power to accept deposits and to issue transferable

\textsuperscript{55} A variable annuity is classified also as a security, which banks may sell as representatives of the buyer or the issuer. See § 16 of the Glass-Steagall Act, 12 U.S.C. § 24 (1988 & Supp. IV 1992).


\textsuperscript{58} 1 Tamar Frankel, Securitization § 7.5 (1991).

\textsuperscript{59} ld.

\textsuperscript{60} ld. at 195.

\textsuperscript{61} ld. at 196.
certificates of deposit. I conclude that banks have incidental powers to sell the deposits they issue.

Bank Powers to Sell Bank Annuities Issued by Other Banks

If banks have incidental powers to sell bank annuities of their own issue, do they have incidental powers to sell the same kind of annuities issued by other banks? By analogy to the sale of loans and the sale of deposits, banks should have these incidental powers. Arguably, the main purpose of regulating banks is to assure their safety and soundness. If they are allowed to issue certain instruments, they should be allowed to sell them, in the interest of safety and soundness. The counter argument is that the business of issuing poses different risks for banks than the business of selling.

One answer to this argument is that today, banks are currently more active in selling financial instruments than in the past. In the opinion of the Comptroller, such sales are necessary to maintain the banks' safety and soundness. Second, in general, the risks to the seller of financial assets are lower than the risks to the issuer and obligor under these assets. Finally, the risks to buyers, which are not a focus of banking regulation, can be reduced by subjecting banks to the same regulation as those governing other sellers of the same products.

CONCLUSION

The Fifth Circuit decision in Variable Annuity Life Ins. Co. v. Clarke is over-broad. During the pay-in period, annuities should be excluded from the definition of an insurance contract, even if the pay-out period involves contingencies. Annuities with no life contingencies are not insurance contracts; they may be within the business of insurance companies but are outside the monopoly of the insurance industry and its regulators. These annuities may be issued by non-insurance institutions, outside the regulatory reach of the insurance regulatory agencies.

Annuities with no contingencies can be structured, issued and sold as bank deposits. Annuities holding bank annuities with the same terms as insurance fixed annuities will be taxed as holders of insurance annuities. Banks have the express power to issue deposits that provide alternatives to annuities—"annuity bank accounts." If banks can issue annuity bank accounts, the banks have incidental powers to sell such annuity accounts issued by themselves and by other banks (or perhaps also by investment

63. The battle of the banks to remain outside the regulation of those activities has been all but lost; subsidiaries of bank holding companies are regulated as securities broker dealers, investment advisers, members of stock exchanges, and brokers of futures contracts, among others.
companies). If insurance companies sell such accounts as annuities, banks may buy them from insurance companies or sell them for insurance companies.

As a matter of judicial policy, the Fifth Circuit also has asserted broad powers. By statute, administrative agencies are vested with the power to guide the current development of the banking industry. If the language of the statute regarding bank powers is ambiguous, the courts should defer to the regulators' interpretation of the statute.64 The courts are far less qualified to set such guidelines. In view of the enormous changes taking place in the whole financial system, a strong argument exists for judicial interpretation of ambiguous legislation that would leave guidance of the development of the financial system to expert administrative agencies in charge of implementing congressional policies. Between the two, courts may be less qualified to make the policy choices.

Further, the effect of the decision is to limit the distribution of annuities and the competition for the sale of annuities.65 This limitation would adversely affect the insurance industry. It is unclear whether insurance agents, who are the main proponents of limiting banks' sales of insurance annuities, will disappear if the banks compete with the agents.66 Even if the present distribution system is threatened, there is no evidence of how bank distribution of annuities would be harmful to the financial system as a whole, and to the public.

To these arguments the Fifth Circuit's answer is—let the banks go to Congress. Banks need not do so. They can design annuities to fit the historic mold. With very few exceptions, financial instruments are fungible; with different names they can promise the same things, sometimes for the same uses. Rather than fight a battle for turf, banks can offer alternatives to achieve the same goals.


65. Id. at 844 ("The panel's holding . . . seriously thwarts competition in a major market, with no indication that is what Congress intended.").

66. Independent insurance agents themselves certainly seem to think so. They consider themselves surrounded by enemies on several fronts: banks, the traitorous insurance companies, and the Federal government ("Agents have . . . been at the mercy of banking regulators who want to expand insurance powers, and courts that are loath to stop them.") Editorial Comment: Congress Has to Stand Up and Be Counted, Nat'l Underwriter, Life & Health/Fin. Services Ed., Sept. 13, 1993, at 18. See Editorial Comment: Truth in Banking, Nat'l Underwriter, Life & Health/Fin. Services Ed., June 21, 1993, at 30.