



Office of Thrift Supervision
Department of the Treasury

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SUBJECT: Direct Sale of Credit Insurance and Fixed-rate
Annuities by Federal Savings Associations

I. Introduction and Summary of Conclusions

This responds to your inquiries regarding whether federal savings associations may directly sell credit life and disability insurance and fixed-rate annuities. As more fully discussed below, two institutions in your Region are currently offering these products to their customers.

In brief, we conclude that federal savings associations may engage directly in the sale of credit life and disability insurance and fixed-rate annuities on an agency basis (solely upon order and for the account of customers) pursuant to the incidental powers doctrine. When engaging in these activities, however, federal savings associations will be subject to applicable state insurance laws and to certain supplemental policies and conditions imposed by the Office of Thrift Supervision ("OTS"), as more fully described below.

II. Background

A. Credit Insurance

You have advised us that [REDACTED], a federal mutual savings bank ("Association I"), through an agency relationship with [REDACTED] ("Insurance Company"), is directly selling Insurance Company's credit life and disability insurance products to Association I's borrowers. At the time an Association I loan officer takes a loan application from a customer, the loan officer inquires whether the customer wants credit life and/or disability insurance. If the customer desires either, the customer fills out Insurance Company's forms and the cost of the insurance is added to the loan. Association I writes a check to Insurance Company to cover the cost of the insurance and, in turn, Insurance Company sends a commission check to Association I. Association I's commissions from the sales of Insurance Company's credit life and disability products are approximately \$7,000 per year.

The Midwest Region supervisory staff has no safety and soundness concerns with Association I's insurance activities.

B. Fixed-rate Annuities

You have also advised us that [REDACTED], [REDACTED] ("Association II"), is directly selling fixed-rate annuities pursuant to an Administrative Services Agreement with Thrift Financial Agency ("Insurance Agency"), a Texas life insurance agency. The annuity contracts are underwritten primarily through [REDACTED] and [REDACTED] (the "Underwriters").

According to the terms of the Administrative Services Agreement, two licensed life insurance agents who are employees of Association II are located at the home office of Association II for the purpose of selling fixed-rate annuities. In addition to a base salary earned as Association II employees, the two agents earn a

1. Credit life and disability insurance policies pay off the outstanding indebtedness of the loans to which they relate if the borrower dies or is disabled while the loan is outstanding. See e.g., OCC Interpretive Letter No. 283 (Mar. 16, 1984), reprinted in [1983-1984 Transfer Binder] Federal Banking L. Rep. (CCH) ¶ 85,447.

2. In exchange for a one-time lump sum payment or a series of payments, a fixed-rate annuity provides the investor with periodic payments of a fixed amount specified in the annuity to begin upon a date certain and continue for a period designated in the annuity (often for life). OCC Interpretive Letter No. 499 (Feb. 12, 1990), reprinted in [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,090; 2 OTS Regulatory Handbook of Thrift Activities § 630, at 630.13 (Jan., 1994).

sales commission paid by Insurance Agency, which is based on a percentage of their monthly annuity sales volume.

Based on projected quarterly sales volume, Insurance Agency also currently pays Association II a flat fee of \$25,000 a month reimbursement for office space, amenities, and/or salary to the agents, though there is no break down for these costs. This fee is adjusted quarterly to reflect actual sales. Association II received fees of \$266,000 for the 12 month period ended December 31, 1992 and \$105,000 for the 6 month period ended June 30, 1993. In total, for the 18 months ended June 20, 1993, Association II received fee income of \$371,000 from these activities.

Because the annuities are being sold by employees of Association II under supervision of management of Association II, and because fees paid to Association II by Insurance Agency are based on sales volume, we believe Association II should be deemed to be engaged in the direct sale of annuities. The arrangement between Association II and Insurance Agency goes well beyond a traditional lobby-space lease.

Supervisory personnel in the Midwest Region have advised us that they have no safety and soundness concerns with Association II's fixed-rate annuities sales activities and have determined that the annuities have been sold in conformity with Thrift Bulletin 23-1.³

III. Discussion

Regulations issued by the Office of Thrift Supervision ("OTS") authorize federal savings associations to sell, on an agency basis, inter alia, fixed-rate annuities and credit insurance indirectly through their service corporation subsidiaries.⁴ To date, however, the OTS has not addressed whether federal savings

3. The examination of Association II predated the issuance of the Interagency Policy Statement on Retail Sales of Nondeposit Investment Products, adopted on February 15, 1994 and issued by the OTS on February 22, 1994 as Thrift Bulletin 23-2 ("TB 23-2"). TB 23-2 rescinded and replaced Thrift Bulletin 23-1 ("TB 23-1"), the OTS's Guidance on the Sale of Uninsured Products. TB 23-1 and TB 23-2 are similar in most substantive respects. TB 23-2 contains some additional requirements concerning customer disclosures, physical space of sales, and institution policies and procedures. Midwest Region supervisory personnel should make sure that Association II has a copy of TB 23-2 and should confirm that TB 23-2 is being implemented properly.

4. 12 C.F.R. § 545.74(c)(6)(ii) and (c)(4) (1994).

associations may sell fixed-rate annuities and credit insurance directly or through operating subsidiaries.⁵

The OTS' predecessor, the Federal Home Loan Bank Board ("FHLBB"), did address direct sales of credit insurance in several opinions. In those opinions, the FHLBB held that federal savings associations had incidental authority to provide all the services that are normally involved in the sale of credit insurance (e.g., advertise the insurance product, offer and describe the product to the borrower, process the application and contract, and accept payment for the insurance), but could not accept any remuneration for those services beyond reimbursement for expenses.

These FHLBB opinions were based on a narrow construction of the incidental powers doctrine that the OTS has subsequently rejected as inconsistent with the substantial body of case law that has developed in the incidental powers area. The OTS recently issued an opinion dated March 25, 1994, that provides a comprehensive overview of the relevant case law and draws from it a four-part test for assessing what activities fall within the incidental powers of federal savings associations. The four-part test is as follows:

1. Is the activity consistent with the purpose and function Congress envisioned for federal savings associations, as evidenced in the relevant banking statutes and their legislative history?
2. Does the activity facilitate the conduct of an activity expressly authorized by Congress for federal savings associations, or is the activity similar to an activity that Congress has expressly authorized for federal savings associations?
3. Does the activity relate to the financial intermediary role that all federal savings associations were intended to play?

5. OTS regulations restrict the activities of operating subsidiaries to activities that a federal savings association is authorized to conduct directly. 12 C.F.R. § 545.81(b)(1) (1994).

6. FHLBB Op. by Smith (January 6, 1989); FHLBB Op. by Patriarca (June 16, 1986); FHLBB Op. by Miskovsky (November 19, 1980). See also FHLBB Op. by Wilfand (September 1, 1970) (concluding that a federal savings association is authorized to make life insurance contracts available to its customers, provided it receives no compensation beyond reimbursement for expenses).

7. OTS Op. Chief Counsel (Mar. 25, 1994) (concluding that federal savings associations can offer postal services from their retail offices). See this opinion for a detailed analysis of the case law and legal precedent underlying our four-part incidental powers test.

4. Is the activity necessary to enable federal savings associations to remain competitive and relevant in the modern economy, thereby permitting federal savings associations to fulfill the purposes for which they were created?

As noted in our prior opinion, the relative weight given to each of the foregoing factors may vary depending upon the type of activity in question. It is not critical that each question be answered in the affirmative in order to conclude that an activity is permissible. In some instances, it may be proper to give greater weight to one factor or another. For example, when an activity can be shown to be closely related to an expressly authorized activity, it may be less important to wrestle with the nuances of legislative history. In other instances, the level of competitive disadvantage that would result from prohibiting an activity may be so severe that a decisionmaker may reasonably give more weight to that factor.

After reviewing a proposed activity under each of the four factors, a cumulative assessment must be made as to whether an activity has been shown to have a sufficiently strong connection to the business of a federal savings association to be permissible.

In the remainder of this opinion, we will review direct sales of fixed-rate annuities and credit insurance under this four-part test.

A. Application of Four-Part Test

1. The Purpose and Function of Federal Savings Associations as Manifest by the Legislative History of the HOLA

As is explained in considerable detail in our opinion of March 25, 1994, Congress has made numerous amendments to the Home Owners' Loan Act ("HOLA") over the past fifteen years that, inter alia, have expanded and modernized the role of federal savings associations, while strengthening the safety and soundness framework within which these activities are conducted. The legislative history of these amendments indicates that Congress intended to give federal savings associations "flexibility . . . to

8. It is important to note that even an activity that meets each of the foregoing tests could be restricted or prohibited on grounds of safety and soundness. 12 U.S.C.A. § 1463(a)(1) (West Supp. 1994). For this reason, institutions should always consult with the OTS before commencing an incidental activity if: (i) there is no prior opinion of the OTS or former FHLBB authorizing the activity, or (ii) an authorizing opinion has been issued but the opinion indicates that case-by-case safety and soundness review will nevertheless be required.

improve the range of services . . . [provided] to their customers,"⁹ and to "enhance the ability of thrifts to offer complete financial services to the consumer."¹⁰ Congress' objective was to enable federal savings associations to meet the needs of ordinary consumers "across the board" in "one-stop family financial centers."¹¹

The sale of credit insurance and fixed-rate annuities is entirely consistent with this statutory mission. Both products are basic building blocks in the financial planning of many families and consumers.

Credit insurance is a means of protecting both the borrower and lender by facilitating the repayment of debt in the case of death or disability of the borrower.¹² The decision whether to buy credit insurance is integral to the loan transaction. The ability of borrowers to apply for and obtain credit insurance at the time they apply for a loan and through the same company advancing the credit would be completely consistent with Congress' desire that federal savings associations offer "complete financial services to the consumer" in "one-stop."

Fixed-rate annuities are also a basic financial product commonly used by families and consumers as a tax-sheltered means of providing for retirement and ensuring their long-term financial security.¹³ Many consumers no longer place their entire savings in deposit accounts (i.e. CDs, money market funds and savings accounts), but rather seek to diversify and supplement their investment portfolio with basic nondepository products such as annuities and other types of securities and insurance.

Significant convenience and efficiency is achieved when consumers can move funds from deposit accounts to non-depository investments and vice versa in "one-stop" at a single "family financial center." As noted above, it would be clearly consistent with Congressional intent to allow consumers to use the same company to execute basic financial transactions.

Thus, authorizing federal savings associations to sell fixed-rate annuities and credit insurance would be consistent with

9. H. Conf. Rep. No. 899, 97th Cong., 2d Sess. 87 (1982).

10. S. Rep. No. 368, 96th Cong., 1st Sess. 13 (1979), reprinted in 1980 U.S. Code Cong. & Admin. News 236, 248.

11. Id.

12. See E.W. Armstrong, Jr., The Insurance Guide for Savings Institutions at 118 (1988).

13. OCC Interpretive Letter No. 499 (Feb. 12, 1990), reprinted in [1989-90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,090.

the statutory mission Congress has assigned to federal savings associations.

2. Similarity to or Facilitation of Express Powers

Another test that the courts often employ when considering whether an activity falls within the incidental powers of a financial institution is whether the activity is similar to or facilitates the conduct of one of the institution's express powers.

HOLA § 5(c)(1)(B) expressly authorizes federal savings associations to "invest in, sell or otherwise deal in . . . loans on the security of liens upon residential real property."¹⁴ HOLA § 5(c)(2)(D) expressly authorizes federal savings associations to "make loans for personal, family, or household purposes," i.e., consumer loans.¹⁵ Offering and selling credit insurance clearly facilitates the making of these loans. When evaluating whether to originate a loan, a lender must consider the risk that a borrower may die or become disabled during the term of the loan and the costs and complexities associated with repossessing and reselling property or pursuing a deficiency claim against a borrower's estate.¹⁶ Credit insurance provides a way to address these lending risks.

Although a borrower could generally obtain credit insurance through someone other than the lender, the lending process is made more efficient and secure if the lender itself is able to offer borrowers a credit insurance product with which the lender is already familiar and that is underwritten by a company that the lender knows to be sound.¹⁷ The ability of the lender to offer credit insurance on the spot as part of the loan origination process is also likely to reduce the lender's credit risk overall by increasing the percentage of borrowers who will acquire credit insurance, since a certain number of borrowers who purchase insurance through the lender would likely be deterred from

14. 12 U.S.C.A. § 1464(c)(1)(B) (West Supp. 1994).

15. 12 U.S.C.A. § 1464(c)(2)(D) (West Supp. 1994).

16. See OCC Interpretive Letter No. 283 (Mar. 16, 1984), reprinted in [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,447; Independent Bankers Ass'n of America v. Heimann, 613 F.2d 1164, 1168 (D.C. Cir. 1979), cert. denied, 449 U.S. 823 (1980).

17. A lender may require a borrower to obtain credit insurance from a company or person approved by the lender as a condition for granting a loan. See 12 C.F.R. § 563.35(b) and (c) (1994). However, the lender cannot require that the borrower purchase such insurance from the lender or an affiliate (12 U.S.C.A. § 1464(q) (West Supp. 1994); 12 C.F.R. § 563.35) or refuse to extend credit because the credit insurance is not available on the basis of the applicant's age (12 C.F.R. § 202.7(c)(1994)).

purchasing insurance if they had to obtain it from a separate source. Thus, the ability of federal savings associations to sell credit insurance as part of their lending operation is important not only because it enhances efficiency and customer convenience, but also because it offers a method of risk reduction that comports with safety and soundness.¹⁸ For these reasons, we believe the sale of credit insurance clearly facilitates the conduct of the express lending powers of federal savings associations.

With respect to fixed-rate annuities, HOLA § 5(n) expressly authorizes each federal savings association, upon application to and approval by OTS, to exercise the same trust powers as are available to state banks, trust companies, or other competitors of the association that are located in any state where the association is located.¹⁹ Thus, federal savings associations located in virtually all, if not all, states are able to offer a full range of traditional trust services to their customers.

In their capacity as trustees, federal savings associations routinely give investment advice to customers regarding the purchase of fixed-rate annuities, as well as other securities and insurance products, and routinely buy and sell fixed-rate annuities, as well as other securities and insurance products, for the account of trust beneficiaries. Thus, the activities involved in the direct sale of fixed-rate annuities on an agency basis are quite similar to activities that federal savings associations are already expressly authorized to perform in their capacity as trustees.

3. Fulfilling the Role of Financial Intermediary

Another test commonly employed to determine whether an activity is properly incident to the business of a financial institution is the financial intermediary test. The courts have recognized that, when reduced to their essence, financial institutions serve as financial intermediaries for the public. In other words, the public looks to financial institutions to facilitate the flow of money and credit among different parts of the economy. As the Supreme Court stated in Auten v. United States

18. We also note that selling credit insurance is quite similar to selling debt cancellation contracts, which is already an authorized activity for federal savings associations. OTS Op. Chief Counsel (Sept. 15, 1993).

19. 12 U.S.C.A. § 1464(n) (West Supp. 1994).

20. The fact that a federal savings association can engage in certain activities as a trustee does not necessarily mean that the association can perform all such functions outside of its fiduciary role. Similarity to an express power is only one of several factors to be considered in determining whether an activity is within the incidental powers of federal savings associations.

National Bank, 174 U.S. 125, 143 (1899), "[t]he very object of banking is to aid the operation of the laws of commerce by serving as a channel for carrying money from place to place, as the rise and fall of supply and demand require."

Financial institutions carry out this function of channeling available funds from points of surplus to points of demand not only by the traditional means of receiving funds from one source and investing them in another (as is the case when deposits are received and loans originated or securities purchased), but also by providing support for financial transactions that serve this same purpose (as is the case when a financial institution facilitates a customer's direct investment of available funds in a non-depository financial product, such as annuities, securities and other insurance products).²¹ Although in the latter instance the funds in question do not pass through the asset and liability accounts of the financial institution, the institution nevertheless provides the advice and/or technical assistance necessary to enable the funds to flow from the point of supply to the point of demand via the purchase and sale of a financial instrument. In this type of transaction, the financial institution still serves as an essential intermediate link between persons with excess funds and persons in need of funds.

The sale of credit insurance and fixed-rate annuities both involve funds intermediation. The connection may be somewhat more obvious in the case of fixed-rate annuities since annuities are commonly viewed as investment products. In exchange for use of the annuitant's funds, the issuer of an annuity promises to pay a specified return. When viewed this way, an investment in a fixed-rate annuity is little different than an investment in a certificate of deposit (minus federal deposit insurance). A savings association that helps its customers purchase annuities is clearly facilitating investment in a financial product that results in funds flowing from a point of surplus to a point of demand.

When reduced to its essence, credit insurance is quite similar. In exchange for use of the purchaser's funds, the issuer of a credit insurance policy promises to pay a financial return to the purchaser, but only upon the occurrence of certain contingencies (i.e., death or disability). Since the contingencies may or may not occur, the amount of funds required to purchase the policy is proportionately less than when purchasing an annuity or some other investment product. The transaction is still nevertheless purely a financial or monetary one. The quid pro quo for the purchaser's investment is a promised monetary return, rather than physical goods or services.

21. OCC Interpretive Letter 499 (Feb. 12, 1990), reprinted in [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,090; OCC No Object Letter 87-5 (June 20, 1987), reprinted in [Transfer Binder 1988-1989] Fed. Banking L. Rep. (CCH) ¶ 84,034.

Thus, the sale of fixed-rate annuities and credit insurance both constitute funds intermediation. In both instances, a savings association is helping customers execute basic financial transactions that result in the flow of funds from a point of surplus to a point of demand.

4. Adaptation to Modern Economic Circumstances

Finally, when assessing whether an activity properly falls within the scope of a financial institution's incidental powers, the courts also frequently consider whether institutions of the type in question need to engage in the activity in order to keep pace with changes in the modern economy. When employing this test, the courts often consider whether the activity is one that consumers have come to expect financial institutions to perform as a matter of convenience and/or whether financial institutions need to offer the services in order to keep pace with their competitors.

The OCC has long permitted national banks to provide credit insurance to their loan customers.²² As a result, many customers have become accustomed to the convenience of applying for credit insurance at the time they apply for a loan. Authorizing federal savings associations to act as agents for the sale of credit life insurance would help them remain competitive with national banks in the provision of customer services.

National banks are also permitted to sell fixed-rate annuities.²³ As noted above, consumers increasingly expect access to securities and insurance products, including fixed-rate annuities, as part of the range of financial products made available by depository institutions. Competing financial services

22. See, e.g., 12 C.F.R. § 2.6 (1994); OCC Interpretive Letter No. 283 (Mar. 16, 1984), reprinted in [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,447. This authority has been upheld by a federal court. IBAA v. Heimann, 613 F.2d 1164 (D.C. Cir. 1979), cert. denied, 449 U.S. 823 (1980).

23. The OCC has authorized national banks to offer annuities pursuant to their incidental power under the theory that annuities are non-insurance investment contracts. Insurance companies have challenged this position, arguing that annuities are insurance contracts and, therefore, subject to the specific provision of the banking statutes that restricts the insurance sales of national banks to towns of less than 5,000 inhabitants. See Variable Annuity Life Insurance Co. v. Clarke, 998 F.2d 1295 (5th Cir. 1993), rehearing denied, 13 F.3d 833 (5th Cir.) (overruling the OCC's position), cert. granted, Nationsbank v. Variable Annuity Life Insurance Co., 114 S. Ct. 2161 (1994). The case now before the Supreme Court primarily present an issue of statutory construction not before the OTS and need not delay the issuance of this opinion which is based upon incidental powers under the HOLA rather than under the National Bank Act.

firms, such as securities firms, for example, offer not only securities products, but often insured deposit accounts of an affiliated bank or thrift.²⁴ To remain competitive, federal savings associations must be able to respond to this trend toward one-stop shopping for financial products. As indicated in Part III.A.1. above, this is clearly what Congress intended.

Accordingly, we conclude that each of the factors commonly considered by the courts to determine whether an activity falls within the scope of an institution's incidental powers supports the conclusions that federal savings associations may sell credit insurance and fixed-rate annuities on an agency basis pursuant to the association's incidental powers under the HOLA.

When exercising this authority, however, federal savings associations must comply with all applicable federal and state laws, as well as certain policies and conditions imposed by the OTS. The remainder of this opinion provides an overview of these laws, policies, and conditions.

B. Compliance With State Laws Regulating Insurance Activities

There are a variety of state insurance laws that, unless preempted, will affect the manner in which -- and, in some cases, even whether -- federal savings associations may offer credit insurance and fixed-rate annuities. These state laws include:

1. Laws prohibiting financial institutions from engaging in the insurance business ("anti-affiliation laws"). Although most state anti-affiliation laws specifically exempt credit insurance, they do generally apply to the sale of annuities.
2. Laws requiring insurance agencies (or their officers and employees) to obtain licenses from the state and/or to be examined by the state.
3. Laws regulating the manner in which insurance agency activities are conducted (e.g., consumer protection laws).

Congress has delegated to the OTS broad authority to preempt state laws that adversely affect the operation or regulation of

24. This does not mean that a federal savings association can engage in any activity permissible for a securities firm or other financial services provider. Adaptation to modern economic circumstances is only one of several factors to be considered in determining whether an activity is within the incidental powers of federal savings associations.

federal savings associations.²⁵ The OTS is authorized to preempt any state law that may have a detrimental impact on the safety and soundness of federal savings associations or inhibit their ability to fulfill their statutory mission to accept deposits and provide credit and other financial services to the public in the best possible manner.²⁶

When state insurance laws are, at issue, however, the McCarran-Ferguson Act ("McCarran Act")²⁷ is an additional factor that must be considered. The McCarran Act provides, inter alia, that:

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.²⁸

Questions regarding the scope and intent of the foregoing provision have been the subject of significant recent litigation between national banks and various states and the insurance industry. Conflicting federal district court decisions regarding whether state anti-affiliation laws fall within the ambit of the above-quoted provision of the McCarran Act are currently on appeal in the Sixth and Eleventh Circuits. Owensboro National Bank v. Moore, 803 F. Supp. 24 (E.D. Ky. 1992) (holding that a Kentucky anti-affiliation law is not protected by the McCarran Act); and Barnett Banks, N.A. v. Gallagher, 839 F. Supp. 835 (M.D. Fla. 1993) (holding that a Florida anti-affiliation law is protected by the McCarran Act).

In addition, the Supreme Court recently granted certiorari in a case that raises the question of whether variable and fixed-rate annuities constitute "insurance" for purposes of 12 U.S.C. § 92, which authorizes national banks to sell insurance in towns of less than 5,000.²⁹ The Supreme Court's resolution of this issue may provide guidance regarding whether the sale of annuities constitutes "the business of insurance," for purposes of the McCarran Act. If annuity sales are not "the business of

25. 12 U.S.C.A. § 1464(a) (West Supp. 1994).

26. Fidelity Federal Savings & Loan Association v. de la Cuesta, 458 U.S. 141 (1982).

27. 15 U.S.C. §§ 1011 et seq. (1988).

28. 15 U.S.C. § 1012(b) (1988).

29. See Variable Annuity Life Insurance Co. v. Clarke, 998 F.2d 1295 (5th Cir. 1993), rehearing denied, 13 F.3d 833 (5th Cir.), cert. granted, NationsBank v. Variable Annuity Life Insurance Co., 114 S. Ct. 2161 (1994).

insurance," the McCarran Act would not apply to state laws regulating the sale of annuities.

In light of the foregoing, the OTS will defer any ultimate determination regarding the extent to which state insurance laws apply to sales of credit insurance and fixed-rate annuities by federal savings associations pending further clarification in the case law. In the interim, federal savings associations should comply with all state insurance laws (including anti-affiliation laws) unless specifically advised otherwise by the OTS. As a practical matter, this will mean that federal savings associations in some states may be barred from offering fixed-rate annuities for the time being. Credit insurance operations should not be significantly affected, however, since most state anti-affiliation statutes specifically exclude credit insurance from their coverage.

Federal savings associations that sell fixed-rate annuities or credit insurance should maintain all records related to those activities separate from their other records. Pending further notice, the OTS will not object to state examination of the records of a federal savings association that relate to the sale of credit insurance and annuities. Since federal savings associations will merely be acting as agencies (rather than underwriters), the states should have no need to conduct a general review of the financial standing or other records of any federal savings association.

C. Compliance With OTS Policies and Conditions

In addition to complying with applicable state insurance laws, there are several OTS policies that federal savings associations must follow when selling credit insurance or fixed-rate annuities.

Section 630 of the OTS Regulatory Handbook of Thrift Activities (Jan., 1994) is devoted to evaluating the risks associated with insurance activities conducted by savings association service corporations. This section provides guidance on potential areas of risk that should be examined by savings associations and OTS examiners, including: risk containment measures, adequacy of records and related safety and soundness concerns, and objectionable practices. The OTS will instruct its examiners to use the principles in Section 630 to evaluate the risks of direct sales of credit insurance and fixed-rate annuities by federal savings associations. Institutions should use this section as guidance in structuring their sales policies and procedures.

In addition, with respect to fixed-rate annuities, in February of 1994 the federal banking agencies released an Interagency Statement on Retail Sales of Nondeposit Investment Products, which the OTS published as TB 23-2. By its terms, TB 23-2 covers the sale of annuities. TB 23-2 is designed to ensure that customers are fully informed of the nature and risks

associated with nondeposit investment products. TB 23-2 covers disclosure and advertising, suitability of products and sales practices, compensation of sales personnel and other employees, and compliance with applicable laws and regulations. Federal savings associations selling fixed-rate annuities should ensure that their sales practices conform with TB 23-2.

With respect to compensation from the sale of both credit insurance and fixed-rate annuities, OTS regulations provide that compensation paid to savings association officers, directors and employees must be reasonable and commensurate with their duties and responsibilities.³⁰ The OTS also prohibits officers, directors and employees from placing themselves in a position that leads to, or could lead to, a conflict of interest that would have an adverse effect on the safety or soundness of a savings association.³¹ Federal savings associations selling insurance products should establish compensation policies that are consistent with these regulations.

Finally, both the HOLA and OTS regulations expressly prohibit "tying" arrangements, which are deemed to occur when, inter alia, a savings association conditions the extension of credit on the borrower purchasing other services from the association or an affiliate.³² Institutions must enforce sales policies and train product salespersons to ensure that these anti-tying prescriptions are carefully followed.

We defer to the Midwest Region to determine whether Association I and Association II are conducting their credit insurance and fixed-rate annuity sales in a manner consistent with the foregoing OTS regulations and policies and applicable state law.

cc: All Regional Directors
All Regional Counsel

John Downey
John Price
Robyn Dennis
Donna Miller

30. 12 C.F.R. §§ 563.39 and 563.161(b) (1994). TB 23-2 (which by its terms applies to the sale of annuities but not to the sale of credit insurance) provides that incentive compensation from the sale of nondeposit investment products must not be structured in a way that will result in unsuitable recommendations.

31. 12 C.F.R. § 571.7 (1994).

32. 12 U.S.C.A. § 1464(q) (West Supp. 1994) and 12 C.F.R. § 563.35 (1994).