

Bank-Owned Life Insurance (BOLI)



Advantages of Bank-Owned Life Insurance (BOLI)

BOLI is a tax-efficient tool commonly used by banks to informally finance employee retirement and benefit program liabilities. It can help banks deliver on benefit promises made to employees and enable them to provide more competitive benefit programs while containing costs. As an asset on the bank's balance sheet, BOLI is an efficient asset/liability management tool that can positively impact the bank's overall financials.

How BOLI works

The bank purchases life insurance on the lives of a group of employees, such as executives and officers that participate in the bank's benefit plans. Written consent is obtained from all individuals to be insured. The bank pays the premium, owns the cash value of the policies and is the beneficiary of the insurance. When properly designed and funded, BOLI has the potential to generate income from the growth of the policy's cash value and from tax-free insurance proceeds paid to the bank on the death of an insured. Any cash value growth is tax-deferred, and the death benefit is generally tax-free to the bank, assuming compliance with applicable tax laws.

BOLI offers banks a tax-advantaged solution to manage the growing liability and expense of their benefit plans.



Types of BOLI products

General Account BOLI	Separate Account BOLI	Hybrid BOLI
Policy cash values are backed by assets in the general account of the insurance carrier — underscores the importance of selecting a sound carrier	Policy cash value from assets are separately held by the carrier — offers insulation from the claims of creditors and other policyholders in the event of carrier insolvency	Policy cash values are held in a book value separate account by the carrier — offers insulation from the claims of creditors and other policyholders in the event of carrier insolvency
Offers a solution for financing pre- and post-retirement benefit plan liabilities for community, regional and large banks alike	Provides flexibility — a program can be custom designed to meet the specific objectives and risk profile of a given bank	Offers financing solutions for community, regional and large banks combined with a flexible program to meet each bank’s individual risk profile
Fixed interest rate — reset annually based on expected return of assets earmarked by the carrier, less a spread for expenses and capital	Variable yield — based on the return of underlying variable policy assets, less expenses	Fixed interest rate is reset at least quarterly at the beginning of each quarter. Crediting rates are generally reset quarterly at the beginning of each quarter based on the projected book yield of the assets in the portfolio, less a spread for expenses and defaults, any applicable IMR adjustment, capital and the guarantee provided by the general account
Provides the security of a contractually guaranteed minimum interest rate for the life of the policy	Stable value wraps have the potential to smooth earnings volatility	Provides the security of a contractually guaranteed minimum interest rate for the life of the policy
	Potential for lower Risk-Based Capital requirements — based on a “look-through” to the underlying assets of the separate account	Potential for lower Risk-Based Capital requirements — based on a “look-through” to the underlying assets of the book value separate account

New money vs. portfolio crediting

Two approaches commonly used in determining how interest will be credited to general account policies are the “New Money” and “Portfolio” methodologies. In either case, the interest rate cannot be set below the contractually guaranteed minimum interest rate.

New Money	This philosophy credits interest based on the rate of specific assets available at the time of purchase. These assets are nominally tracked and will continue to determine the interest rate throughout the life of the plan.
Portfolio	This approach is based on a pooling philosophy. The insurer pools all of its assets or, perhaps, all of its BOLI assets, then determines a rate for all policies regardless of when the policies were purchased.

Investment choices

A critical element to consider when selecting a separate account BOLI product is the breadth and depth of the separate account investment offerings of the insurance carrier. A sound carrier will have an established process for selecting and monitoring investment managers. Products should offer a variety of managers and funding options in multiple asset classes across the risk-return spectrum. Sophisticated alternative investments and strategies such as hedge funds may also be offered.

It is important to keep in mind that “investor control” and separate account asset diversification requirements must be met in order to maintain the favorable tax treatment of a variable life insurance contract. The bank cannot have influence over investment decisions in the separate account and the account must be adequately diversified, as prescribed in § 817(h) of the Internal Revenue Code of 1986, as amended and Treasury Regulation §1.817-5(b).

Costs

Depending on the type of BOLI product purchased, costs may include:

- Premium loads (state premium & DAC taxes, commissions)
- Asset-based charges (M&E, commissions)
- Monthly charges (Policy fees, cost of insurance)
- Investment management fees (separate account manager fees)
- Custody & accounting fees (outside managed custody charges)
- Stable value fees

Liquidity

BOLI should be treated as a long-term asset to offset the costs associated with a long-term obligation. If necessary, BOLI policies can be surrendered, subject to the terms of the contract and the terms of the stable value agreement. If a policy is surrendered, there may be income tax consequences if there is gain in the contract on the date of surrender.

Pre-purchase analysis

Before purchasing BOLI, a bank's board and senior management should understand the risks, rewards and characteristics of BOLI. A valid business purpose must be identified, such as offsetting employee retirement and benefit obligations. Banks may potentially use up to 25% of Tier 1 capital for BOLI (15% with any one carrier for General Account BOLI), less an allowance for loan loss reserves. The Federal bulletin "OCC 2004-56" provides guidance on the analysis banks should undertake when purchasing BOLI. Information can be found at <http://www.occ.gov/news-issuances/bulletins/2004/bulletin-2004-56a.pdf>.

Our advantage

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