Top 10 Reasons
BANKS OWN BOLI

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Banks continue to increase the amount of Bank Owned Life Insurance (BOLI) they own across the US. Based on data from the Equias Alliance/ Michael White Bank-Owned Life Insurance (BOLI) Holdings Report™, it is evident that this alternative use of capital is a popular asset to own. The first quarter 2017 report notes that 62.6% of US banks have BOLI holdings on their balance sheet, representing $163.2 billion in cash surrender value. This figure is up by 3.6% from a similar period the previous year and continues to grow annually. Banks of any size are permitted to own BOLI and Interagency Memorandum (IAM) 2004-56 provides the regulatory guidance on the ownership and design of a BOLI program.

Banks continue to experience increases in healthcare and qualified benefit expenses (e.g., 401(k), profit sharing, ESOP, disability, group term insurance), and often seek the consistent returns and protection BOLI provides to ease that burden. The unique asset and income characteristics of BOLI make it an ideal asset to help offset these ever-increasing costs. To understand why BOLI remains so popular, listed below is a summary of 10 reasons why more than half of US banks own BOLI as an asset.

1. BOLI is an effective way to offset the rising costs of employee benefits.

According to the 2016 ABA Compensation Survey, 73.9% of banks are experiencing rising healthcare costs with an average 8.4% increase from 2015. Appropriately designed BOLI contracts will provide policy income to help offset and recover a portion of employee benefit expenses as long as the purchases are documented, among other things, with a proper pre-purchase analysis and ongoing annual risk assessments (IAM 2004-56).

2. BOLI provides consistent and competitive tax-preferred yields from high credit quality insurance carriers.

Since BOLI is a life insurance contract, the build-up in the cash value of the policies grows on a tax-preferred basis as long as the bank does not surrender the policy prior to the death of the insured. Additionally, the net life insurance proceeds are received free of tax by the bank as the bank is both the owner and beneficiary of the policy. Current net yields range from 2.50% to 3.75%, which means a taxable asset would need to generate yields of 4.03% to 6.05%, based on a 38% corporate tax rate to be competitive.

3. BOLI enables banks to offer competitive compensation plans.

One of the original uses of a BOLI contract was to offset the Supplemental Executive Retirement Plan (SERP) liability created when a bank provided a benefit to a key executive. Today, this type of arrangement remains in vogue. However, banks are also offering other types of Non-Qualified Deferred Compensation (NQDC) plans to retain, reward, and recruit other key bank employees, such as high-performing lenders who generate significant revenue for the bank. In today's competitive job market, the NQDC plan, financed by a BOLI contract, enables a bank to be on the cutting edge of compensation programs.

4. BOLI creates the ability for a bank to offer life insurance to its executives at little or no net cost to bank or to the executives.

A bank may choose to use a portion of the proceeds it receives as beneficiary of the life insurance contract to provide a pre-retirement death benefit to the insured. This benefit is documented through an agreement between the bank and the insured. If the insured dies while employed at the bank, the bank would receive the life insurance proceeds and then subsequently pay the insured's beneficiary the pre-determined amount. The bank may also enter into a Split-Dollar agreement, where a portion of the net life insurance is paid directly from the insurance carrier to the insured's beneficiary upon his or her death. This arrangement may result in taxable imputed income for the insured and a liability accrual for the bank if the Split-Dollar benefit extends post termination, however, death proceeds received by the insured's beneficiary, will be received income tax free.

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5. BOLI can improve a bank's earnings.

As the cash value of a BOLI policy is booked on a monthly basis as 'non-interest income', the asset appreciates according to the net yield on the policy. This accretion can enhance the overall earnings of the bank when taking into account the tax-preferred status of the BOLI asset.

6. BOLI adds diversification to a bank's asset portfolio.

Since BOLI is not a traditional bank investment (i.e. commercial or residential loan, Treasury, municipal bond) and relies on the investment capability of the insurance company, the bank is able to further its diversification. Different product types are available to banks such as general account, hybrid separate account and variable separate account. The type most commonly used today is the general account. The general account will vary by insurance company, but is often comprised of securities a bank may not be able to directly invest in (e.g., corporate bonds, private placements, equities, etc.).

7. BOLI protects the bank when a key executive dies.

In addition to the monthly net income the bank will book, the life insurance contract promises a death benefit to the bank when the insured dies. The death benefit amount is generally a factor of the premium paid, age, gender, smoking status, and overall health of the individual and will fluctuate based on these criteria. When an insured dies, the bank will receive a tax-free death benefit that it can use to recruit a new executive and/or to assist with other financial needs of the bank.

8. BOLI carriers offer book value accounting.

Although BOLI interest crediting rates will vary over time with market changes, it will do so on a lagging basis because the bank's cash value is invested in the insurance company's portfolio of assets with varying degrees of maturity. Hence, for banks that invest in a general account, the carriers bear the mark-to-market risk which smooths out volatility for the policy owners since market fluctuations in the underlying assets will not flow through to the banks financial statements. With a general account product, the policyowner is a general creditor of the carrier, therefore it is important for banks to only purchase BOLI from financially sound insurance companies.

9. BOLI is an accretive asset from inception.

No loads or surrender charges exist in a specifically designed BOLI contract. Once a bank wires the initial premium, the interest will start accruing on the first day. Essentially, if the bank were to wire $1,000,000 of premium, the cash surrender value on the following day will be the premium plus one day's interest. If the bank were to surrender the policy prior to the death of the insured, the bank would pay tax on any gain earned in addition to a Modified Endowment Contract penalty of 10%.

10. BOLI policies may be issued without medical underwriting.

According to IRC §101(j), a bank may own a life insurance policy on individuals who fall within the top 35% of employees based on their compensation. If the bank is able to insure at least 10 lives, it could qualify for Guaranteed Issue (GI), which requires no medical underwriting. This would be available to a bank with at least 29 employees. In order to comply with IRC §101(j) and to obtain GI is that the bank must obtain the insured's consent to be insured.

Certainly, the benefits BOLI provides to a bank extend beyond the income it generates. When considering a BOLI program, consulting with a qualified and reputable vendor with years of experience is vital due to the long-term nature of BOLI and the benefit expenses it is offsetting. This is not only from a design and product perspective, but also from a data security standpoint, which is important in today's connected world.

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