BANK OWNED LIFE INSURANCE

What Do Bank Boards Need to Know About BOLI

More than half of all the banks in the country now have Bank Owned Life Insurance, or BOLI, on their executives' lives, according to a recent review of regulatory filings by Equias Alliance, a BOLI consulting firm.* So what is BOLI and what do boards need to know about it? David Shoemaker of Equias Alliance addresses some common questions his customers have about BOLI.

What is BOLI?

BOLI is a widely used vehicle for helping to finance the cost of employee benefits such as health care and supplemental executive retirement plans on a tax-advantaged basis. In a BOLI plan, the bank typically pays a single premium and is the owner and beneficiary of life insurance policies on one or more consenting officers or directors. It is a highly effective financing tool as it offers a higher after-tax yield than most other investments of similar risk and duration.

What are the yields now on BOLI assets?

Despite the low interest rate environment, some of the top insurance carriers in the market are currently offering net yields of approximately 3 percent to 4 percent with tax equivalent yields of 4.84 percent to 6.45 percent for a bank in the 38 percent tax bracket. There are several reasons they can do this, including investing longer on the yield curve than banks because their liabilities are longer; having different investments in their portfolio such as corporate bonds and private placements; and leveraging off investments made several years ago when market yields were higher.

What will happen to the value of a bank's BOLI assets if interest rates start to rise?

Even if market rates rise, the carrying value on BOLI assets in the standard non-variable general account and hybrid separate account products will not be negatively impacted. BOLI assets in these portfolios are not subject to a mark-to-market adjustment. In fact, the yield on the BOLI policy will generally follow changes in market rates, but because of the portfolio's longer duration, the changes will occur over time and lag market changes.

Is it typical for participating bank executives and board members to receive any direct benefits from a BOLI program?

Banks often share a portion of their life insurance benefits under the BOLI policy with key executives and/or board members who designate their own beneficiaries. For example, bank executives are frequently provided with a death benefit, payable to their beneficiaries, equal to one to two times salary or a flat amount ranging from $50,000 to $1 million. The death benefit provided to directors' beneficiaries is typically $50,000 or $100,000.

What's the impact on the bank if the board decides to terminate the BOLI program?

BOLI can be surrendered at any time, and the full amount of the cash surrender value may be withdrawn. There are no financial penalties imposed by the insurance company. However, there could be adverse tax consequences. In addition to the usual tax on gains, an additional 10 percent penalty tax will be imposed on the gains if the policy is deemed a modified endowment contract, which most single premium policies are.

Would having BOLI impact a future change of control for the bank?

It is important to distinguish between a BOLI policy, which is an asset owned solely by the bank, and any Supplemental Executive Retirement Programs (SERP) or other executive benefits that are informally funded by the BOLI. In my experience, having BOLI on the books earning a reasonable rate of return is not seen as negative. In fact, in most situations, the acquiring bank will also have BOLI holdings and understand the advantages of BOLI ownership. If your SERP plan or other executive benefits are indirectly funded by BOLI, just like other SERP plans, they may require significant additional accounting charges in the event there is accelerated vesting upon a change of control.

How does a bank know which service provider to choose?

The bank should assess the reputation of the group (e.g., the number of exclusive endorsements the firm has from national and state banking associations); the background and experience of the consultant; and the level of service they will receive after the sale (e.g., having the CPAs, attorneys and other professionals on staff to handle tax, accounting, legal, regulatory or administrative matters that come up).

**Source: Equias Alliance/Michael White BOLI Holdings Report (2013). David Shoemaker is a registered representative of, and securities are offered through, ProEquities Inc., a Registered Broker/Dealer, and member of FINRA and SIPC. Equias Alliance is independent of ProEquities Inc.*

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