Bank Owned Life Insurance: More Than a Funding Vehicle for Benefit Plans

By Bennett S. Meyer

ACB Business Partners aligns with best-in-class companies to provide member-advantaged business solutions designed to enhance your bank's competitiveness and to improve your bottom line. Our newest partnership with Meyer-Chatfield delivers optimally structured BOLI programs to provide key man insurance for directors and officers. Meyer-Chatfield specializes in the BOLI transaction and has a long history of helping community banks realize the full potential of this asset. All policies in this program will require the consent of individual employees.

Marketplace dynamics are driving community bankers to evaluate and consider bank-owned life insurance programs. These dynamics also demand that banks explore the latest BOLI structures to remain competitive. Contrary to conventional wisdom, BOLI is much more than a simple funding vehicle for non-qualified benefit plans. In light of recent product evolution, there is no better tool than BOLI for "financing" the benefit plan liability. Recently added features of these BOLI plans create new uses for the asset. While BOLI must not exceed the extent of employee benefit liabilities numerically, it can and must exceed this scope strategically.

"Life insurance is a financial instrument that serves many necessary and useful business purposes," according to the Office of the Comptroller of the Currency in a guidance letter from 2000. It is a mistake to regard BOLI as only being able to contribute to one strategic goal. Since banks are able to purchase life insurance worth up to 25 percent of capital, senior management should examine the potential of insurance as they would any other asset. Management must determine BOLI's impact on the investment portfolio, recognize the effect on the bank's risk management (Asset/Liability Management Committee, or ALCO) function, and recognize any other pertinent issues.

BOLI has many aspects that, when combined, make it a remarkable instrument. Most banks have found that a properly structured BOLI program can provide after-tax returns of 200 to 300 basis points higher than traditional bank investments with similarly low risk. With the correct structure, BOLI plans will achieve a net return on assets in excess of 200 basis points year after year. This is possible because BOLI cash value grows tax-deferred and death benefits are tax-free. Finally, with BOLI, many risks associated with traditional investments are transferred to the insurance carrier, including the credit and price risks of the underlying investments, as well as the interest rate risk.

A bank should consider BOLI's application as a funding vehicle for employee benefits only after its value and appropriateness have been established with regard to the institution's unique situation. Increased competition in the bank marketplace, improved earnings, and stronger performance ratios are only part of the reason that community banks should consider BOLI. The current political climate is the prime reason that a bank must first examine BOLI as an asset. Today's environment demands that an investment be justified beyond its benefit for a select group of top-level executives. BOLI, when implemented properly, is an asset that meets regulatory guidelines and can easily be justified.

BOLI is the most accepted way to insure officers and key personnel at a bank. Nearly 2,000 community banks have purchased BOLI in the last 15 years. The justification behind past strategies was the ability to finance non-qualified benefit plans. However, regulators now require a thorough review and documentation of the BOLI transaction, including market, products, carriers, and consultants involved in the process. These guidelines, when followed properly, preclude abuse of the asset. Our relationship with ACB will follow the highest of standards.

More fundamentally, as the name indicates, BOLI is bank-owned. It is an investment, not a liability. The insurance contracts, which are funded through a single premium, grow tax-deferred at an annual variable rate. Ultimately, death proceeds, which include this growth, are received tax-free. Carriers are providing competitive returns that, combined with this tax-favored treatment, ensure superior ROA and ROE and also create increased earnings per share.

As competition for higher-yielding investments has risen over the last three to four years, BOLI products have been refined to a level where they can outperform traditional investments and fulfill multiple objectives. Newer designs can provide enhanced credit protection, higher yields, and even allow risk-weighted advantages that older designs lacked. Meyer-Chatfield is currently working to develop new BOLI plans, including plans especially designed for community banks. These products will incorporate mortgage-backed securities and would receive pass-through treatment for risk-based capital purposes, as well as meeting qualified thrift lender requirements.

At Meyer-Chatfield, we understand that attracting and retaining strong directors and executives is essential to the longevity and success of a community bank. We also understand that properly implemented BOLI plans create increased earnings, create increased shareholder value, and contribute to the overall financial success of the bank.

The Meyer-Chatfield team has the knowledge and experience necessary to ensure that BOLI plans are designed and implemented properly. Meyer-Chatfield pioneered the community bank BOLI marketplace in 1998 and we continue to evolve with the industry. Our firm works hard to produce high-yielding BOLI products that support recruitment and retention needs, as well as meeting the needs for high-yield, low-risk assets. The added value that BOLI brings, when properly structured, is too compelling to ignore.

Bennett S. Meyer is chief executive officer of Meyer-Chatfield, Corp. Opinions expressed in this article are the author's. For information about the ACB/Meyer-Chatfield partnership contact Helen Sullivan, senior vice president, ACB Business Partners, at (202) 857-3157 or hsullivan@acbankers.org.