



**DBF GUIDANCE FOR GEORGIA STATE-CHARTERED BANKS, BANK HOLDING COMPANIES, CREDIT UNIONS, AND TRUST COMPANIES**

TO: Supervision Staff

CC: Georgia State-Chartered Banks, Trust Companies, and Credit Unions

FROM: Melissa Sneed  
Deputy Commissioner for Supervision

SUBJECT: PURCHASE OF FINANCIAL INSTITUTION OWNED LIFE INSURANCE PRODUCTS

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The Department's Guidance contained herein shall apply to bank-owned life insurance (BOLI) for banks and trust companies and credit union-owned life insurance (CUOLI) for credit unions.

LEGAL AUTHORITY TO PURCHASE BOLI AND CUOLI PRODUCTS

The general corporate power provisions of O.C.G.A. § 7-1-260(9) for banks and trust companies and O.C.G.A. § 7-1-650(13) for credit unions permit a financial institution to procure, for its benefit, insurance on the life of any of its directors, officers or employees or any other person whose death might cause financial loss to the financial institution; or, pursuant to any contract lawfully obligating the financial institution as guarantor or surety, on the life of the principal obligor.

Additionally, O.C.G.A. § 7-1-261(11) for banks and trust companies and O.C.G.A. § 7-1-650(6) for credit unions provides for incidental powers. The general corporate powers and the incidental powers provisions authorize the purchase of BOLI and CUOLI insurance policies by banks, trust companies, and credit unions, provided that all necessary safety and soundness considerations are met in the purchase of these products. Department approval is not necessary to purchase these products, except as noted in the later discussion of safety and soundness considerations.

INTERAGENCY STATEMENT ON THE PURCHASE AND RISK MANAGEMENT OF LIFE INSURANCE

On December 7, 2004, the Interagency Statement on the Purchase and Risk Management of Life Insurance (“Interagency Statement”) was issued to provide guidance for banks purchasing life insurance. Through Department Rule 80-2-4-.07, the Interagency Statement was also made applicable to credit unions. As highlighted in the Interagency Statement, appropriate Board and senior management oversight of the risks involved in the purchase of life insurance, appropriate analysis and vendor assessment before the purchase and during the holding period, and proper accounting of the insurance on the financial institution’s books is required. (For additional accounting guidance with regard to bank insurance policies purchased in connection with deferred compensation arrangements, reference should be made to FDIC FIL-16-2004, “Interagency Advisory on Accounting for Deferred Compensation Agreements and Bank-Owned Life Insurance”).

Financial institutions should avoid investing a significant percentage of capital in such life insurance policies. When establishing internal limitations for such policies on an individual and aggregate basis, the institution’s lending limitations and capital concentration threshold should be considered. The Interagency Statement recommends, and the Department expects, that institutions utilize the concentration threshold of 25 percent of Tier 1 capital (25 percent of Net Worth for credit unions) as a benchmark when establishing internal limitations for the aggregate cash surrender value of all policies purchased. Generally, holdings above this concentration limit will receive additional scrutiny and criticism and require justification on the part of the financial institution’s Board.

Purchases of life insurance should be made in accordance with this Interagency Statement. Deviations which represent safety and soundness concerns may subject the financial institution to criticism and possibly administrative action as part of the examination and supervision process. Instances where the BOLI or CUOLI product was in conformity with standards at the time of purchase and subsequently moved outside of these standards due to changes in the cash surrender value or changes in the financial institution’s capital, will be evaluated independently to determine a course of corrective action based upon the extent of any safety and soundness concerns.

### SAFETY AND SOUNDNESS CONSIDERATIONS

Safety and soundness factors are the primary considerations in the purchase of BOLI and CUOLI products. These include several specific safety and soundness factors that should be actively monitored and reviewed in the consideration of these products during the examination and supervision process as noted below:

#### **De novo Institutions**

The Department regards de novo banks and credit unions as higher risk enterprises as compared to financial institutions with an established operating record due to the lack of a positive sustained earnings history, lack of a sustained and proven business plan model, constraints on providing additional capitalization, and other risk factors. Therefore, the Department expects that a decision to obtain BOLI or CUOLI needs to be supported with a determination that the product(s) are appropriate, non-detrimental to the financial institution, supplementary to the earnings and capital positions, and consistent with the business plan. Unless the purchase of BOLI or CUOLI was contained in the Department-approved business plan, this acquisition should receive prior

Department approval during the de novo period. De novo institutions requesting approval of BOLI or CUOLI purchases should contact the Department for further guidance on submitting a letter form application documenting identified considerations.

### **Problem Institutions**

It may not be appropriate for financial institutions with problem characteristics, particularly those subject to administrative actions, to purchase BOLI or CUOLI products, depending upon the nature or severity of the problems. Financial institutions with asset quality or earnings issues, asset/liability mismatches, insufficient liquidity, or less than satisfactory capital might find these problems exacerbated by the purchase of certain BOLI or CUOLI products. The Department might specifically require the approval of the purchase of such products as a condition of a formal or informal enforcement action.

### **Excessive Compensation or Insider Abuse**

In evaluating BOLI or CUOLI products, financial institutions should make certain that the purchase of such products, when combined with other forms of compensation paid to employees, does not represent excessive compensation. Although limited to banks, Part 30 of Title 12 of the Code of Federal Regulations addresses safety and soundness standards, and contained within Appendix A to this regulation is a section prohibiting excessive compensation as an unsafe and unsound practice. The Interagency Statement, which is applicable to banks and credit unions, also addresses excessive compensation. Excessive compensation is based on a determination of the reasonableness of the benefit being provided by the BOLI or CUOLI, the reasonableness of the cost of providing that benefit, and the reasonableness of total compensation being provided. Additionally, the use of BOLI would not be appropriate if the use of the product represented insider abuse, fraud, or breach of trust, or if the use of such products could lead to material financial loss for the institution. The Board should consider the duration of this type of obligation. Carefully monitoring exposures to capital should also include consideration of longer term needs to be able to offer this employee benefit to future talent. The Board may be limiting the ability to offer this employee benefit if long-term contracts exist in current management teams.

### **Credit Union Purchase of Split-Dollar Life Insurance**

Department Rule 80-2-4-.07 requires credit unions to obtain written approval from the Department prior to purchasing, holding, or funding split dollar life insurance or a product substantially similar to split dollar life insurance. Letter form applications provided to the Department should ensure consistency with the Interagency Statement on the Purchase and Risk Management of Life Insurance and safety and soundness principles related specifically to split-dollar life insurance. Credit unions requesting approval of split-dollar life insurance products purchases should contact the Department for further guidance on submitting a letter form application documenting identified considerations.

## **Other Safety and Soundness Considerations**

Additional factors might be identified as supervisory concerns during the examination process if it is determined that safety and soundness risks are posed to the financial institution. These concerns include the following:

- substantial surrender charges on the BOLI or CUOLI products that effectively “lock in” the financial institution to the insurance product;
- inadequate financial strength of the insurance company offering the BOLI or CUOLI products;
- failure to properly meet the provisions of GAAP in accounting for these products;
- purchase of life insurance products on individuals that are not “Key Persons,” unless the product is otherwise demonstrated to be appropriate;
- failure to meet other applicable regulatory compliance issues, such as FDIC Rules and Regulations and Federal Reserve Regulation O;
- apparent potentially adverse tax consequences caused by the products;
- required policy endorsements and assignments not properly executed; and
- BOLI products representing potential legal concerns with minority shareholders in banks.

## **SUMMARY OF THE DEPARTMENT’S POSITION ON THE PURCHASE OF BOLI AND CUOLI PRODUCTS**

The Department recognizes the need for BOLI and CUOLI products particularly in providing executive retirement plans needed to retain key executive officers or to offset the cost of providing employee benefits; however, safety and soundness benchmarks are needed to maintain diversification and moderation of risk. The Department regards purchases of BOLI or CUOLI from one issuer in excess of the Georgia statutory lending limits or aggregate purchases of BOLI and CUOLI in excess of the concentration of credit guidelines to be potentially problematic and subject to adverse regulatory comment. While there are no statutory limitations regarding the purchase of BOLI or CUOLI products, financial institutions should comply with safety and soundness provisions outlined in this Guidance and detailed in the Interagency Statement to limit potential financial and operating risk to the financial institution.