



# NYLEX News

*News and Events in the Executive Benefit Program Marketplace*

## **Banks Should Continue to Buy BOLI**

*TO OUR CLIENTS AND FRIENDS*

THIS ISSUE OF NYLEX NEWS DISCUSSES BANK-OWNED LIFE INSURANCE (BOLI). WITH HOME MORTGAGE DEFAULTS ON THE RISE AND THE RECENT UPHEAVALS IN THE CREDIT AND FINANCIAL MARKETS, BANKS SHOULD CONTINUE TO FOCUS ON BOLI AS A FINANCING STRATEGY.

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### **Recent Headlines**

Bank-Owned Life Insurance (BOLI) is considered to be a stable, low-risk source of financing for employee benefits. Despite recent headlines about Wachovia Corp. and Fifth Third Bancorp having to take large write-downs related to their BOLI portfolio, BOLI continues to be an attractive financing strategy for banks.

So, what happened? Why the write-downs? One factor was the risky underlying investments, i.e., hedge funds, selected by these banks within their BOLI separate account products. Even though the investments were bank eligible, the hedge funds selected were apparently invested in the same kind of risky, hard-to-value securities that have declined in value during the credit crisis. Another factor is a possible failure on the part of these banks to do proper due diligence in understanding

the products they were purchasing.

### **BOLI**

Bankers have wholeheartedly embraced BOLI arrangements as a safe and economic financing tool and have found BOLI to be advantageous for the bottom line. According to the Federal Deposit Insurance Corporation (FDIC), more than 4,000 (about half) of the nation's commercial and savings banks own BOLI policies with aggregate cash surrender values exceeding \$120 billion at the end of 2007.

Banks buy BOLI for a variety of reasons, including funding bank executive and director supplemental pensions (SERPs), deferred compensation plans, healthcare costs and other employee benefits; to improve their income statement; to enjoy favorable tax benefits; and to

strengthen the financial stability of the bank.

Banks typically buy BOLI in single-premium tranches. Generally, banks insure an aggregate pool of employees who fall within the top 35% of their employees ranked by compensation (to meet IRS requirements). The bank is the owner, premium payer and beneficiary of the entire insurance arrangement.

BOLI products can be general account or separate account products with investments in more traditional fixed income accounts, treasury funds, or mortgage-backed securities. Many larger institutions prefer separate account products because of investment flexibility, greater transparency (that is, explicit disclosure of costs) and

creditor protection. Assets held by the insurance company on behalf of the policy owners in the separate account are intended to be beyond the reach of the insurance company's creditors in the event of insolvency. Separate account products with alternative investment structures (bank eligible investments) have been used generally by very large and sophisticated banks which are able to evaluate and model these investment strategies.

**Proper Approach to Purchasing BOLI**

Knowledgeable bank CEOs recognize BOLI as among their best performing assets and frequently purchase the maximum amount that regulations allow. Banks are heavily regulated, and the Office of the Controller of the Currency (OCC) details allowable uses for BOLI and promulgates specific guidelines for the use of BOLI through its Bulletin 2004-56 ("the Bulletin")<sup>1</sup>.

The Bulletin discusses the critical steps of an essential and effective pre-purchase analysis the most important of which are:

- Assessment of vendor
- Review of the characteristics of suitable insurance products
- Selection of carrier

It is critical that a thorough and careful evaluation of BOLI is conducted in the pre-purchase

analysis; and, post purchase risk assessment analyses are conducted at least annually.

*Assessment of Vendor*

Banks generally rely on an experienced and qualified vendor in evaluating a proposed BOLI purchase. The Bulletin reaffirms the importance of careful vendor selection and states that institutions should evaluate the vendor's:

- Services and its reputation, experience, financial soundness, and commitment to the BOLI product.
- Commitment to investing in the operational infrastructure necessary to support BOLI.
- Ability to honor its long term commitments.

*Review of Suitable Insurance Products*

In reviewing available insurance products, an institutional product developed specifically for banks should be considered. These often maximize the return through higher cash surrender value.

General account and hybrid separate account BOLI products offer significant protection for a bank including:

- Minimum crediting rate protection
- Opportunity for general account or separate investments in conservative portfolios.

BOLI separate account products require due diligence by bank management to review and understand:

- Portfolio management
- Investments in the separate account

*Carrier Selection*

Selection of the carrier is the most important decision in a BOLI purchase and one that can have long term consequences. The Bulletin states that a Bank should review the carrier's commitment to BOLI products as well as its:

- Credit ratings,
- General reputation,
- Experience in the marketplace, and
- Past performance.

Following the BOLI purchase, the institution should continue to monitor the financial condition of the insurance carrier.

**NYLEX Benefits Can Help In Your Decision**

NYLEX Benefits understands that purchases of BOLI should be consistent with safe and sound banking practices. We can help your Board and management understand BOLI's product options, the compliance process, and ongoing administration requirements.

We take great care to assure that your BOLI program is practical and cost effective and that it is designed to achieve your strategic and operational goals.

<sup>1</sup> On December 7, 2004, federal banking regulators – OCC, FRB, FDIC, and OTS – released the first formal interagency statement on BOLI, cited as OCC Bulletin 2004-56.



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## About **NYLEX**Benefits

NYL Executive Benefits LLC (NYLEX Benefits) is an independently managed subsidiary and the executive benefits consulting arm of the New York Life Insurance Company, a Fortune 100 company. New York Life is the largest mutual life insurance company in the United States, with an enviable 163 year history.

New York Life as of 12/31/07 had \$12 billion in surplus, GAAP total revenue of \$21.1 billion and \$280 billion in assets under management. New York Life has among the highest ratings from the leading independent ratings agencies, including (at December 2007) A.M. Best (A++), Moody's (Aaa), Standard and Poor's (AAA) and Fitch (AAA) for financial strength.

NYLEX Benefits provides supplemental executive benefit programs to a wide range of commercial clients. We focus on developing cost effective executive benefit solutions that are designed to attract, reward and retain key employees.

Our services are designed to assist clients at all stages in the adoption and operation of executive benefit programs and include:

- Initial assessment
- Plan design
- Funding
- Plan implementation
- Ongoing administration

NYLEX Benefits' professional staff includes the following professional disciplines, all dedicated to supporting our client's programs, processes, systems and services:

- Accountants
- Actuaries
- Attorneys
- Benefit specialists
- Insurance specialists

We take great care to assure that client programs are practical and cost effective and that they are designed to achieve our clients' strategic and operational goals.

NYLEX Benefits  
281 Tresser Boulevard, Suite 1110  
Stamford, CT 06901  
(203) 353-5800 FAX (203) 353-5844

[www.nylexbenefits.com](http://www.nylexbenefits.com)

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