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Bank-Owned Life Insurance: A Primer for Community Banks

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Since the 1980s, banks have purchased bank-owned life insurance, or BOLI, for various business purposes — most commonly to recover losses associated with the death of a key person, to recover the cost of providing pre- and post-retirement employee benefits, and to provide a direct employee benefit. While the products and the reasons for purchasing BOLI are not new, the overall use of BOLI at community banks has been increasing, and regulators continue to receive questions about BOLI investments by community banks.

A BOLI Primer

Key-Person versus Split-Dollar Life Insurance

Key-Person Life Insurance: When the death of a bank officer or other key person would be of such consequence to the bank as to give it an insurable interest, key-person life insurance insures the bank on the life of the individual. The bank generally pays the entire premium and is the beneficiary. The primary purpose of this type of insurance is to indemnify the bank against the potential loss of net income that may result from the death of the insured.

Split-Dollar Life Insurance: This policy is a form of additional direct compensation, whereby the bank pays part or all of the insurance premiums and the executive's beneficiary receives some or all of the death benefit.

BOLI is a life insurance policy purchased by a bank or bank holding company to insure the life of certain employees. Typically, the insured employee is an officer or other highly compensated employee, but a bank may purchase insurance for any employee. Since the bank owns the policy, the bank receives the proceeds from the death benefit, and accrues revenue from investment earnings. However, banks may also purchase split-dollar life insurance policies as an employee benefit. With these policies, the bank and the employee share rights to the policy's cash surrender value (CSV) and death benefits.

BOLI Holdings at Financial Institutions

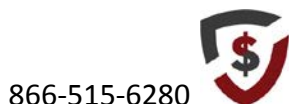
The number of banks reporting life insurance assets and the total reported balances of these assets have been increasing.³ As shown in Table 2, more than 3,500 commercial and savings banks reported over \$137 billion in life insurance assets at year-end 2013. And it is clear from the table that BOLI is not just a product for large banks; 3,467 community banks reported \$29 billion in BOLI assets at year-end 2013. This was an increase not only in the number of community banks reporting life insurance assets but also in the balances outstanding and the level of the concentration of life insurance measured as a percentage of tier 1 capital.

Table 2: Commercial Banks and Savings Associations Reporting Life Insurance Assets in Call Report Filings

Banks by Asset Size	12/31/2013			12/31/2012			Year-over-Year Change		
	# Banks	Balances	Average % Tier 1 Capital + ALLL	# Banks	Balances	Average % Tier 1 Capital + ALLL	# Banks	Balances	Average % Tier 1 Capital + ALLL
Under \$100 million	698	\$819	17.28%	708	\$790	16.80%	-1.41%	3.67%	2.82%
\$100 million – \$500 million	1,913	\$7,837	15.63%	1,878	\$7,322	15.43%	1.86%	7.03%	1.28%
\$500 million – \$1 billion	455	\$5,321	15.25%	450	\$4,906	14.55%	1.11%	8.46%	4.82%
\$1 billion – \$10 billion	401	\$14,924	13.89%	382	\$13,787	13.75%	4.97%	8.25%	0.99%
Community Bank Total	3,467	\$28,901	15.71%	3,418	\$26,805	15.41%	1.43%	7.82%	1.95%
Over \$10 billion	66	\$108,506	13.27%	65	\$105,003	12.90%	1.54%	3.34%	2.91%
Total	3,533	\$137,407	15.66%	3,483	\$131,808	15.36%	1.44%	4.25%	1.95%

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