



## What You Should Be Asking Your BOLI Provider

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*Bank Strategies*

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## Our Presenters

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## About M Benefit Solutions – Bank Strategies

### M Benefit Solutions - Bank Strategies

- For more than 30 years M Benefit Solutions has helped corporations and banks structure and fund plans to **attract, retain, reward, and retire their key people.**
- Our solutions help banks, executives, and directors **achieve strategic business and personal financial goals.**
- **ICBA Preferred Service Provider since 2004**
- **Providing:**
  - Executive and Director Benefit/Compensation Plans
  - Bank-Owned Life Insurance (BOLI)
  - Supplemental Disability Income (DI) and Long Term Care (LTC) Insurance



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## About M Benefit Solutions – Bank Strategies

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## Today's Agenda

- I. Introduction
- II. Bank Owned Life Insurance (BOLI) Basics
- III. Regulatory Support
  - i. Interagency Statement on the Purchase and Risk Management of Life Insurance (OCC 2004-56)
  - ii. Dodd-Frank Bill – *Proposed* Volcker Rule
- IV. Questions to ask your BOLI Provider
  - i. Industry Best Practices for Proper BOLI Portfolio Management
- V. M Benefit Solutions - Bank Strategies

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## II. Bank Owned Life Insurance (BOLI) Basics

### What is BOLI?

- Bank-Owned Life Insurance (**BOLI**) is used as a tax efficient method for offsetting the costs of employee benefit programs.
- The cash value growth in the policy is tax deferred (tax free if held until death) and the death benefits are tax-free.
- The policies insure the lives of key employees and/or bank directors.

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## II. (BOLI) Basics

### Why do Banks Buy BOLI?

- Tax-favored returns that exceed the after-tax returns of more traditional bank investments by 150 to 300 basis points
- Cash values grow tax-deferred (tax-free if held until death)
- Death benefits are tax-free
- Ability to efficiently generate gains to offset costs associated with employee benefits programs
- Products institutionally priced and designed specifically for financial buyers
- Immediately accretive to earnings
- Risks that are well within standard business risks in the bank's investment portfolio
- Well-defined guidance on permissible usage by regulatory authorities
- No surrender charges
- Diversifies investment portfolio
- Ability to immediately increase ROE and ROA

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## II. (BOLI) Basics

### How Does BOLI Work?

- A bank purchases the life insurance with either a single premium, or a series of annual premiums, on a select group of key employees and/or bank directors.
- The bank is the owner and beneficiary, although many banks opt to share a portion of the insurance proceeds with the participants.
- The cash value growth within a BOLI policy produces a return greater than the opportunity cost, or what the bank would have made in an alternative investment and is used to offset the costs of employee benefit programs.

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## II. (BOLI) Basics

### How Does BOLI Work?

- The accounting for BOLI is governed by **FASB Technical Bulletin No. 85-4** and should be recorded on the balance sheet as an “other assets”.
- The increase in cash surrender during a specific period, as well as the final net insurance proceeds at maturity, should be recorded as “other income.”
- BOLI is a long term asset and, when properly implemented and administered, offers the bank a highly rated investment option.

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## II. (BOLI) Basics

### FASB EITF Issue No. 06-4 – Sample Report

- Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements

#### **The Bank**

#### *Endorsement Split-Dollar Plan*

#### Liability Benefit Accounting

	Name	Gender	Status (A or V)	Valuation Age	Retirement Age	Post- Retirement Benefit	12/31/2011 Accrued Liability (Pretax)	2012 ASC 715 Charge (Pretax)	12/31/2012 Accrued Liability (Pretax)
1	Executive 1	M	A	51	65	\$50,000	\$2,588	\$1,039	\$3,627
3	Executive 2	M	V	65	n/a	50,000	737	274	1,011
4	Executive 3	F	A	46	65	50,000	1,731	631	2,362
<i>totals:</i>							\$5,056	\$1,944	\$7,001

#### Assumptions

Valuation Date—January 1, 2012

Discount Rate—5.25% [Source: IRS Sept 2011 2nd Segment Rate]

Mortality Table—2011 Applicable Mortality Table



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## II. (BOLI) Basics

### BOLI Rate Spreads

- The following chart illustrates a hypothetical investment comparison between a hypothetical BOLI purchase and alternative investments.

	Hypothetical Investment Comparison				
	Fed Funds	5 Year Treasury	MBS Portfolio	Municipal Bonds	BOLI
	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000
Yield	0.15%	0.85%	2.95%	2.20%	3.75%
Income	\$7,500	\$42,500	\$147,500	\$110,000	\$187,500
Tax (35%)	(\$2,625)	(\$14,875)	(\$51,625)	\$0	\$0
Net Income	\$4,875	\$27,625	\$95,875	\$110,000	\$187,500
TEFRA Disallow. (Est.)				\$4,445	
Net Income	\$4,875	\$27,625	\$95,875	\$105,555	\$187,500



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## II. (BOLI) Basics

### BOLI Facts and Figures

- BOLI continues to be a popular investment choice for a variety of banks.
- As of November 30, 2011, over 3,700 banks nationwide reported BOLI cash surrender values on their regulatory filings.
- Almost 59% of banks nationwide with assets between \$100 million and \$1 billion currently own BOLI.

Asset Size	Total Banks	Banks with BOLI		Averages for Banks with BOLI*		
		#	%	Capital**	BOLI CSV	% BOLI to Capital
>\$10B	107	70	65.4%	21,427,930	2,417,762	11.3%
\$5-\$10B	62	41	66.1%	756,732	101,478	13.4%
\$1-\$5B	500	378	75.6%	198,839	27,289	13.7%
\$500M-\$1B	685	479	69.9%	147,368	21,428	14.5%
<\$500M	6,148	2,781	45.2%	59,329	9,260	15.6%

Data Source: SNL Financial Database as of 9/30/11

\* Numbers in thousands

\*\* Tier 1 Capital plus Loan Loss Allowance, if applicable

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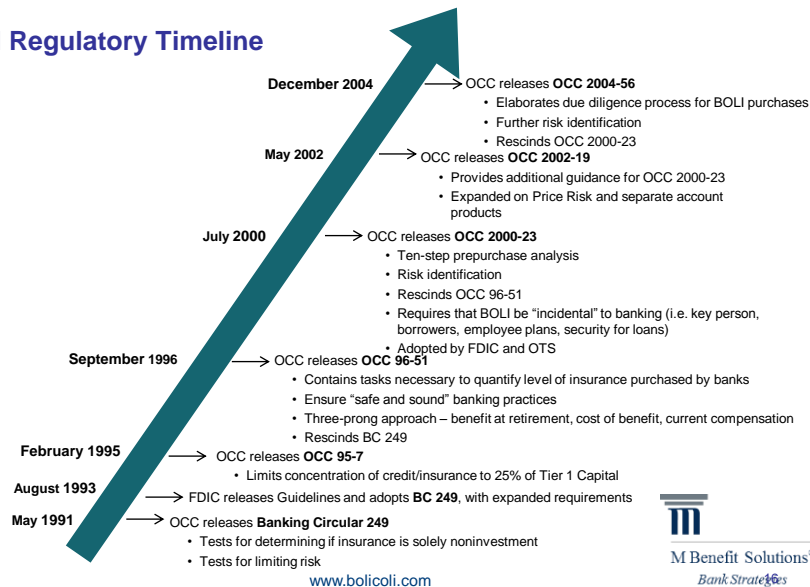


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## III. Regulatory Support - OCC 2004-56

### BOLI Regulatory Timeline



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### III. Regulatory Support - OCC 2004-56

#### INTERAGENCY STATEMENT ON THE PURCHASE AND RISK MANAGEMENT OF LIFE INSURANCE (OCC 2004-56)

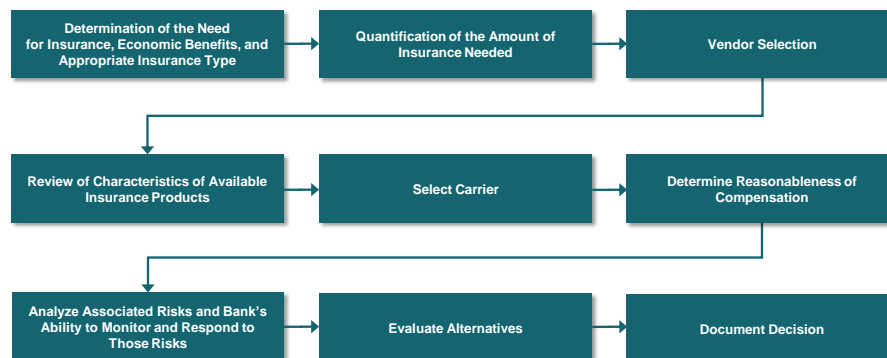
- This statement provides general guidance for institutions regarding supervisory expectations for the purchase of and risk management for bank-owned life insurance (BOLI).
- The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) provided this guidance to help ensure that institutions' risk management processes for BOLI are consistent with safe and sound banking practices, including:
  - Senior management and board oversight of BOLI
  - A thorough pre-purchase analysis of risks and rewards and post-purchase risk assessment
  - Review of the risks and associated safety and soundness considerations related to BOLI

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### III. Regulatory Support - OCC 2004-56

#### OCC 2004-56 Pre-Implementation Analysis Steps



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### III. Regulatory Support – Proposed Volcker Rule

#### Section 619 of the Dodd-Frank Act, AKA “The Volcker Rule”

- Intent was to promote safe and sound banking practices by prohibiting any banking entity from engaging in proprietary trading or owning/sponsoring a hedge fund or private equity fund.
- **The issue for BOLI:**
  - Separate account BOLI<sup>1</sup> could have theoretically fallen under the overly broad definition of a “hedge fund” or a “private equity fund” in the initial rule’s language.

However, the Agencies have now proposed to exclude separate account BOLI from the rule and reaffirm the important role BOLI plays for banks.

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### III. Regulatory Support – Proposed Volcker Rule

#### Section 619 of the Dodd-Frank Act, AKA “The Volcker Rule”

*Banking entities have for many years invested in life insurance policies that cover key employees, in accordance with supervisory policies established by the Federal banking agencies...*

*...when made in the normal course, these investments **do not involve the speculative risks** intended to be addressed by section 13 of the BHC Act. Moreover, applying the prohibitions in section 13 to these investments would eliminate **an investment that helps banking entities to reduce their costs of providing employee benefits as well as other costs.***

*The Agencies have structured this exemption in the proposed rule so as **to allow a banking entity to continue to manage and structure its risks and obligations related to its employee compensation or benefit plan obligations in a manner that promotes and protects the safety and soundness of banking entities,** which on an industry-wide level has the concomitant effect of promoting and protecting the financial stability of the United States.<sup>2</sup>*

<sup>1</sup> Separate account BOLI is, by definition, a Variable Universal Life (VUL) product.  
<sup>2</sup> Excerpts from Proposed Volcker Rule; Section \_\_.14 (Covered fund activities and investments determined to be permissible; a. Investments in certain bank owned life insurance separate accounts)  
 NOTE: bold text added for emphasis and is not part of the actual proposal.

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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### BOLI Portfolio Management

#### Questions:

- What is the process for annual BOLI compliance and review? Do you follow a master calendar?
- How is the policy information delivered?
- What is the methodology of cash value reporting – actual vs. projected?
- Does your provider communicate and educate bank on new products and industry relevant news?
- Can we obtain annual inforce illustrations?
- Do you provide internal ratings reports analysis in addition to publicly available?
- Is your Bank BOLI Board Policy in place?
- Do you understand the availability of internal policy upgrades, analyze the impact on guarantees and 1035 exchange possibilities?

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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### BOLI Portfolio Management

#### Questions:

- Within our current portfolio are their cash value riders enhancing yield that are subject to carrier or wrap provider ratings?
- What range of products do you have access to?
- Do you provide an annual Board Memorandum and education about our portfolio and associated plans?
- Are you following the new Call Report requirement for type of BOLI in place (general, hybrid, and/or separate account)?
- What are the options for adjusting the risk weighting of my portfolio?
- Do you regularly evaluate current sub-accounts invested and assess our options to ensure these accounts properly align with our investment goals and strategies?

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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### BOLI Portfolio Management

#### Questions:

- Do you periodically review the matching of death benefit liabilities to funding?
- Have you reviewed EITF reporting options? What imputed income table is used?
- How are death benefits processed?
- Do you provide peer specific comparisons?
- For multi-pay, or annual pay, policies, do you evaluate when premiums should stop and the effect on yield?

#### Takeaways:

- A crucial part of ongoing management of a bank's BOLI portfolio involves efficient and effective communication, data management and product/industry education.
- Your BOLI provider should be a source of information about your portfolio but also a proactive advocate to ensure your ongoing needs and strategies are being met.

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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### Data Security

#### Questions:

- What policies and procedures are in place to ensure my data is secure?
- What technologies do you employ to keep data safe?

#### Takeaway:

- A BOLI and benefits plan administrator deals with sensitive, private client information and must prove that they have proper policies in place and employ the top technologies to ensure data security.

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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### Administrative Systems and Quality Control Processes

#### Questions:

- Do you have emergency plans and systems in place in case your primary data center is compromised?
- Do you have proprietary administrative software or is it out-sourced?
- Do you employ full-time software engineers?
- Do you provide online client access to plan information? Is it secure?
- What is your strategic policy to keep your administrative infrastructure and technology up to date?
- How often are you audited? By whom? Can I get a copy of audit? Do you have a Statement Standards for Attestation Engagements 16 (SSAE 16)?
- Describe how you internally audit your client information?

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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### Best Practices:

#### A BOLI provider should regularly provide the following information:

- Inforce policy illustrations and industry yield comparisons
- Periodic (monthly or quarterly) cash values
- Risk Evaluation
  - BOLI holdings comparison to peer banks
  - Carrier ratings reports, news, financials
  - BOLI concentration analysis
- Notifications of internal upgrades within products

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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### Best Practices:

- Policy performance reviews
  - Advise on options to align holdings to bank's investment strategies
- Benefit plan vitals
  - Review funding and liabilities matching
  - Actuarial certification of accounting entries; imputed income; FICA; plan documents; individual statements
- EITF Reporting
- A BOLI provider should offer the bank easy access to all information vital to their BOLI Holdings.
  - Via client customized administrative website

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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### Best Practices:

- A BOLI provider should make sure a BOLI Board Policy is in place as well as provided an annual board memorandum and ongoing board education.
- A BOLI provider should inform and educate the bank of policy structure and options
  - Information delivery methodology should be efficient (electronic/direct downloads).
- A BOLI provider should have flexible reporting capabilities that conforms to the bank's schedule.

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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### Best Practices:

- A BOLI provider should inform and educate the bank of policy structure and options
- A BOLI provider should regularly offer informative and educational material, such as White Papers and articles on new product and/or regulatory/legislative developments.
- Provider should maintain clear and concise security policies and have appropriate technologies in place.
- Provider should perform and make available to clients a Statement Standards for Attestation Engagements 16 (SSAE 16) or similar third-party attestation of the firm's administration claims and operations.



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## IV. Questions to Ask Your BOLI Provider – Best Practices for Proper BOLI Portfolio Management

### BOLI Vendor Assessment and Qualifications Audit

**BANK-OWNED LIFE INSURANCE**  
**VENDOR ASSESSMENT AND QUALIFICATIONS AUDIT**

The Integrity Statement on the Purchase and Risk Management of Life Insurance (IGC 2004-56) provides general guidance for banks and writing reservations regarding experience requirements in the purchase and risk management for bank-owned life insurance (BOLI). Among the risks and associated handling practices discussed in the Integrity Statement is the need for vendor management and board oversight of BOLI, including both a thorough pre-purchase analysis of risks and rewards and post-purchase risk assessment. The guidance discusses the possibility of BOLI purchases and holdings, as well as their risks and associated safety and soundness considerations.

Management Action Item 12 in the Supervisory Guidance, the purchase Analysis section of OCC 2004-56 states that an institution must properly assess a BOLI vendor's qualifications. Examples from the Action Item are as follows:

**Critical to Success of BOLI Plan Operation\***

- ... the vendor's services can be extensive and may be critical to successful implementation and operation of a BOLI plan.
- Long-term Commitment\*\*
- ... the vendor's ability to honor its long-term commitments, particularly when the vendor is expected to be associated with the institution's insurance program over an extended period of time.
- Reputation and Financial Stability
- \*\*The institution should evaluate the adequacy of the vendor's services and its reputation, experience, financial soundness and commitment to the BOLI product.
- Infrastructure and Technology
- ... the vendor's commitment to investing in the operational infrastructure necessary to support BOLI.

This vendor audit focuses on qualifications with associated experience noted in OCC 2004-56 as well as other experience criteria to be considered when selecting a vendor to design, implement, maintain or administer BOLI plans and related non-qualified executive benefits plans.

\*Note: text is bold in actual for emphasis and not a part of the source document.

**Audit Report – Vendor OCC 2004-56 AND BEST PRACTICES STANDARDS ASSESSMENT**

Category/Concern	Description	Yes	Yes	All Bases Covered (Bank Strategies)
<b>Industry Experience</b>	Company established and in industry > 1 year			
	Company established and in industry 2-10 years			
	Company established and in industry 10-20 years			
<b>Ownership Structure and Stability</b>	Publicly held			
	Private/limited			
	Other Regulated Products			
	Company ownership > 1 year			
<b>Services Provided to Insurer</b>	Company ownership > 10 years			
	Company ownership > 10 years			
	Specialty			
	BOLI product experience and writing support			
<b>Services Provided Our Beneficial Third Party</b>	Regulatory compliance			
	Ongoing health and life submissions			
	Professional Advisory			
	Specialty			
<b>Depth, Caliber, Continuity of Staff</b>	BOLI product experience and writing support			
	Regulatory compliance			
	Ongoing health and BOLI submissions			
	Professional Advisory			
<b>Depth, Caliber, Continuity of Staff</b>	Adverse or staff			
	Certified Public Accountant (CPA) on staff			
	Adverse or staff			
	Average total years of industry related experience > 10 years			
<b>Security</b>	Average years working with Insurer > 10 years			
	Average years working with Insurer > 10 years			
	Average years working with Insurer > 10 years			
	Average years working with Insurer > 10 years			
<b>Security</b>	Policy: Standardized (non-complex security policies)			
	Testing: Internal testing (regulation program audit)			
	Penetration: Penetration testing (regulation program audit)			
	Technology: Operational procedure technology in place including:			
<b>Security</b>	• Firewalls			
	• Access control policies			
	• Encryption			
	• Patch management			
<b>Security</b>	• Vulnerability assessments			
	• Monitoring: Custom monitoring for internal and external website activities			



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## Questions?



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