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Why Credit Unions Purchase Credit Union-Owned Life Insurance (CUOLI)

by Russell McMillan

The credit union industry as a whole has done an admirable job since the economic downturn, but it still faces a myriad of challenges. Assets and capital continue to grow, credit unions continue to attract deposits, and, on average, credit unions with over $50 million in assets are close to their pre-2008 return on asset and return on equity levels. However, credit unions continue to battle increased regulatory burdens, rising employee benefit costs, a difficult lending environment, and poor investment returns. For an institution to be successful, it must have strong leadership to develop and deploy a strategic plan to combat these current challenges and to achieve its long-term goals. Credit Union-Owned Life Insurance (CUOLI) can help in many of these areas.

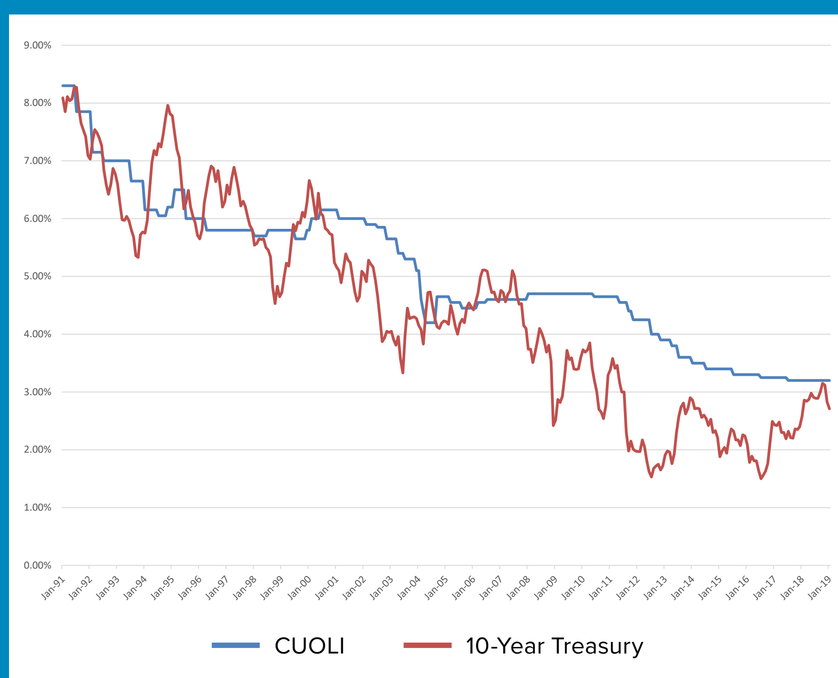
What is CUOLI?

CUOLI is an efficient method for credit unions to offset the costs of employee and executive benefit programs while potentially generating higher yields than more traditional credit union permissible investments. This investment strategy offers returns that can compete favorably with more traditional credit union investments and may offer less interest rate volatility versus investments with mark-to-market concerns.

In Search of Yield

For decades, life insurance has been a popular asset with banks due largely to its tax-favored status producing a substantial increase in yield. Despite not enjoying the tax benefits, credit unions are still drawn to this asset due mainly to the investment qualities of CUOLI. Although interest rates have risen in recent years, credit unions are discovering that CUOLI returns are higher than their traditional investments. Credit unions' investment yields, on average as of December 31, 2018, are at 1.66%.

10-YEAR TREASURIES
VS.
REPRESENTATIVE CUOLI PRODUCT CREDITING RATES



The performance data quoted represents past performance and does not guarantee future results.

These historically low rates have put pressure on credit unions to find yield. Surplus funds and excess liquidity earning an extremely low return make it tempting for credit unions to chase yield by extending maturities in their fixed income portfolio; however, this may expose them to disproportionate interest rate risk. As an asset, CUOLI may also help mitigate interest rate and price risk. This is a function of the investment guidelines and accounting treatment in a carrier's general account. The assets typically average 5–7 years in duration; are accounted for at book value; and gains are spread out over time, helping them to provide a less volatile return to policyholders.

Rising Employee Benefit Costs and Executive Compensation

According to the Kaiser Family Foundation 2018 Employer Health Benefits Survey, employer-sponsored health care premiums rose 5.0% for family coverage with an average employer annual contribution of $14,069 per employee for family plans and $5,711 for single plans. Credit unions are also adding new employees to handle the ever-increasing regulatory compliance burdens, with a coinciding benefit cost increase that supports no revenue production and is comparable to a sunk cost.

In addition, competition for top talent is a constant issue for credit unions and has intensified as the number of credit unions and banks have reduced substantially in the past decade. A strategic retention and rewards program is essential. Typically, credit unions employ a nonqualified deferred compensation program (457(f) plan) or a supplemental executive retirement plan (SERP) that provides motivation to achieve goals and to retire with the organization.

CUOLI provides a valuable tool for credit unions to efficiently finance general employee health and welfare benefits and executive benefit programs.

The National Credit Union Administration (NCUA) allows for the purchase and holding to maturity of CUOLI products if it complies with §701.19 of NCUA's rules regarding benefits for Federal Credit Union employees. Credit unions may recover the cost of the employee benefit and the cost of the funding for that benefit.

Specifically, section (c) of §701.19 states:

> *(c) Investment authority. A federal credit union investing to fund an employee benefit plan obligation is not subject to the investment limitations of the Act and part 703 or, as applicable, part 704, of this chapter and may purchase an investment that would otherwise be impermissible if the investment is directly related to the federal credit union's obligation or potential obligation under the employee benefit plan and the federal credit union holds the investment for as long as it has an actual or potential obligation under the employee benefit plan.*

CUOLI is an asset with specific uses: to offset the cost of any general employee benefit programs including healthcare, other group benefits, and executive benefit plans. The more important aspect of CUOLI might be in its investment qualities, as it is a secure and liquid capital asset that competes favorably with more traditional credit union investments, allows for portfolio diversification, and access to investments normally considered impermissible. Utilizing CUOLI strategically can help solve some of the major issues facing a credit union today ranging from tightening margins to the long-term motivation and retention of its key people.

To learn more about how M Benefit Solutions can help your credit union

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