

# What is Bank-Owned Life Insurance (BOLI) and How Can You Benefit?

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Bank Owned Life Insurance (is an institutional financial product used by most U.S. banks the first policy was issued in 1983.

BOLI is used to provide benefits to key employees, retain top bank directors and executives, and protect against the loss of critical employee, in addition to enhancing non interest income.

The bank is the policy owner, premium payor, and beneficiary the insureds are consenting key executives.

Policies are placed with top quality insurance carriers and funded on a single premium basis, with cash values growing income tax deferred and death benefits paid income tax free.<sup>1</sup>

Policies with similar characteristics can be used for organizations, families, and individuals to provide protection and enhance current balance sheets.

## Who Owns Boli?

Did you know that many commercial banks have more invested in life insurance policies than they do in bank premises, fixed assets and all other real estate assets combined?

As of the third quarter of 2019 nearly 3,800 banks owned \$190 billion in BOLI policies. **For example**, Bank of America owns \$22 billion, JP Morgan Chase owns \$11 billion, and Wells Fargo owns \$18 billion in BOLI assets<sup>2</sup>.

BOLI is highly regulated by various federal and state banking authorities Regulations allow banks to hold up to 25% of their most vital regulatory capital known as Tier 1 in BOLI policies.<sup>3</sup>

## What is the Purpose of BOLI?

Even though BOLI can be a very attractive place for banks to earn higher current yields on their safest capital, these policies are not purchased for the sole purpose of enhancing non-interest income.

Rather, BOLI is used as a tax-favored asset to increase bank earnings and offset rapidly rising costs of employee benefits, such as sky-rocketing medical, disability, and workers' comp insurance premiums.

BOLI is also used to protect (indemnify) the bank from the unexpected loss of skilled and valuable executives, often referred to as "key person" life insurance.

Banks also utilize BOLI as a vehicle to finance the cost of providing a deferred compensation plan for key officers.

# How is BOLI Funded?

BOLI is institutionally-priced, permanent life insurance, funded with a single, lump-sum premium.

The premium equals the cash surrender immediately. BOLI products have no-loads, no-surrender charges, and all the income.



## How Does BOLI Enhance a Bank's Balance Sheet?

One of the biggest ancillary benefits is that BOLI policies produce far superior returns than traditional bank investments, such as municipal bonds, 5- and 10-year U.S. Treasuries, and mortgage-backed securities (refer to Chart A).

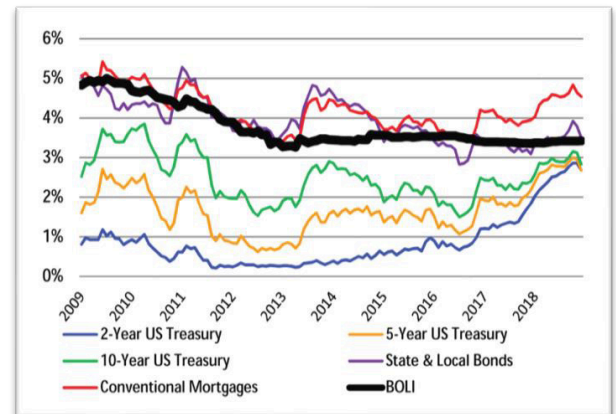
BOLI generates non-taxable profit and loss earnings equal to the growth in cash surrender value, and any death benefits are paid out are completely tax-free.

In fact, the tax advantages enjoyed by using BOLI are usually absent in other nonqualified retirement packages and benefit plans, which is what makes BOLI such a valuable component of a general deferred compensation program.

To emphasize earnings, BOLI policies are structured to maximize the cash value growth and minimize the expense of the death benefit portion of policy.

BOLI is issued by highly-rated insurance companies, which means that the chance for default, bankruptcy, or other negative situations is remote.

In fact, banks and their regulators are comfortable using life insurance companies to protect their safest capital because they do not use excessive leverage.



Rates indicated above are not adjusted for fees or charges that may apply. BOLI information is averaged from rates obtained from life insurance companies. Other rates are obtained from the U.S. Statistical Release website at: <http://federalreserve.gov/releases/H15/data.htm>

***For example, if a bank has \$1 on deposit, it can lend out up to \$10 to borrowers. This leverage can lead to instability and, in excess, bank failure or a "run" on the bank where it cannot meet depositor demand.***

However, if a life insurance company has the same \$1 on deposit, it may loan out no more than \$0.92, and usually only a fraction of that amount, which makes them stable institutions in down economies and a good fit for a portion of banks' safest capital.



# Who is BOLI Policy Owner, Insured, and Beneficiary?

The bank is the owner and beneficiary of the policies. When the insured employee passes away this tax-free death benefit can be used to fill the vacuum left by the death of the key executive, as well as fund other business needs.

Banks typically keep the life insurance policies on retired or separated executives because the rate of return can be even higher when the policies are held until death.

A portion of the death benefit may be shared with insured officers via a supplemental life insurance plan which can serve as a valuable "Golden Handcuff."

Depending on the insurance companies and amount of premium, if 10 or more executives participate, then in most cases no medical tests are required.

## Can I Benefit From BOLI?

Life insurance companies only issue institutionally priced BOLI policies to commercial banks.

However, some carriers allow selected agents to design retail policies with loads and fee structures that are like BOLI. These policies are used to protect families against the loss of breadwinners and to protect businesses, including nonprofits, against the loss of owners and key employees.

Just like BOLI, these policies also generate higher current yields on cash value compared to those offered by other safe, liquid assets, such as CDs, U.S. Treasuries, and bonds (**refer to Chart B**).

### Traditional Investment Yield VS. BOLI Yield

Traditional Bank Investment		Bank-Owned Life Insurance	
Bank Invests	\$2,000,000	BOLI Premium	\$2,000,000
1.5% Earnings	\$30,000	3.5% Earnings	\$70,000
26% Tax on Earnings	-\$7,800	No Tax on Earnings	\$0
<b>Net Income</b>	<b>\$22,200</b>	<b>Net Income</b>	<b>\$70,000</b>
<b>Net Yield</b>	<b>1.11%</b>	<b>Tax Equivalent Yield</b>	<b>4.29%</b>
<b>Additional Earnings from BOLI = \$47,800</b> <b>Additional Yield from BOLI = 3.18%</b>			

# Example

Suppose you own a successful business that keeps cash and other liquid assets on its balance sheet for emergency purposes and to take advantage of future buying opportunities. Assume you earn 1% on these assets, subject to income tax.

By repositioning these dollars to a policy designed like a BOLI contract, your yields increase from 1% to a projected 2.5%-5.0%<sup>4</sup> with gains tax-deferred and positively correlated to interest rates.

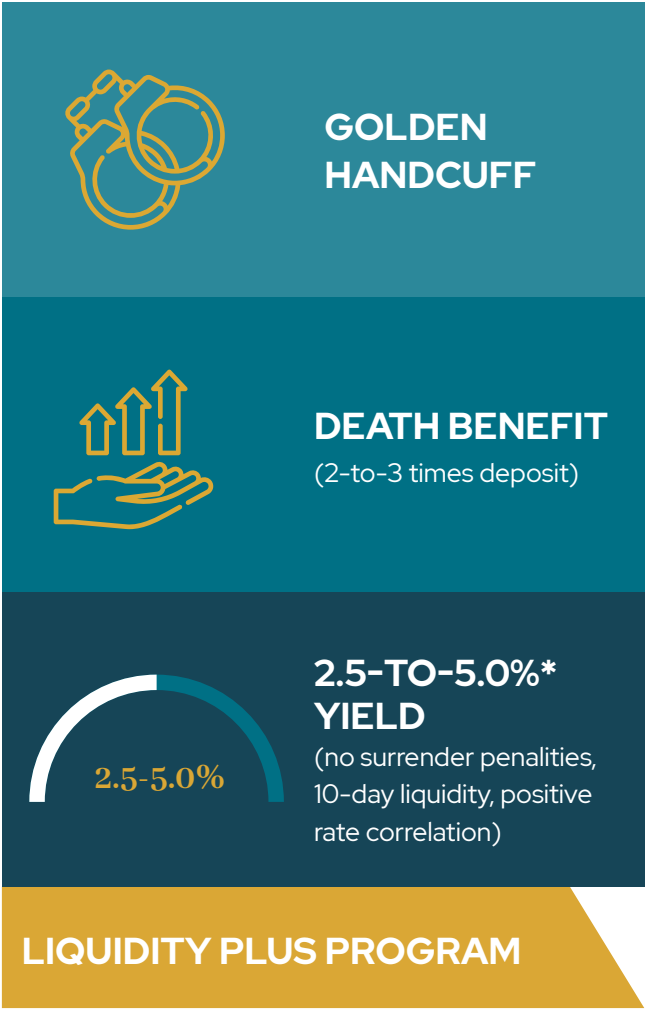
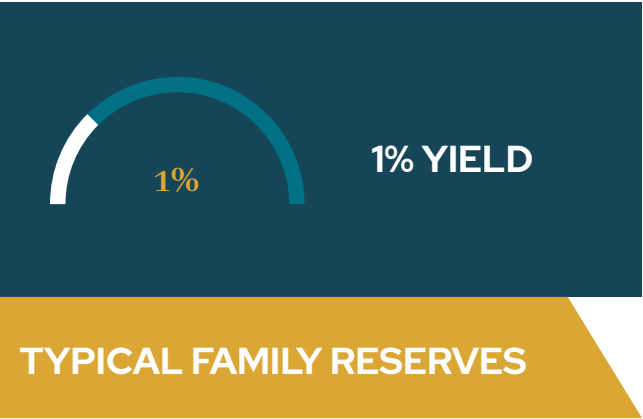
The extra income could simply be added to your company's bottom line, or perhaps used to fund a deferred compensation plan for you and your key people.

There is also a tax-free life insurance death benefit of 2-to-3 times the deposit that could be used to protect your family and/or your business in the event of your demise **(refer to Chart C).**

Another option could be to insure a non-owner key employee and provide a portion of the death benefit to the insured's beneficiaries as a retention tool (Golden Handcuff).

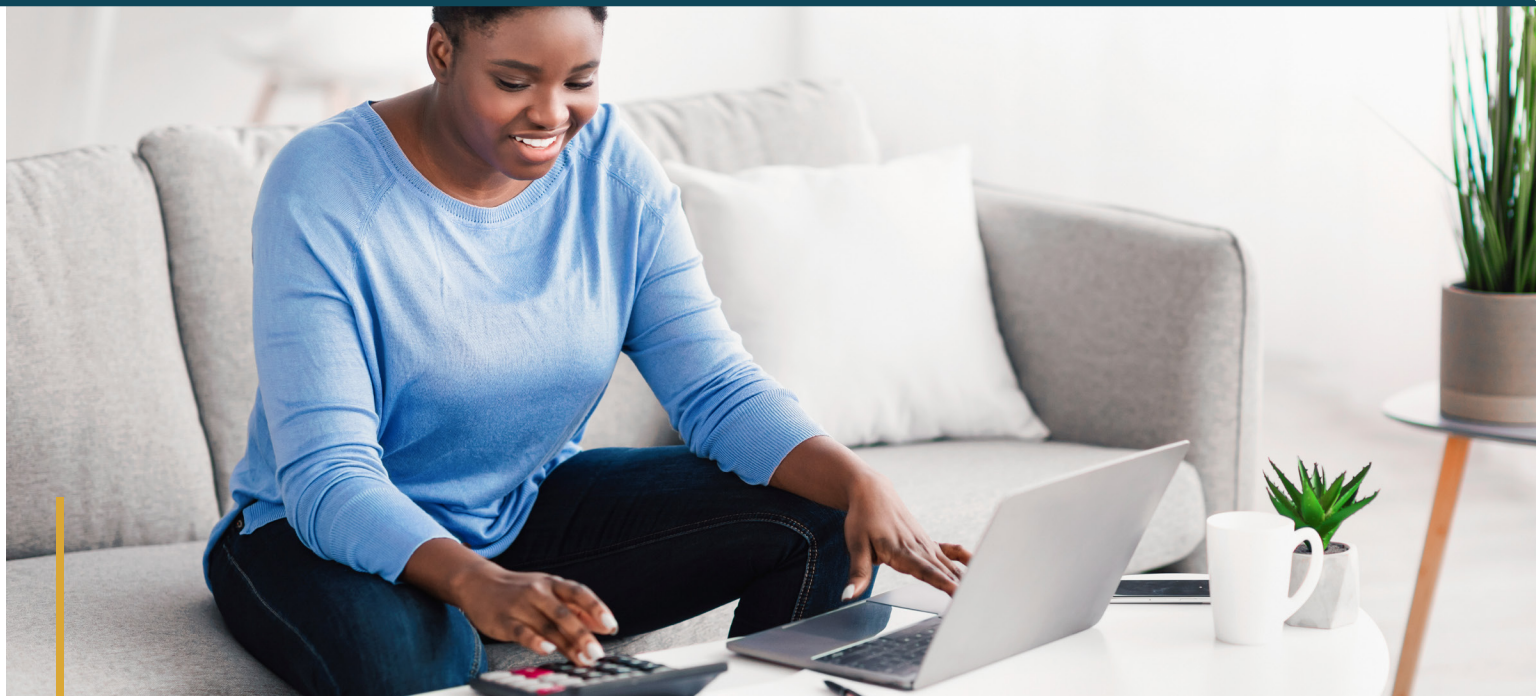
Most people have not seen policies designed like BOLI. But as they learn how and why commercial banks have used them for over 35 years, they see how these specialized life insurance policies can be used to help them meet their business and/or personal asset protection and balance sheet goals.

To learn more about these policies and to see if they could be a good fit for you and your situation, please contact our office to schedule an appointment.



\*Please refer to complete illustration for details. Figures based on current rates and charges and are not guaranteed. Utilizes fixed general account life insurance products which are not considered securities. Claims are based on the strength of the underlying insurance carrier and are not FDIC insured.

# Summary



BOLI is permanent life insurance purchased by a bank on its executives with a single premium, primarily to recover costs of employee benefits and to offset liabilities for retirement benefits, as well as to generate higher yields.

If having permanent life insurance protection and generating higher current yields would help you achieve your planning goals, you might consider using life insurance designed like those policies issued to banks.

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