WHITE PAPER

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M Benefit Solutions®
Bank Strategies

An M Financial Group Company

BOLI Product Options: General Account, Separate Account, and Hybrid

For over twenty years, banks have utilized bank-owned life insurance (BOLI) as an effective tool for offsetting expenses associated with employee benefit plans. While originally most common at large money-center banks, BOLI has become much more prevalent with community banks in the last ten years. In fact, over 3,800 banks nationwide reported BOLI on their December 31, 2009 call reports.

BOLI is life insurance purchased by a bank on its key employees (generally, BOLI can be purchased on up to the 35% most highly compensated employees). Premium payments are made by the bank, which owns the policies and is typically the beneficiary of all, or a portion of, policy death benefits.

While a bank's rationale for purchasing BOLI has fluctuated little in the past twenty years, the product landscape has evolved tremendously. This evolution has resulted in improved product options for banks. A bank now has the ability to purchase a life insurance product that better fits its specific needs. These product options include General Account, Separate Account, and Hybrid products.

General Account

The first institutional BOLI products were mostly General Account, meaning the policies' assets are held in the General Account of the insurance carrier and the carrier makes all investment decisions. A carrier's General Account portfolio is typically made up of high-quality corporate bonds and collateralized mortgages. The associated policyholder returns are based on either the underlying rate of the overall portfolio or a new money rate tied to the time the policy was purchased. These policies typically have a minimum guaranteed crediting rate and are easy to understand.

General Account BOLI is still a very popular product choice among community banks, but given today's economy, there are two important features that must be considered before the purchase of General Account BOLI. First, the bank has no choice in the direction of its investment. Second, the underlying assets in the policy are also part of the carrier's general fund, so the bank is fully exposed to the credit risk of the carrier and the asset carries a Risk-Based weighting of 100%.

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Separate Account

To answer the desire for investment direction, separated credit risk and lower Risk-Based weightings, carriers developed Variable Universal Life (VUL) Separate Account BOLI products. Separate Account BOLI provides bankers with several asset class choices, the ability to diversify their assets within the same product, and transfer assets between Separate Accounts (although there are typically restrictions as to the amount and timing for transfers). Separate Account products, unlike most General Account policies, don't have a minimum guaranteed interest rate and are a bit more complex. VUL products are long-term investments and may not be suitable for all investors. An investment in variable life insurance is subject to fluctuating values of the underlying investment options and entails risk, including the possible loss of principal.

With Separate Account BOLI, there is greater product transparency due to the way the product is built and securities disclosure regulations—not only is a banker able to get a better understanding of where the bank's money is being invested, but also what charges are deducted from the investment.

These policies are also often structured with a stable value wrap that helps "smooth" the returns of the underlying portfolio. Many stable value wraps have 0% guarantees. The funds are also separate from the insurer's General Account and are protected from the general creditors of the insurance company (Note: if there is a third-party stable wrap provider, the stable wrap portion has credit risk associated with the third-party wrap provider). Separate Account policies may also offer lower Risk-Based weighting account options (as low as 20%), which solidifies a bank's Risk-Based Capital (RBC) Ratio and frees up capital for other purposes.

Hybrid

Another recent product development, known as a "Hybrid" BOLI product, attempts to combine certain features of both the General and Separate Account policies. Hybrid products have separate accounts to hold funds, so in the event of carrier bankruptcy, the assets would be protected from the credit risk of the carrier. The crediting rate is based on the underlying yield of the assets held in the overall portfolio.

Hybrid products are less complex as they do not have a stable value wrap, are not classified as securities products, and offer a minimum guaranteed interest rate. Similar to Separate Account options, these products typically have various investment portfolios to choose from, and each invests in securities and other assets according to specific investment objectives and guidelines. Many Hybrid products offer lower Risk-Based Capital weightings and have greater product transparency when compared to General Account products.

Summary

The BOLI industry has come a long way over the past twenty years and today offers choices that are likely to fit the needs, investment appetite, and strategic financial goals for many community banks. The advantages and disadvantages of each type of product should be analyzed in detail for each investment decision to fit the unique financial goals of banks.

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General Account vs. Separate Account and Hybrid BOLI Products

	1 General Account BOLI	2 Separate Account BOLI	3 Hybrid BOLI
Portfolio Composition	Typically, high-quality corporate bonds and collateralized mortgages.	Same, however, depends on portfolio selected. Stable value wrap provider often purchases futures to reduce risks.	Typically, high-quality corporate bonds and collateralized mortgages.
Returns	Depends on underlying general account yield.	Based on yields of underlying assets in portfolio, though mark-to-market returns can be “smoothed” through the use of a stable value wrap.	Depends on underlying portfolio yield.
Guaranteed Rates	2–3.5%	Many stable value wrap have 0% guarantees.	2–3.5%
Risk-Based Capital Weighting	100%	Most investment subaccounts are lower than 100%. Any Fixed Account option is weighted at 100%.	Typically, carrier will offer at least one investment option with RBC weighting below 100%.
Investments	Carrier general account. Carrier makes all investment decisions.	Bank chooses asset managers and investment strategy subject to bank investment eligibility and, possibly, stable value restrictions.	Bank often chooses among offered Investment Portfolios.
Accounting	Cash surrender values pursuant to ASC 325 (FAS 85-4).	Mark-to-market cash surrender values pursuant to ASC 325 (FAS 85-4). Stable value wrap provides ability to smooth returns and book based on amortized value of gains and losses.*	Cash surrender values pursuant to ASC 325 (FAS 85-4).

NOTE

*Stable Value wrap fees will apply.

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General Account vs. Separate Account and Hybrid BOLI Products

	1 General Account BOLI	2 Separate Account BOLI	3 Hybrid BOLI
Credit Risk	Full exposure to general account. Credit risk of underlying asset default borne by carrier.	Market value of assets protected from general creditors of insurance company. Where stable value wrap exists, credit risk of third-party, stable-value wrap provider. Credit risk of underlying asset borne by policyholder.	Full book value of assets protected from general creditors of insurance company.
Minimum Purchase	Varies by carrier. Typically $250,000 to $500,000.	Varies by carrier. $1 million minimum for stable value wrap.	Varies by carrier. Typically $250,000 to $500,000.
Simplicity	Easy to understand.	Numerous parties and complex pricing components. Stable value wrap more complex to understand.	Depending on carrier, Hybrid options can be easy to understand. Some carriers offer Hybrid products that have more complex underlying assets.
Tax Risks	Very little.	If nonexperience-rated, very little. Experience-rated separate account products entail some additional tax risk.	Very little.

Important Disclosures

Product guarantees, including the death benefit, are subject to the claims-paying ability of the issuing insurance company.

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