

## BANK-OWNED LIFE INSURANCE (BOLI)

### Core Analysis Procedures

*Examiners are to consider these procedures but are not expected to perform every procedure at every bank. Examiners should complete only the procedures relevant for the bank's activities, business model, risk profile, and complexity. If needed, based on other identified risks, examiners can complete additional procedures. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive.*

#### Resources

Refer to the Interagency Statement on the Purchase and Risk Management of Life Insurance, [SR 04-19](#) (FRB) or [FIL-127-2004](#) (FDIC).

#### Preliminary Review

1. Review prior audit and examination reports, prior examination work papers, and file correspondence to identify previously identified weaknesses or high-risk elements relative to BOLI. Consider items such as general BOLI plans, split-dollar life insurance (SDLI) arrangements, and key-person life insurance policies.<sup>1</sup>
2. Review actions taken by management to correct prior audit and examination findings.
3. Review other information regarding BOLI activities to determine the bank's risk profile, such as:
  - The amount of life insurance assets in the bank's general account, separate account, and hybrid account holdings reported in Call Report Schedule RC-F. Also reported in FR Y-9 Schedule HC-F for holding companies;
  - Line items for BOLI income and Memorandum Item 6b for BOLI income exceeding 3 percent of Other Noninterest Income (for larger community, holding companies) in FR Y-9C, Schedule HI;
  - Respective agency surveillance screens;
  - Other regulatory reports, examinations, investigation materials, and correspondence from state and federal banking authorities;
  - Pending or threatened litigation;
  - Earnings reports that mention BOLI income or losses; and
  - Concentrations of BOLI assets.
4. Review components of the bank's BOLI program. Request a detailed list of the cash surrender value (CSV) of BOLI assets that ties to the bank's balance sheet, including the amounts attributable to:

<sup>1</sup> BOLI is permanent life insurance that typically covers a select group of employees and is generally purchased with a single, lump-sum premium.

<ul style="list-style-type: none"> <li>• General BOLI plans covering a group of employees used to recover the cost of employee compensation and benefit programs,</li> <li>• SDLI arrangements, and</li> <li>• Key-person life insurance.</li> </ul>
<p><b>5. Determine whether written policies and procedures govern the risk management process relative to BOLI holdings. Effective policies generally include the following:</b></p> <ul style="list-style-type: none"> <li>• Objectives;</li> <li>• Permissible products;</li> <li>• Pre- and post-purchase analysis requirements;</li> <li>• Tax, accounting, and regulatory requirements, including risk-based capital treatments for banks subject to the risk-based capital rules;</li> <li>• Aggregate BOLI CSV limits from all insurance companies and per-carrier limits;<sup>2</sup></li> <li>• Requirements for evaluations of third-party vendors and service providers;</li> <li>• Responsibilities of the bank's credit risk-management function to select and monitor insurance carriers;</li> <li>• Requirements for independent validations to ensure the amount of BOLI purchased reasonably correlates to, and is not excessive compared to, the bank's exposure under employee compensation and benefit programs;</li> <li>• Restrictions to ensure BOLI is not purchased for speculation or does not constitute an unsafe and unsound practice;</li> <li>• Potential adverse financial effects of early surrender of life insurance policies (accrued earnings since inception and capital gains on BOLI investments are subject to income taxes upon early surrender and may be subject to additional early surrender charges);</li> <li>• Procedures for senior management and board approval of BOLI purchases;</li> <li>• Annual reviews by the audit or compliance function to ensure adherence to laws and regulations, (including state insurable-interest laws, federal tax laws, and appropriate financial reporting in compliance with GAAP);</li> <li>• Responsibilities for reporting, authorizing, and monitoring policy exceptions;</li> <li>• Monitoring covered employees, insurable interest, and whether the amount of BOLI continues to be commensurate with the risks hedged; and</li> <li>• Peer analyses of BOLI holdings.</li> </ul>
<p><b>6. Evaluate the frequency and timeliness of policy reviews and updates to procedures for the purchase of life insurance.</b></p>

<sup>2</sup> When establishing these internal CSV limits, management and the board should consider applicable legal lending limits, concentration thresholds, and state restrictions on BOLI holdings.

Internal Controls
<p><b>7. Assess management’s BOLI pre-purchase analysis. Effective analysis generally involves:</b></p> <ul style="list-style-type: none"> <li>• Identifying the need for insurance, considering appropriate insurance products, and assessing the potential economic benefits;<sup>3</sup></li> <li>• Quantifying the amount of insurance appropriate for the management’s objectives;</li> <li>• Assessing vendor qualifications;</li> <li>• Reviewing the characteristics of the available insurance products;</li> <li>• Selecting the carrier;</li> <li>• Determining the reasonableness of the compensation provided to the employee;</li> <li>• Identifying the associated risks and the processes to manage the risks;</li> <li>• Evaluating alternatives;</li> <li>• Documenting decisions; and</li> <li>• Establishing exit strategies for liquidating BOLI holdings in the event of: <ul style="list-style-type: none"> <li>○ Anticipated or significant credit deterioration of an insurance company underwriter of general account BOLI; or</li> <li>○ A need for liquidity, particularly when BOLI holdings represent a significant portion of the bank’s capital.</li> </ul> </li> </ul>
<p><b>8. Determine whether management has procedures in place that conform with applicable state laws regarding insurable interests and the insured party’s consent requirements to ensure that the bank has an insurable interest in covered employees.<sup>4</sup></b></p>
<p><b>Audit or Independent Review</b></p>
<p><b>9. Determine whether there is an appropriate audit and compliance framework for the BOLI program. Determine whether the scope of audit coverage is commensurate with the level of risk associated with BOLI activities.</b></p>
<p><b>10. Determine whether audit findings are properly and promptly reported to the board or an appropriate committee.</b></p>
<p><b>11. If recent audit or independent reviews disclosed any deficiencies, assess management’s response(s).</b></p>

<sup>3</sup> For general account products, the general assets of the insurance company support the policy CSV. For separate account products, the CSV is supported by assets segregated from the general assets of the carrier.

<sup>4</sup> State laws vary and the creation of an out-of-state trust to hold BOLI assets to take advantage of more favorable insurable-interest laws does not guarantee safety from legal challenges regarding insurable interest.

<b>Information and Communication Systems</b>
<i>Management should follow GAAP applicable to life insurance products for financial and regulatory reporting. Refer to ASC Subtopic 325-30, Investments in Insurance Contracts.</i>
<p><b>12. Determine whether the board or its designated committee receives adequate information concerning significant BOLI risks, such as:</b></p> <ul style="list-style-type: none"> <li>• New BOLI purchases;</li> <li>• New insurance products (e.g., a separate account product with stable value protection);</li> <li>• BOLI capital concentrations;<sup>5</sup></li> <li>• Accounts involving complaints or threatened/pending litigation;</li> <li>• Exceptions from established policies, procedures, or risk limits;</li> <li>• Audit and regulatory reports; and</li> <li>• Financial impact of BOLI holdings.</li> </ul>
<b>13. Validate the accuracy of BOLI CSVs in the Call Report.</b>
<p><b>14. Determine whether the BOLI assets are properly treated for banks subject to the risk-based capital rules:</b></p> <ul style="list-style-type: none"> <li>• General account BOLI is risk weighted at 100 percent if the CSV is invested in the insurer's general account.</li> <li>• Separate account BOLI is risk weighted based on the riskiest combination of asset holdings permissible for the separate account, as stated in the separate account policy prospectus.<sup>6</sup></li> </ul>
<b>15. Review information provided to the board and any compensation committee to determine the quality, accuracy, timeliness, and completeness of information pertaining to the purchases of life insurance.</b>
<b>16. Determine whether the board considers the benefits of SDLI arrangements when evaluating overall compensation arrangements for affected employees, particularly its senior employees. If so:</b>

<sup>5</sup> Examiners should closely scrutinize risk management policies and controls for institutions holding BOLI in an amount that approaches or exceeds the applicable 25 percent of capital concentration threshold. Examiners should refer to the applicable agency concentration instructions (FDIC: refer to the Manual of Examination Policies Sections 3.7 and 16.1; FRB: refer to the Commercial Bank Examination Manual Section 2050.1).

<sup>6</sup> The net carrying value of qualifying separate account assets should be risk weighted based on a full look-through approach; a simple, modified look-through approach; or an alternative modified look-through approach. However, in no case can the separate account investment risk weighting for the bank's aggregate holding in that account be less than 20 percent. Refer to 12 CFR 217.53 (FRB) and 12 CFR 324.53 (FDIC).

<ul style="list-style-type: none"> <li>• Determine whether the bank has endorsement SDLI arrangements or collateral assignment SDLI arrangements.</li> <li>• Determine whether the board ensures SDLI arrangements conform with accounting guidance for the deferred compensation and postretirement benefit aspects in ASC Subtopic 715-60, Compensation - Retirement Benefits - Defined Benefit Plans - Other Postretirement.</li> </ul>
<b>Managerial Effectiveness</b>
17. Review the approval process for BOLI policies and practices, including exceptions from established policies, procedures, or risk limits.
18. Determine whether management and the board receive sufficient reports to ensure compliance with established policies and procedures related to BOLI.
19. Determine whether senior management and the board identify and monitor BOLI risks. Consider whether the following risks are addressed in the risk management process: <ul style="list-style-type: none"> <li>• Liquidity Risk,</li> <li>• Transaction/Operational Risk,</li> <li>• Tax and Insurable Interest Implications,</li> <li>• Credit Risk,</li> <li>• Interest Rate Risk,</li> <li>• Compliance/Legal Risk, and</li> <li>• Price Risk.</li> </ul>
20. Determine whether management maintains adequate supporting documentation for the BOLI program, such as: <ul style="list-style-type: none"> <li>• Identifying which employees are or will be insured (e.g., titles, grade levels);</li> <li>• Assessing death benefit amounts relative to employee salaries;</li> <li>• Calculating the percentage of insured persons still employed by the bank;</li> <li>• Evaluating material changes to BOLI risk management policies;</li> <li>• Analyzing mortality performance and impact on earnings;</li> <li>• Evaluating material audit findings and independent risk management reviews;</li> <li>• Identifying the reason for any policy surrenders and any tax implications;</li> <li>• Conducting peer analysis of BOLI holdings; and</li> <li>• Identifying permissibility of underlying investments in separate account BOLI.</li> </ul>

<b>End of Core Analysis.</b>
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