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The Many Benefits of Corporate and Bank Owned Life Insurance (COLI / BOLI)

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Knowledge You Can Bank On™

The Many Facets of Corporate and Bank Owned Life Insurance (COLI / BOLI)

Companies use Corporate and Bank Owned Life Insurance (COLI/ BOLI) to help fund their employee benefit plans, increase earnings and shareholder value as well as recruit, reward and retain key officers and directors. Tell us something we do not already know.

Supports the Bank and Its Community

Background:

The bank initially purchased BOLI on a few of its executives and directors to informally finance the cost of deferred compensation plans. Later, the bank decided to purchase additional BOLI (on a Guaranteed Issued basis—i.e. no medical underwriting) on all of its existing officers where the bank was the owner and sole beneficiary without establishing new or additional deferred compensation or other benefit plans.

Need:

The purpose of this purchase was to provide key person protection for the bank, and to offset the bank's growing existing employee benefit expenses.

Results:

Years later, a key officer passed away. The bank received the tax-free death benefit from the insurance which helped the bank through a difficult financial time: lost revenue, employee transition cost and lost goodwill in the community due to the death of the officer. However, with the additional tax-free gain, the bank made a large charitable donation in memory of the deceased officer to one of his passions—a new local community library. Not only did his family love this because of his memory living on in their hometown, but the bank was able to make an additional charitable contribution to strengthen the community over and above its normal giving.

Bottom Line:

BOLI is not just helpful for deferred compensation and executive benefit plans. BOLI, through earnings and life insurance, protects the bank from a key person perspective and helps keep the bank financially strong to better serve the community. A community and its community bank are interdependent—when one is strong, they both thrive.

“Tax-free key person protection for the bank to hire replacements for the executive without incurring extra loss.”

Supports Business Succession and the Executive's Family

Background:

The bank implemented a Salary Continuation Plan as a way to reward and retain certain key executives. The Bank purchased BOLI as way to informally finance this benefit plan while also providing key person protection for the Bank.

Need:

One of the bank's top executives passed away suddenly. Based on the Salary Continuation Plan, the executive's widow received 15 years of survivor benefits. This benefit helped her to maintain her lifestyle and keep her family in their home. In addition, the bank needed to hire two people to replace the work done by the key executive.

Results:

The executive's widow did not receive this benefit directly from the BOLI purchased by the Bank. However, BOLI provided the following for the bank:

1. Tax-free income to offset the increase in the liability for the 15 year survivor income stream, and
2. Tax-free key person protection for the bank to hire replacements for the executive without incurring extra loss.

Bottom Line:

It is important to have good benefits on key executives – it is good for the bank and also for the executives' families. BOLI helps to finance these benefits and protect the bank and family from incurring further monetary losses in an already tough time.

“A community and its community bank are interdependent—when one is strong, they both thrive.”

Offset Increased Health Insurance Expenses

Background:

Facing an issue that is not uncommon today, a bank incurred an 8.9% increase in its health insurance premiums. Because of lower margins and a low-yield environment, the bank passed all of the increased expenses to its employees. The bank was unable to compete in its market for top talent with this short-term solution and also incurred the risk of losing some of its key employees.

Need:

The bank was forced to think creatively of ways to offset these increased expenses and, therefore, looked to purchase BOLI on key officers. The cash value yield on BOLI provided better incremental income than what was otherwise available in the market (ie: 2% pre-tax yield), which indirectly helped to offset the increased health insurance expenses.

“BOLI decreased the amount of imputed income the officers had to recognize on their W-2’s.”

Health care cost offset

| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---|-----------|-------------|-------------|-------------|-------------|
| Total Medical Insurance Expense (1) | \$978,000 | \$1,065,042 | \$1,159,831 | \$1,263,056 | \$1,375,468 |
| BOLI Gain Above 2% Investment Performance Yield (2) | \$129,600 | \$133,424 | \$141,818 | \$149,446 | \$158,876 |
| Net Cost | \$848,400 | \$931,618 | \$1,018,013 | \$1,113,609 | \$1,216,591 |
| Total Savings | 13% | 13% | 12% | 12% | 12% |

(1) Based on cost of current health insurance premiums with an assumed 8.9% annual increase.
 (2) Based on the incremental earnings advantage of BOLI versus a taxable 2% yield in an alternative investment.
BOLI assumption: \$8 million initial investment at a current net yield of 2.82% after expenses and cost of insurance.
Alternative investment: 2% pre-tax yield and a corporate tax rate assumption of 40%.

Results:

The bank no longer intends to pass the increased healthcare expenses to its employees and also lessened the financial impact of this increased expenses to the bank. As an additional strategic byproduct of the BOLI, the bank provided a Supplemental Life Insurance Plan which saved the bank some expense of its group term insurance and decreased the amount of imputed income the officers had to recognize on their W-2’s.

Bottom Line:

BOLI offers a creative solution to offset the cost of increased healthcare expenses, it reduces the expense of group term life insurance premium for the employer and it provides lower imputed income for all officers. Win-win- win!

Supports Continued Operations and Cash Need

Background:

Prior to September 11, 2001, the airline industry went into a deep recession and many airlines were struggling. Cash flow was king and retaining key executives was paramount. This company implemented a nonqualified voluntary deferral plan to rectify the low government limits placed on 401k annual contributions. The participation was good as executives desired to save as much as possible on a pre-tax basis above the 401k limits. This company reviewed various financing alternatives for their nonqualified plan liabilities and turned to Corporate Owned Life Insurance (COLI) as a preferred solution from a tax advantage standpoint as well as a self-completion standpoint.

Need:

A year into this plan, one of their key executives, who was only 35 years old, passed away of cancer. A claim was paid on the COLI policy owned by the company. The tax-free income received as part of the key man life insurance policy helped finance the benefit liability owed to the deceased executive's family and provided a meaningful amount of cash that the company put back in the operations.

Results:

During those lean months, airlines carried two weeks of capital on their balance sheet. This cash from informally financing their nonqualified plan liabilities with Corporate Owned Life Insurance was crucial for this company to make it through another month of operations in this trouble time.

Bottom Line:

While many corporations (over 50% according to a recent survey) utilize Corporate Owned Life Insurance to finance nonqualified plan liabilities, few do it strictly for the death benefits payable to the corporation. When these benefits are received by the corporation, it is typically welcomed cash flow that can be used to subsidize operations or to fill the void in many of their unfunded benefit liabilities.

“This cash from informally financing their nonqualified plan liabilities with COLI was crucial for this company to make it through another month of operations.”

Look for more information on this topic as it develops by visiting www.ebn-design.com and please [contact us](#) with further questions or comments.

Executive Benefits Network welcomes questions and comments. Please contact Nikki Kook at (414) 755-8276 or nkook@ebn-design.com.

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About Executive Benefits Network

Executive Benefits Network (EBN) specializes in the design, administration and informal financing of customized **deferred compensation** plans and the procurement of **Bank Owned Life Insurance (BOLI)** programs. BOLI can help offset the costs of **nonqualified plans** for key employees and/or the costs of existing employee benefits. In addition, BOLI is immediately **accrue to earnings** and improves non-interest income and shareholder value.

EBN emphasizes the importance of **education** and builds long-lasting relationships with clients. As the **leading industry advisor**, EBN develops **customized** plans to attract, retain and reward **key executive talent**. EBN can service in all 50 states and has access to the highest rated insurance companies in the nation. Please contact EBN today for more information on how to improve your financial portfolio.

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