EXECUTIVE BENEFITS NETWORK

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Investing in BOLI/COLI When Tight on Liquidity

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insights

INVESTING IN BOLI/COLI WHEN LIQUIDITY IS TIGHT

Management teams are responsible for ensuring that their company's investments are getting the best returns. One investment option that they may consider is Bank Owned Life Insurance (BOLI) or Corporate Owned Life Insurance (COLI). While BOLI/COLI can provide a variety of benefits, many companies with tight liquidity overlook life insurance as one of their investment options.

In this whitepaper, we will discuss how companies that are tight on liquidity may still have the opportunity to invest in BOLI/COLI.

UNDERSTANDING BOLI/COLI

BOLI is typically purchased as a single-premium investment, with one large premium paid at the time the policy is purchased. Due to this payment structure, these policies are typically considered Modified Endowment Contracts (MECs), which we will discuss in more detail in the next section. COLI, on the other hand, can be funded by a single, lump sum premium, or more typically, through a series of annual payments.

Earnings and insurance proceeds from BOLI/COLI can be used to offset employee benefit plan expenses

To better understand why BOLI/COLI can be considered as a viable investment alternative for many companies, below are a few of the most common benefits:

- Earnings and insurance proceeds can be used to offset the costs of new and existing employee benefit plan expenses, offset costs of Nonqualified Plans for key employees and provide Keyperson Life Insurance
- Death benefits are received by the corporate beneficiary 100% income tax-free
- Cash Value Earnings are income tax-free if policy is held to maturity.
- Allows for portfolio diversification, without adding additional risk
- Immediately accretive to earnings and improves non-interest income and shareholder value
- Cash values are backed by highly-rated insurance companies with a strong AAA credit rating

MODIFIED ENDOWMENT CONTRACT (MEC)

A MEC is a heavily funded life insurance policy (typically single-premium) that provides higher cash yields and lower death benefits, and is taxed less favorably than other life insurance contracts, unless the policy is held to maturity where all benefits are tax-free.

- For life insurance policies issued June 21, 1988 or later, if the cumulative premium paid exceeds the premium limit established by the Internal Revenue Code (IRC Section 7702), the policy is classified as a **MEC**
- A **10% penalty tax** is imposed on any Cash Value amount received and is includable in gross income unless the distribution is made after the taxpayer becomes disabled, attains age 59 ½ , or the distribution is part of a series of substantially equal periodic payments made for the taxpayer's life or life expectancy

MEC VS. NON-MEC

	MEC	Non-MEC
Tax-Deferred Cash Value Growth	Yes	Yes
Tax-Free Death Proceeds	Yes	Yes
Tax-Free Policy Loans	No	Yes
Tax-Free Withdrawals to Basis	No / LIFO	Yes / FIFO
Avoids 10% Penalty on Withdrawals and Loans	No / LIFO	Yes / FIFO
Initial Death Benefits	Low minimums to qualify as insurance	Higher due to premium payment structure
1035 Exchange Charge/Restrictions	Typical (15 years)	Possibly

A MEC provides higher cash yields and lower death benefits

NON-MEC BOLI ALTERNATIVE

An alternative to using a Single Premium MEC product for a BOLI/COLI purchase is to use an **annual premium, non-MEC product**. Non-MEC BOLI/COLI requires a substantially lower up-front cash commitment, which allows companies experiencing lower liquidity the opportunity to use this financing tool. The annual premium product still has a tax-free death benefit, which can be used to recover the cost of benefits and premiums paid, but has smaller equal premium payments spread out over several years. Additionally, the company has tax-free and MEC penalty tax-free, access to the policy cash values at any time. It is a benefit to have the cash values available if needed, however, paying retirement benefits with company earnings is more efficient than using the cash value.

ADVANTAGES TO ANNUAL PREMIUM, NON-MEC

- Lower annual payments to help free up liquidity
- Higher initial death benefit amount than with the single premium product
- Able to pay retirement benefits from policy cash value (tax free)
    - Withdrawals of cash up to basis without income tax nor MEC penalty
    - Loans against policy gain without penalty
- Ability to change the insured on an inforce policy
    - For banks with a young workforce this is ideal where some turnover is likely

DISADVANTAGES TO ANNUAL PREMIUM, NON-MEC

- Commitment to paying an annual premium
- Slightly lower initial yields than single premium product
- Potential need for insured to go through medical underwriting (versus Guaranteed Issue underwriting) due to higher initial death benefit levels

Non-MEC BOLI/COLI requires a lower up-front cash commitment, which allows companies experiencing lower liquidity the opportunity to use this financing tool.

CONCLUSION

The annual premium non-MEC product gives the business more flexibility in times of lower liquidity and allows for an easy change of insured option. The initial investment is much smaller than a single-premium product and provides the business the same options. The business must be prepared to make all annual premium installment payments to realize benefits and yields. BOLI/COLI is a great option to consider when thinking of key employees, liquidity and the return of investments for the company. The following pages provide examples of annual premium BOLI purchases, with the company paying SERP benefits from company earnings and the policy cash value.

SAMPLE ANNUAL PREMIUM BOLI PURCHASE

SERP Assumptions:

Company Pays SERP Benefit from Company Earnings

Retirement Age: 65 | Annual Benefit: $100,000 | Benefit Duration: 10 Years

Age	Annual Outlay	Illustrated Net Cash Value	Illustrated Cash Value Yield	Tax Equivalent Yield*	Illustrated Death Benefit	Annual Retirement Benefit
50	($50,000)	$51,686	3.37%	4.68%	$931,514	$0
51	(50,000)	104,652	2.92%	4.05%	931,514	0
52	(50,000)	158,279	2.35%	3.26%	931,514	0
53	(50,000)	212,815	2.18%	3.02%	931,514	0
54	(50,000)	268,235	2.06%	2.86%	931,514	0
55	(50,000)	324,749	2.05%	2.84%	931,514	0
56	(50,000)	382,497	2.07%	2.87%	931,514	0
57	0	395,934	3.51%	4.88%	931,514	0
58	0	409,991	3.55%	4.93%	933,986	0
59	0	424,678	3.58%	4.98%	939,242	0
60	0	440,024	3.61%	5.02%	945,211	0
61	0	458,195	4.13%	5.74%	956,407	0
62	0	477,055	4.12%	5.72%	968,188	0
63	0	496,604	4.10%	5.69%	980,579	0
64	0	516,861	4.08%	5.67%	993,525	0
65	0	537,842	4.06%	5.64%	1,007,007	100,000
66	0	559,569	4.04%	5.61%	1,020,981	100,000
67	0	582,054	4.02%	5.58%	1,035,352	100,000
68	0	605,319	4.00%	5.55%	1,050,154	100,000
69	0	629,677	4.02%	5.59%	1,065,786	100,000
70	0	654,843	4.00%	5.55%	1,081,849	100,000
71	0	680,785	3.96%	5.50%	1,098,306	100,000
72	0	707,398	3.91%	5.43%	1,115,260	100,000
73	0	734,628	3.85%	5.35%	1,132,549	100,000
74	0	762,467	3.79%	5.26%	1,150,147	100,000
75	0	790,942	3.73%	5.19%	1,168,080	0
80	0	944,421	3.51%	4.87%	1,267,016	0
85	0	1,109,769	3.11%	4.32%	1,379,417	0
90	1,474,182	0	18.36%	25.50%	0	0
PV	($94,383)					

Cost Recovery of premiums, interest, and benefits paid

Paid from Company Earnings

**Assumes 28% Tax Rate; 5% cost of money.*
Insurance values based on non-guaranteed 4.75% Tier 1 Interest crediting rate. Assumes Age 50, Premier, Non-Tobacco UW status.
Retirement benefits paid from company earnings; Premiums and SERP benefits recovered from death benefit proceeds.

SAMPLE ANNUAL PREMIUM BOLI PURCHASE

SERP Assumptions:

Company Pays SERP Benefit from Policy Cash Values

Retirement Age: 65 | Annual Benefit: $100,000 | Benefit Duration: 10 Years

Tax-free policy withdrawals to make after-tax benefit payments

Age	Annual Outlay	Illustrated Net Cash Value	Illustrated Cash Value Yield	Tax Equivalent Yield*	Illustrated Death Benefit	Annual Retirement Benefit
50	($85,000)	$87,954	3.48%	4.83%	$1,583,604	$0
51	(85,000)	178,089	2.97%	4.12%	1,583,604	0
52	(85,000)	269,350	2.38%	3.31%	1,583,604	0
53	(85,000)	362,159	2.20%	3.06%	1,583,604	0
54	(85,000)	456,467	2.08%	2.89%	1,583,604	0
55	(85,000)	552,647	2.06%	2.87%	1,583,604	0
56	(85,000)	650,929	2.08%	2.89%	1,583,604	0
57	0	673,890	3.53%	4.90%	1,583,604	0
58	0	697,910	3.56%	4.95%	1,589,880	0
59	0	723,003	3.60%	4.99%	1,599,034	0
60	0	749,220	3.63%	5.04%	1,609,392	0
61	0	780,246	4.14%	5.75%	1,628,634	0
62	0	812,447	4.13%	5.73%	1,648,869	0
63	0	845,826	4.11%	5.71%	1,670,140	0
64	0	880,414	4.09%	5.68%	1,692,355	0
65	72,000	841,168	4.05%	5.63%	1,583,604	100,000
66	72,000	799,945	4.00%	5.56%	1,511,604	100,000
67	72,000	756,633	3.94%	5.47%	1,439,604	100,000
68	72,000	711,122	3.87%	5.37%	1,367,604	100,000
69	72,000	663,759	3.85%	5.35%	1,295,604	100,000
70	72,000	613,935	3.75%	5.20%	1,223,604	100,000
71	72,000	561,434	3.60%	5.00%	1,151,604	100,000
72	72,000	505,928	3.37%	4.68%	1,079,604	100,000
73	72,000	446,769	2.96%	4.11%	1,003,363	100,000
74	72,000	383,561	2.35%	3.26%	921,024	100,000
75	0	391,845	2.16%	3.00%	909,858	0
80	0	426,759	1.37%	1.90%	839,109	0
85	0	441,110	0.18%	0.24%	735,155	0
90	617,835	0	40.67%	56.49%	0	0
PV	**($147,873)**					

**Assumes 28% Tax Rate; 5% cost of money.*
Insurance values based on non-guaranteed 4.75% Tier 1 Interest crediting rate. Assumes Age 50, Premier, Non-Tobacco UW status.
Retirement benefits paid from company earnings; Premiums and SERP benefits recovered from death benefit proceeds.

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Pat is a Co-Owner and Managing Director of Executive Benefits Network and a 19-year veteran of the financial services industry. Prior to entering the financial services industry, Pat worked as a senior accountant in audit for KPMG in the bank service area and as an attorney for Michael Best & Friedrich LLP where he concentrated on general corporate and securities law. Pat's career focus is in the BOLI/COLI marketplace, as well designing creative strategies for executive compensation planning, business succession planning and estate planning. Pat is a shareholder and Director of a bank in Iowa and is an active member in the State Bar of Wisconsin. He is a frequent speaker in industry meetings and seminars. He is a member of the Community Bankers of Iowa, Iowa Bankers Association and Wisconsin Bankers Association.

ABOUT EXECUTIVE BENEFITS NETWORK (EBN):

As the leading industry advisor, EBN specializes in the customized design, administration, and informal financing of Nonqualified Executive Compensation and Benefit Plans (Deferred Compensation Plans), as well as the procurement of Bank Owned Life Insurance (BOLI) programs to attract, retain, and reward key executive talent. We emphasize the importance of education and build long-lasting relationships with clients in all 50 states, and we have access to the highest rated insurance companies in the nation. Lastly, we believe that no two companies are alike in their needs; therefore, customization of executive benefit and compensation plans is paramount to a successful program.

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