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MEMORANDUM

December 8, 2004

To Our Clients and Friends

Re: Agencies' Statement on Bank-Owned Life Insurance

The Federal banking agencies¹ (the "Agencies") have issued a statement on practices they expect banks and savings associations to use when purchasing and holding bank-owned life insurance ("BOLI"). The guidance discusses accounting, legal, risk management and risk-based capital treatment for BOLI.

The Agencies' statement discusses the legal underpinning for BOLI. While the ability of state-chartered banks to purchase BOLI is governed by state law, state banks may engage in activities or make investments that are not permissible for national banks only if they obtain the consent of the FDIC. The guidance indicates that national banks and federal savings associations may hold equity-linked variable life insurance policies only for the purpose of hedging their equity-linked obligations under employee benefit plans.

The statement discusses procedures a depository institution must follow when considering the purchase of BOLI. The institution must conduct a thorough analysis of its needs and perform a credit analysis of the companies from which the insurance will be purchased. The Agencies indicate that generally it is not prudent to hold BOLI with an aggregate cash surrender value that exceeds 25 percent of the institution's Tier 1 capital. Any amount in excess of this limit must be approved by the institution's board or board committee.²

The guidance also requires banks to establish a comprehensive and prudent risk management process for purchasing and holding BOLI. An institution must apply on-going risk management procedures to all holdings of BOLI regardless of when it entered into the

¹ The Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve Board, the Comptroller of the Currency and the Office of Thrift Supervision ("OTS").

² The OTS requires savings associations to obtain OTS approval before investing more than 25 percent of their total capital in BOLI.

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contracts. An institution holding BOLI in a manner inconsistent with safe and sound banking practices will be subject to supervisory action.

The statement also discusses the treatment of BOLI for risk-based capital purposes. If the BOLI is a general account insurance product (i.e., the general assets of the insurer support the policy's cash surrender value), then a 100 percent risk weight will apply for risk-based capital purposes. If the BOLI consists of a separate account,³ the guidance states that "look-through" treatment may be applied to assets in the separate account for purposes of assigning risk weights, subject to a minimum risk weight of 20 percent.

The Agencies' guidance can be found at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.

³ A separate account is a feature whereby the cash surrender value of the policy is supported by assets segregated from the general assets of the insurer. The policyholder assumes all investment risk, although the policyholder does not own the underlying separate account or control investment decisions.