BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

DIVISION OF BANKING
SUPERVISION AND
REGULATION

SR 04-19
December 7, 2004

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK

SUBJECT: Interagency Statement on the Purchase and Risk Management of Life Insurance

The staffs of the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision (the agencies) have issued the attached Interagency Statement on the Purchase and Risk Management of Life Insurance. This guidance discusses the safety and soundness and risk management implications of purchases and holdings of life insurance by banks and savings associations (institutions).

Institutions may purchase life insurance on their employees or others for several appropriate business purposes. The most common purposes for which institutions purchase bank-owned life insurance (BOLI) are to recover the cost of providing pre- and post-retirement employee benefits, to recover losses associated with the death of a key person, and to obtain insurance on borrowers.

Over the past several years, purchases of BOLI by institutions have increased steadily and significantly. This has given rise to concerns among the agencies that some institutions may not have an adequate understanding of the full array of risks posed by BOLI, including liquidity, operational, reputational and compliance/legal risks. The agencies also are concerned that some institutions may have committed a significant amount of capital to BOLI holdings without properly assessing the associated risks. Over the same period, agency staffs have noticed a significant rise in the number of inquiries pertaining to BOLI posed by supervised institutions and bank examination staff.

Such developments have highlighted the need for the agencies to enhance and harmonize their supervisory guidance on BOLI. The attached guidance is for institutions and examination staff to help ensure that risk management practices for BOLI are consistent with safe and sound banking practices.

The guidance addresses the need for both a comprehensive pre- and post-purchase analysis of BOLI risks and rewards, as well as its unique characteristics. The agencies expect institutions to have comprehensive risk management processes applicable to their BOLI purchases and holdings, including:

- Effective senior management and board oversight;

- Comprehensive policies and procedures, including appropriate limits regarding purchases; and
- An effective ongoing system of risk assessment, management, monitoring and internal control processes, including appropriate internal audit and compliance frameworks.

The guidance highlights the agencies' expectation that when an institution plans to acquire BOLI resulting in an aggregate cash surrender value in excess of 25 percent of the applicable concentration threshold, it should obtain prior approval from its board of directors or the appropriate board committee. The Federal Reserve's concentration guidelines applicable to state member banks define the capital base used to determine the concentration threshold as a percentage of Tier 1 capital plus the allowance for loan and lease losses.

The guidance also states that a "look-through" treatment may be applied to BOLI holdings in separate account assets for the purposes of assigning a regulatory capital risk weight, subject to a 20 percent risk weight floor. An institution using the look-through treatment should document its assessment, based upon applicable state insurance laws and other relevant factors, that the separate account assets would be protected from the insurance carrier's general creditors.

Reserve Banks are asked to distribute this SR letter and the attached interagency guidance to state member banks as well as to supervisory and examination staff. Questions pertaining to this letter should be directed to Barbara Cornyn, Senior Project Manager, Special Activities Section, at (202) 452-2434; Nancy Oakes, Counsel, Enforcement Section, at (202) 452-2743; Mark Van Der Weide, Senior Counsel, Legal Division, at (202) 452-2263; or William Tiernay, Supervisory Financial Analyst, Supervisory and Risk Policy Section, at (202) 872-7579.

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Director

Attachment (126 KB PDF)

Cross-references: SR letters 04-4, 94-23, and 93-37