



State of Washington
DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF CREDIT UNIONS

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DATE: July 15, 2013
TO: Washington State Credit Unions
FROM: Linda Jekel, Director
Division of Credit Unions
RE: Credit Union-Owned Life Insurance

Division of Credit Unions Interpretive Statement I-13-04 REVISED

1.0 Background

A Washington State-chartered credit union (“Credit Union”) under the Washington Credit Union Act, chapter 31.12 RCW (“State Act”), recently inquired whether it may invest in insurance policies that insure the life of one or more of its employees (in particular, so-called “key-person insurance”), which is commonly referred to as bank-owned life insurance (“BOLI”).¹ In addition, another Credit Union has recently inquired and the Director of Credit Unions has opined in regard to the permissibility of and standards for investment by a Credit Union in employee benefit plans. You may refer to the interpretive statement of the Department’s general counsel, Joseph M. Vincent, in reply to the latter inquiry,² which has been authorized by the Division of Credit Unions.

On April 24, 2013, the Director of Credit Unions issued an earlier version of this Interpretive Statement that also incorporated a lengthy discussion of employee benefits plans previously

¹ Throughout this interpretive statement, the acronym “BOLI” is used, which literally stands for “bank-owned life insurance.” However, “BOLI” is a term of art used in the financial services industry to denote the ownership of life insurance by any depository financial institution (bank, thrift, or credit union). The use of “BOLI” in this interpretive statement, where applicable, specifically refers to ownership of life insurance by a Credit Union.

² See Interpretive Statement of General Counsel (ISGC-2013-002-DCU), dated February 28, 2013 (DFI General Counsel Joseph M. Vincent), issued under authority of the Director of Credit Unions (“DFI General Counsel’s Opinion”).

addressed in Mr. Vincent’s above-referenced legal interpretation made on behalf of the Division of Credit Unions. However, upon receiving some stakeholder feedback, the Director of Credit Unions has elected to revise her earlier Interpretive Statement of April 24, 2013, and issue this revision, which is limited only to setting forth the permissibility of and standards for purchase and risk management of life insurance products (“Life Insurance Products”) — including BOLI — which specifically benefit a Credit Union rather than its employees.

1.1 Definition of Life Insurance Products. As used in this Interpretive Statement, the term “Life Insurance Products,” in relation to a Credit Union, includes, without limitation, key-person insurance, insurance to recover the Credit Union’s cost of providing pre- and post-retirement employee benefits, insurance on designated borrowers, and insurance taken as security for loans.

1.2 BOLI and Bank Investment in Life Insurance Products. Beginning in the 1990’s, a number of banks aggressively increased their holdings in BOLI. Such investment rose to a level in which a number of banks owned BOLI with an aggregate cash surrender value in excess of twenty-five percent (25%) of capital even though federal banking agencies had previously identified this capital concentration threshold as the level that banks should have considered when establishing internal limits for their BOLI holdings. Some banks acquired BOLI as part of a “yield-chasing” asset/liability management strategy in an attempt to increase earnings during periods of low interest rates and reduced loan demand. Accordingly, federal banking agencies became concerned that a number of banks had committed a significant amount of capital to BOLI without an adequate understanding of the full array of risks that it posed — especially difficult-to-measure operational, reputation, and legal risks.

Accordingly, on December 7, 2004, the four principal federal banking agencies — Office of the Comptroller of the Currency (“OCC”), the Board of Governors of the Federal Reserve System (“FRB”), the Federal Deposit Insurance Corporation (“FDIC”), and the former Office of Thrift Supervision (“OTS”)³ (collectively, “Federal Banking Agencies”) — adopted and published an *Interagency Statement on the Purchase and Risk Management of Life Insurance* (“Interagency Statement”).⁴ In the Interagency Statement, the Federal Banking Agencies reviewed the legal authority of national banks (under the National Bank Act⁵) and federal thrifts (under the Home Owners Loan Act) to purchase and hold certain types of life insurance as part of their “incidental powers” to carry on the business of banking, subject to various OCC and OTS interpretations. Under these authorities, national banks and federal thrifts have been able to purchase key person insurance, insurance to recover the Credit Union’s cost of providing pre- and post-retirement employee benefits, insurance on designated borrowers, and insurance taken as security for loans. The OCC and OTS have approved purchasing and holding of other types of life insurance

³ Under Section 312 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111–203), the OTS was merged into the OCC, and the OCC is now the primary regulator of federally chartered savings banks and savings associations under the Home Owners Loan Act of 1933, as amended.

⁴ *Interagency Statement on the Purchase and Risk Management of Life Insurance*, OCC 2004-56, December 7, 2004.

⁵ 12 U.S.C. §24 (Seventh).

products on a case-by-case basis. However, national banks and federal thrifts have been precluded from purchasing life insurance products —

- For speculation;
- To provide funds to acquire shares of stock from the estate of a major shareholder upon the shareholder's death, for the further purpose of controlling the distribution of ownership in the bank;
- As a means of providing estate-planning benefits for insiders, unless the benefit is a part of a reasonable compensation package; or
- To generate funds for normal operating expenses other than employee compensation and benefits.

Notwithstanding these previous pronouncements from the OCC and OTS, the Federal Banking Agencies came to the conclusion in 2004 that there was sufficient outstanding management risk associated with investment in BOLI to adopt and publish the Interagency Statement, which is a comprehensive roadmap for industry practices and risk management associated with the purchase and holding of life insurance products.

2.0 Issue

Under what circumstances may a Credit Union purchase and hold Life Insurance Products for its own benefit (i.e., BOLI)?

3.0 Findings and Determination

3.1 Power and Discretion to Interpret the State Act. The Director of Credit Unions has the power and broad administrative discretion to administer and interpret the provisions of the State Act to facilitate the delivery of financial services to the members of a Credit Union.⁶ In the exercise of this power and discretion, the Director of Credit Unions finds that the purchasing and holding of life insurance products for its own benefit (i.e., BOLI), as set forth in this Interpretive Statement, facilitates the delivery of financial services to members of a Credit Union.

3.2 Parity with Powers of a Federal Credit Union – “Key-Person Insurance”. Pursuant to the State Act, which accords a Credit Union the power and authority that a federal credit union had on December 31, 1993, or a date not later than July 22, 2001, without specific permission from the Director of Credit Unions,⁷ a Credit Union may purchase BOLI as “key-person insurance” in order to provide itself with protection from the loss of key personnel.

⁶ RCW 31.12.516(4).

⁷ RCW 31.12.404(1).

3.3 Purchase and Risk Management of Life Insurance Products by a Credit Union as an Exercise of Incidental Powers under the State Act – Conditions and Limitations. Pursuant to the State Act, a Credit Union may “[e]xercise such incidental powers as are necessary or convenient to enable it to conduct the business of a credit union.”⁸ Further, consistent with her power and broad administrative discretion to administer and interpret the provisions of the State Act,⁹ the Director of Credit Unions finds and determines that a Credit Union subject to the State Act may, as an exercise of *incidental powers*, purchase and hold Life Insurance Products, so long as the Credit Union conforms to all standards set forth in this Interpretive Statement, including, without limitation, the Interagency Statement issued by the Federal Banking Agencies, which is attached to and made a part of this Interpretive Statement. In addition, the Director of Credit Union recommends a State Credit Union set a concentration limit on life insurance to an overall aggregate cash surrender value (“CSV”) not to exceed twenty-five percent (25%) of its net worth and further set a concentration limit on an aggregate CSV of life insurance from any one life insurance company not to exceed fifteen percent (15%) of net worth.

3.4 Conditions of Exercise of Powers Conferred by This Interpretive Statement. While the Director of Credit Unions has determined that the purchase and holding of Life Insurance Products is a useful operational tool, the grant of powers and authorities in this Interpretive Statement requires limits and conditions. As the Federal Banking Agencies’ Interagency Statement makes clear, there are several ways in which the purchase and holding of Life Insurance Products can result in practices that are unsafe or unsound. Therefore, the Director of Credit Unions has determined that if the exercise of the powers and authorities granted by this Interpretive Statement would likely result in a Credit Union engaging an unsafe or unsound practice,¹⁰ the Director of Credit Unions may preclude a Credit Union from making such a purchase of applicable Life Insurance Products or otherwise compel a Credit Union to divest of its holdings therein, or, in the alternative, direct a Credit Union to conduct itself consistent with the Federal Banking Agencies’ Interagency Statement.

3.5 Future Guidance. Notwithstanding the findings and determination contained in this Interpretive Statement, the Director of Credit Unions may, from time to time, issue guidance with respect to the policies contained herein.

4.0 Conclusion

This Interpretive Statement is effective immediately, and shall thereafter be applicable to all Credit Unions organized under the State Act, similarly situated.

For any questions concerning this Interpretive Statement, contact Linda K. Jekel, Director of Credit Unions, at linda.jekel@dfi.wa.gov, or (360) 902-8778.

⁸ RCW 31.12.402(24).

⁹ RCW 31.12.404(1).

¹⁰ See RCW 31.12.005(26).