

MEMORANDUM

TO: North Dakota State-Chartered Banks

FROM: Department of Financial Institutions

SUBJECT: Bank-Owned Life Insurance on Employees or Directors

DATE: March 26, 2021

Life insurance products can serve a number of appropriate business purposes and may be used to offset risks and costs incurred by a bank. These products exhibit characteristics that are different than other bank assets; therefore, the reasons for purchasing, your due diligence process, and ongoing monitoring of life insurance are governed by separate rules and an interagency policy statement to address oversight and risk management processes.

Bank-owned life insurance (BOLI) is addressed by [North Dakota Administrative Code \(NDAC\) § 13-02-14](#), which was last amended April 1, 2003. Although this statute pre-dates the [Interagency Statement on the Purchase and Risk Management of Life Insurance 2004-56](#), the Department's rules are consistent with this statement.

A question the Department occasionally receives is whether a bank can continue to hold life insurance on an employee or director after that person is no longer with the bank. That depends on the purpose, whether the policy is for a key person or in connection with compensation and benefit plans.

Key Person:

If the policy is key person insurance held to compensate the bank for the loss of the key person, the bank cannot hold the life insurance in excess of their risk of loss to be covered. Therefore, once the key person retires, resigns, is discharged, or leaves for any other reason, the risk of loss is eliminated, and the bank cannot hold key person insurance on that person. NDAC § 13-02-14-03(7) states: "The bank's authority to hold life insurance on any key person ceases when the key person is no longer employed by the bank, or no longer meets the definition of key person." The documentation requirement for key person insurance is outlined in NDAC § 13-02-14-05(1): "In purchasing life insurance for key person purposes, the bank's board of directors must adequately document in its minutes the basis for its insurable interest and the basis for the amount of insurance. The bank's board of directors must also document in its minutes the basis for determining how that employee or director meets the definition of a key person."

Compensation and Benefit Plans:

If the life insurance was held by the bank as a financing or cost recovery vehicle for pre- and post-retirement employee benefits such as individual or group life, health, dental, or vision insurance or

tuition reimbursement, deferred compensation, and pension benefits, the life insurance can be held by the bank even after the employer's relationship with the insured employee is terminated. NDAC § 13-02-14-03(8) states: "The bank's authority to hold life insurance on a director ceases when that director is no longer a member of the board of directors and there is no liability or obligation under director compensation and benefit plans." Therefore, as long as there is a continued liability or obligation, the bank can continue to hold the policy. Furthermore, NDAC § 13-02-14-03(10) states: "In purchasing life insurance in connection with employee compensation and benefit plans, the bank may retain the policies after the insured's employment is terminated, provided the bank has continuing liabilities or obligations under such plans." The documentation requirement outlined in NDAC § 13-02-14-05(2) is: "In purchasing life insurance in connection with compensation and benefit plans for employees, officers, and directors, the bank's board of directors must approve and document such plans or programs including the reasonableness of the plans or programs."

Page 23 of the 2004 Interagency Policy Statement says in part: "In these arrangements, an institution insures the lives of directors or employees in whom it has an insurable interest to reimburse the institution for the cost of employee benefits. The group of insured individuals may be different from the group that receives benefits. The institution's obligation to provide employee benefits is separate and distinct from the purchase of the life insurance. The life insurance purchased by the institution remains an asset even after the employer's relationship with an insured employee is terminated. The employees who receive benefits, whether insured or not, have no ownership interest in the insurance (other than their general claim against the institution's assets arising from the institution's obligation to provide the stated employee benefits)."

On November 13, 2003, the State Banking Board discussed at length whether NDAC § 13-02-14-03(10) supports the proposition that a bank may buy BOLI to offset or recover employee benefit costs for all bank employees. The consensus of the Board was that this is indeed the case. One member did emphasize the need for documentation and asked "to make sure if the State Banking Board says this is authorized and during an examination a bank would have to defend its purchase of BOLI for purposes of covering rank and file employee benefits."

Potential Reputation Risks:

Holding a policy on a former employee even if part of a larger employee benefits plan may subject the bank to reputational risks, creating the perception that the bank unjustly benefited upon the death of the individual. The Department recommends as a best practice that the bank, when purchasing the policy, obtain written consent from the insured to hold the policy during and after employment with the bank. This makes clear the insured was aware of, and consented to, the policy.

Examinations:

During examinations, examiners will continue to review BOLI programs to ensure compliance with the North Dakota Administrative Code, and other applicable risks as outlined in the 2004 Interagency Policy Statement. The Board and/or management should perform a review before purchase and annually thereafter to ensure continued conformity and retain documentation for examiners to review during regulatory examinations.