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BOLI Carriers Prepare for COVID-19 Impact

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Purchases of bank-owned life insurance were strong in 2019 as bankers capitalized on its attractive yields relative to other investments available to banks.

What 2020 holds remains to be seen, given trends in the market and broader economy. **Total BOLI purchases likely could be lower this year, as carriers are generally not willing to accept large premiums from a single policyholder**. However, BOLI activity in the $10 million and under purchase size may be similar to 2019 levels. At the close of the first quarter, it is too early to know the full impact of COVID-19, but we have a few observations based on discussions with several major BOLI carriers:

1. **The carriers have not priced in any risk premium for potentially higher mortality rates and do not expect to do so**. In addition, the carriers do not expect to tighten the requirements to obtain guaranteed issue underwriting. In a guaranteed issue BOLI case, the insureds answer several questions, but no physicals are required. Guaranteed issue underwriting can be obtained with as few as 10 insureds.
2. **It is virtually impossible for carriers to find fixed income investments that produce yields that approximate the yield on the existing portfolio**, given that short-term interest rates have dropped to near zero and the 10-year Treasury declined from 2.49% on April 1, 2019 to 62 basis points a year later.
3. **While carriers continue to accept new BOLI premium**, some are reluctant to take a large premium from any one customer to avoid diluting the portfolio for existing policyholders. Movements in the yield of the portfolio tend to lag the market because carriers' portfolios are very large (often $50 billion to $200 billion) and generally have a duration of five to 10 years. For this reason, current crediting rates for several carriers remain above 3%.
4. **Several carriers indicated that they started reducing credit exposure and increasing asset diversification several years ago**. While they did not anticipate a pandemic, the market had been good for so long and they thought it would be wise to start reducing the risk in the portfolio ahead of a potential downturn. In addition, credit spreads had also narrowed, so there was less reward for additional risk.
5. **Carriers primarily invest in fixed-income investments**; a decline in the stock market has minimal impact on most carrier investment portfolios.

BOLI Growth In 2019

BOLI purchases totaled $4.3 billion in 2019, an increase of 147% over the 2018 total, according to IBIS Associates, an independent market research firm. The total represents the third-highest amount of BOLI purchases in the past dozen years.

It's even more impressive when considering that most banks continued to have strong loan demand and less liquidity than in most previous years. At year-end 2019, BOLI cash surrender value (CSV) held on the balance sheets of U.S. banks totaled $178 billion, according to the December 2019 NFP-Michael White report.

Robust BOLI activity has been driven by attractive tax-equivalent yields, strong credit quality and leverage ($1 invested in BOLI typically returns $3 to $4 of tax-free death benefits). **Banks can use BOLI as a way to retain key employees by providing life insurance benefits or informally funding nonqualified benefit plans**; BOLI earnings can also be used to offset and recover health care and 401(k) or other retirement plan expenses.

According to the IBIS report, 77% of 2019 BOLI purchases were for general account, 22% for variable separate account and just 1% was for hybrid separate account. In general account policies, the general assets of the insurance company issuing the policies support the CSV. In variable separate and hybrid separate products, the CSVs are legally segregated from the general assets of the carrier, which provides enhanced credit protection in the event of carrier insolvency. The credit risk and price risk of the underlying assets remain with the policyholder in a variable policy, whereas the carrier retains those risks in a general account or hybrid policy.

Purchases of variable separate accounts dominated the market in 2006-07; since that time, general account BOLI has typically led the way. This is due to the simplicity of general account products relative to variable separate products as well as the increased product options, generally higher yields, and the high comfort level bankers have with the creditworthiness of mainstream BOLI carriers.

According to the IBIS data, 2019 general account BOLI purchases were at their highest level in the last 16 years. According to the NFP-Michael White report, 3,346 banks — representing 64.6% of all US banks — now hold BOLI assets. This is an increase from the 64.1% of banks that held BOLI at the end of 2018. Seventy-one percent of banks with over $100 million in assets hold BOLI; 77.3% of banks with over $300 million in assets do.

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