

The Purchase of BOLI Post Tax-Reform

For many decades, banks of all sizes have used bank-owned life insurance (BOLI) as an efficient tool for offsetting employee benefit cost. Today, over \$189 billion of BOLI resides on U.S. bank balance sheets.¹

Life insurance has, and continues to enjoy, certain tax advantages. BOLI cash values grow tax-deferred and claim proceeds are typically received tax free. With the passage of the Tax Cuts and Jobs Act of 2017, the reduction in corporate income tax rates to 21% caused some to question whether BOLI was still a viable asset for bank consideration.

Despite the reduction of corporate tax rates, tax-equivalent yields remain higher than many other bank-eligible assets. Newport Group continues to see banks seeking BOLI because it provides an attractive alternative to typical bank assets. Yields on new BOLI purchases currently range from 3.25% to 4.00%, resulting in tax equivalent yields ranging from 4.11% to 5.06% (assuming a 21% tax rate).²

A general account BOLI policy can give a bank access to the performance of an insurance carrier's general account, which can invest in asset classes not typically available to a bank. This performance is even more attractive when considered with the strong credit characteristics of a typical BOLI policy. Ratings for BOLI insurance carriers range from A to Aaa (Moody's).

Modern separate account products offer access to wide variety of sub-account choices managed by name-brand investment managers. These products can carry risk-weightings as low as 20%.

With continued interest rate increases on the horizon, BOLI's attractiveness should continue to grow. Although product expenses are typically fixed, gross BOLI rates will generally increase as market rates rise. Also, the value of BOLI's tax arbitrage will grow as BOLI yields increase. For example, at current rates, a 4.00% net cash value yield results in taxable equivalent yield of 5.06%. An increase to the net yield of 100 basis points represents increase to the taxable equivalent yield of 127 basis points, demonstrating the expanding value of the tax arbitrage in a rising rate environment.

Recent BOLI purchase activity remains strong. During Q1 2018, 84 banks made BOLI purchases totaling \$482 million of new premium¹, and we expect this trend to continue. Given the consistent high income produced by BOLI policies through high-quality credit exposure, BOLI remains an asset class banks should consider.

Footnotes

¹Source: BOLItracker™ as of 3/31/2018

²As of 3/31/2018

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