INTERPRETIVE LETTER 90-19 (SEPTEMBER 14, 1990)

State bank may purchase insurance contracts for legitimate insurance purposes but not for investment purposes.

Your letter dated * and addressed to * has been referred to me for response. Attached to your letter were documents involving two programs, one from Program One ("P1") and one from Program Two ("P2"). You asked that this Office review those documents and provide an opinion about the programs described in the documents.

First, I will address the P1 proposal. As I understand the P1 proposal, the bank would be taking out a life insurance policy on a bank director, officer or employee. The bank would make annual premium payments of *. The bank would realize some return on the premiums invested in the insurance policy.

It is the position of this Office that insurance products are not a permissible investment vehicle for state banks under the Illinois Banking Act. State banks are authorized to invest only in "marketable investments securities" as described in Section 33 of the Illinois Banking Act. Insurance policies do not qualify as marketable investment securities. The only way in which the bank would be justified in contracting with P1 to purchase this insurance policy is if the bank could justify the policy as meeting a legitimate insurance need that the bank has relative to the director, officer or employee whose life is covered by the policy. In other words, the bank could only purchase such an insurance policy if it could justify that the proceeds paid by the insurance company upon the death of an insured director, officer or employee are necessary to offset the business loss which the bank would suffer as a result to the death of a valued director, officer or employee. If it is not reasonable to construe the P1 proposal as a legitimate insurance product which the bank needs to protect itself against the loss of the director, officer or employee, then this Agency would consider the bank's investments in the P1 proposal as being investments in an unauthorized investment vehicle (i.e., not a marketable investment security). Also, if the bank does believe it can justify the P1 proposal as meeting a legitimate insurance need, it would of course be expected that the bank would be the beneficiary under the policy.

With respect to the P2 proposal, this proposal is described as a "death benefit only fringe benefit...a non-qualified plan consisting of an employer's unsecured promise to pay an executive's beneficiary a benefit upon the executive's death. While the benefit can be a lump sum payment, it usually takes the form of a salary continuation plan at death, in which the deceased executive's salary is paid to the beneficiary (usually spouse) for a stated period of time...." This P2 proposal appears to be distinguishable from the P1 proposal because the P2 proposal is designed as an employee benefit plan, whereas the P1 proposal appears to be a plan to insure the bank against the loss of a key director, officer or employee. Both proposals have certain investment return incentives for the bank. However, as stated previously in this letter, there is no statutory authority for a state bank to invest in an insurance policy for investment rather than legitimate insurance purposes.

There is statutory authority for a bank to fund a program for the benefit of its directors, officers and employees. Under Section 5(5) of the Illinois Banking Act, a state bank is authorized "to adopt and operate reasonable bonus plans, profit-sharing plans, stock-bonus plans, stock-option plans, pension plans and similar incentive plans for its directors, officers and employees." The P2 proposal appears to be a method by which a state bank can fund an employee benefit program which would be authorized under Section 5(5). Again, however, the funding of this benefit plan by the bank must be reasonable. To be a reasonable employee benefit plan, the payments made to the director, officer or employee upon his or her retirement or payments made to the beneficiary of the director, officer or employee upon his or her death must be reasonable compared to the compensation that the director, officer or employee was earning while in the employment of the bank. If the bank is investing amounts in the P2 proposal which will provide for reasonable payments as a retirement program or employee incentive program, the investment in the P2 proposal would be justified under Section 5(5). If the investments in the P2 proposal are entirely disproportionate to a reasonable retirement or employee incentive program, and it appears that the investments in the P2 program are being made for the investment opportunity rather than for a reasonable retirement program or employee incentive program, then the investments in the P2 proposal would not be authorized for the same reasons that investments in the P1 proposal would not be authorized.

[Note: The Agency has issued Examination Guidelines for the purchase of life insurance policies for noninvestment purposes by state banks.]