

## **INTERPRETIVE LETTER 95-2 (APRIL 19, 1995)**

### **A state bank is not authorized to retain life insurance policy on life of retired director once legitimate insurance need is eliminated.**

In your letter dated \*, you requested this Agency's approval for \* ("Bank") to retain life insurance policies on five retired directors. As discussed below, it is the position of this Agency that Bank is not authorized to retain the insurance policies in question.

As we understand the relevant facts, Bank owns six "whole life" life insurance policies that were issued in \*. One of those policies is written on the life of Bank's current Chairman of the Board and President. The other five policies are written on the lives of retired directors. The sum of the annual premiums for the six policies is \$\*. The six policies have an aggregate face value of \$\* and an aggregate cash value of \$\*. The aggregate cash value increases annually by \$\*.

Because Bank has an insurable interest in its Chairman of the Board and President, we do not question the authority for Bank to retain that insurance policy at this time. See enclosed Interpretive Letters No. 90-19 (issued September 14, 1990) and No. 91-8 (issued April 11, 1991). The issue is whether Bank is authorized to retain the insurance policies on the lives of the five individuals who are no longer officers or directors of Bank.

State-chartered banks are authorized to purchase and hold insurance policies only for legitimate insurance needs. Once the identifiable insurance need is no longer present, the state-chartered bank's remaining interest in the insurance policy is related solely to anticipated financial benefits that may result from the continuation of the policy. Such "investment" incentives do not provide authority for banks to retain insurance policies as assets.

The position stated in the preceding paragraph is similar to the one taken by the federal Office of the Comptroller of the Currency ("OCC") with respect to national banks. OCC Banking Circular 249 addresses the circumstances under which a national bank may purchase and hold a life insurance policy. In describing a national bank's authority to hold "keyperson" life insurance policies on the lives of officers and directors, Banking Circular 249 states:

The bank's authority to hold life insurance on a keyperson lapses if the individual, because of retirement, resignation, discharge, change of responsibilities, or for any other reason, is no longer a keyperson for the bank. The desire to obtain the return of the premium paid, interest, or dividends on the policy does not provide an independent basis under 12 U.S.C. ' 24(7) and Interpretive Ruling 7.7115 for

retaining life insurance on an individual who no longer qualifies as a keyperson. Therefore, the economic consequences of terminating the insurance, or the ability to transfer the coverage to another keyperson, should be considerations in selecting a keyperson insurance policy.

Similarly, life insurance policies purchased by national banks in connection with employee benefit plans may not be retained once their insurance purpose has expired. In this regard, Banking Circular 249 states:

Life insurance purchased in connection with compensation agreements and benefit plans must comply with non-investment test (B) of these guidelines. Such policies may be held *for as long as the bank continues to have any liability under the compensation or benefit plans* for which the policies were initially purchased. A bank may, therefore, purchase insurance on a group of persons and continue to hold the insurance *as long as it has any liability under the associated compensation or benefit plan.* (emphasis added)

The fact that Bank might realize a financial gain by retaining the five insurance policies on the retired directors does not justify the retention of those policies. Once the legitimate insurance need is no longer present, the insurance policy is essentially a non-conforming asset, comparable to shares of corporate stock that Bank may acquire in collection of a loan on which the borrower defaulted. In both situations, Bank initially acquired the asset for a lawful purpose but lacks the authority to hold the asset indefinitely. Bank's obligation is to divest the non-conforming asset in a reasonably prompt manner.