

MCUL AC&E 2014
Split Dollar Collateral – Part 2

Michigan Credit Union League & Affiliates
Annual Convention and Exposition
Helping Credit Unions Serve, Grow and Remain Strong #mculace

Split Dollar Collateral (Part Two)

Presented by:
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Opening Comments

John Kolhoff, DIFS
Robin Hoag, Doeren Mayhew
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John J. Kolhoff
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Due Diligence



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Purchase and Risk of Life Insurance

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- DIFS' Office of Credit Unions is adopting the December 07, 2004 Interagency Statement on the Purchase and Risk Management of Life Insurance (issued jointly by the OCC, FRB, FDIC, and OTS), which outlines important due diligence and risk management considerations and practices

FDIC Federal Deposit Insurance Corporation 100 17th Street, NW, Washington, D.C. 20429-9999	Financial Institution Letter FIL-127-2004 December 7, 2004
BANK-OWNED LIFE INSURANCE Interagency Statement on the Purchase and Risk Management of Life Insurance	
Summary: The federal banking agencies are providing guidance on the safe and sound banking practices they expect institutions to employ for the purchase and ongoing risk management of bank-owned life insurance.	
Distribution: FDIC-Insured Banks Suggested Routing: Chief Executive Officer Chief Financial Officer Chief Risk Officer Related Topics: Sections 34 of the Federal Deposit Insurance Act and Part 302 of the FDIC's Regulations Attachments: Interagency Statement on the Purchase and Risk Management of Life Insurance Living Example Summary Contact: FDIC Regional Accountant or Christine M. Roper, Policy Analyst, Division of Supervision and Consumer Protection 202-493-7200, chrisroper@fdic.gov	Highlights: <ul style="list-style-type: none">• Institutions should have a comprehensive risk management process for purchasing and holding bank-owned life insurance (BOLI).• The safe and sound use of BOLI depends on effective senior management and board oversight.• Institutions should establish policies and procedures governing their BOLI holdings, including meaningful risk limits.• A sound pre-purchase analysis helps ensure that institutions understand the risks, rewards and unique characteristics of BOLI.• Institutions also should monitor BOLI risks on an ongoing basis subsequent to purchase.

www.fdic.gov/news/news/financial/2004/fil12704.html

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Tax Compliance

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- Comply with all IRS provisions Sec 457 (f), 409 (a) and maintain documented evidence of compliance
 - Obtain counsel opinion from an attorney retained by the credit union certifying compliance with all applicable laws, rules, and regulations



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Evidence of Proper Valuation

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- Required evidence of proper valuation may include:
 - Biennial actuarial estimates and annual CPA review/validation of accounting/expense recognition/tax reporting, including consideration of any changes in circumstances
 - Risk of forfeiture
 - Constructive receipt
 - Plan distributions
 - Pay out periods
 - Note with recourse



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Accounting & Reporting	MCUL AC&E 2014 Split Dollar Collateral		
<ul style="list-style-type: none">• Accounting and reporting treatment will depends upon the type and structure of the investments and the specific provisions of each deferred compensation agreement.<ul style="list-style-type: none">• Cash surrender values• Insurance premiums invested• Loan outstanding based on premiums paid			
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Accounting & Reporting	MCUL AC&E 2014 Split Dollar Collateral		
<ul style="list-style-type: none">• Board must evaluate financial effects and risks under all reasonable investment performance and employment scenarios<ul style="list-style-type: none">• Voluntary/involuntary termination• Upon/prior to retirement• Disability of employee• Etc.			
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Accounting Requirements	MCUL AC&E 2014 Split Dollar Collateral
<ul style="list-style-type: none">• Generally accepted accounting principles are required for accounting purposes.• Single plans fall under ASC 710-10-25-9• Plans for multiple employees with similar design and benefits structure are considered a form of pension plan and for accounting fall under ASC 715• Life Insurance Owned = Cash Surrender Value (ASC 325-30-05-3 and ASC 325-30-20)	
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Accounting & Reporting	MCUL AC&E 2014 Split Dollar Collateral
<ul style="list-style-type: none">• For investments classified as Held to Maturity, any deficiency between the investment's book value (including accrued interest, if applicable) and the present liquidation value shall be included in the Appropriation for Non-Conforming Investments.• For investments classified as Available for Sale, the difference is reflected in the unrealized loss account.	
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Endorsement Split Dollar Plans

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- Credit union and employee possess rights to different parts of investment (insurance premiums) principal, income stream, or cash flow
- If your credit union is considering entering into a split-dollar life insurance arrangement, consult qualified tax, insurance, and legal advisors independent of the insurance issuer



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Collateral Assignment Split Dollar Plans (CASD)

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- Security interest in a life insurance policy to extend credit on terms that excuse the borrower from making interest and principal payments during the life of the borrower.
 - Loan to CEO to pay insurance premiums
- Extensions of credit secured by life insurance may be made to an executive



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Collateral Assignment Split Dollar Plans (CASD)

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- Plan design and terms must be consistent with safe and sound practices (refer to the risks previously discussed in this presentation.)
- Due diligence and added controls are warranted to manage the unique risks involved



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CASD Loans

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- May only be made to employee
- Loans issued subsequent to employment, other than to complete a pre-existing arrangement, are inappropriate



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CASD Regulatory Implications

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- Investment is not directly purchased and owned by the credit union, the authority to purchase otherwise impermissible investments under the Michigan Credit Union Act (MCUA) Section 401(2)(ss) does not apply
- Loans executed to fund deferred compensation arrangements (including premiums for life insurance products); the aggregate loan limit established by MCUA Section 423(12) does apply

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CASD Regulatory Implications

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- Unfunded commitments must be included when determining compliance with the aggregate loan limit prescribed by MCUA Section 423(12) and reported accordingly on the call report. CASD loans shall also be included in 'Loans to Officials', pursuant to Call Report instructions



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CASD Regulatory Implications

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Example

- Premium loan annual premium at \$300,000/year over 10 years
- In year one after first payment, the unfunded value is \$2,700,000



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CASD Recourse Provisions

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- CASD agreement requires employee to repay the employer irrespective of the collateral assigned, the employee loan is collectible and the employer intends to seek recovery beyond the cash surrender value of the collateral, the loans may be recorded at face-value with corresponding accrued interest (if applicable).
- Board is responsible for maintaining current documentation to support underwriting decision including, at a minimum, the aforementioned factors.






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CASD Accounting & Reporting		MCUL AC&E 2014 Split Dollar Collateral
<ul style="list-style-type: none">• When determining collectability, consideration of 'capacity and intent' to repay must include:<ul style="list-style-type: none">• Borrower's responsibilities/obligations under varying employment scenarios,• Borrower's verified repayment capacity from earnings and/or unencumbered assets pledged, and• Presence/absence of a structured repayment plan.		
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CASD Accounting & Reporting		MCUL AC&E 2014 Split Dollar Collateral
<ul style="list-style-type: none">• Borrower's (employee) must be able to demonstrate capacity and intent to repay• Must demonstrate capacity<ul style="list-style-type: none">• Personal investments and assets• Asset should be recorded at collateral liquidation value, Cash Surrender Value (CSV)• Accrued interest only recorded if/when received or substantiated by the increased value of underlying collateral<ul style="list-style-type: none">• For most plans, value is based on CSV of the life insurance policy		
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CASD Accounting & Reporting

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- Adjustments to regulatory capital and net worth may occur for any deficiency between the credit union's recorded asset(s) and the underlying collateral value.



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Board Responsibilities

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- Board is responsible for:
 - Ensuring and documenting due diligence in the bulletin
 - Gain understanding of the nature and risks associated with the individual CASD arrangement and that appropriate reserves are maintained on CASD credit arrangements

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CASD Loan Arrangements

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- Not designed to be paid upon employment separation or according to a reasonable and timely liquidation plan upon separation
- Board shall maintain documentation demonstrating due diligence has been exercised in the evaluation and control of risks associated with maintaining the CASD arrangement beyond employment separation
- Due diligence shall include legal, accounting, and regulatory capital requirements



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CASD Loan Arrangements

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- Impact on future executive recruiting
- Loan covenants should exist, requiring the borrower to provide periodic updated financial capacity and collateral information necessary for ongoing evaluation of the asset



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CASD Related Collateral Assignments

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- Clearly documented, validated by the investment issuer with effective controls
- Ensure independent monitoring and risk management of the underlying collateral by the credit union throughout the loan's duration
- CASD loans where borrower/employee is not the insured, are considered an **unsafe** and **unsound activity**

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Accounting & Financial Implications

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- Split dollar life insurance
- Collateral assigned life insurance
- Deferred compensation without insurance
- Prefunded or no cash funding



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Questions?



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Thank you

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