COLI and Why It Might be Appropriate for Your Business

Owning and operating a business is complex because there are so many moving parts, considerations, and decisions to make. Some of the biggest issues involve employee hiring and retention, business succession, and executive and employee benefits programs. Many of the planning strategies that impact those issues require proper funding, and typically, that funding is done through corporate-owned (or company-owned) life insurance policies, also known as COLI.

COLI policies are permanent life insurance policies, such as whole life insurance, owned by the company, on the lives of its executives and key employees. Whole life insurance has an investment component (or cash value) as well as a death benefit. Cash values and death benefits are guaranteed at a certain level as long as premiums are paid. Non-guaranteed values may be significantly higher. Cash values grow on a tax-deferred basis (i.e., there are no income tax consequences to the company during cash value accumulation, unlike growth of other investments such as CDs and mutual funds). As a result, COLI can also help the balance sheet of the company and provide an option for investing company cash in assets other than taxable investments.

Indeed, many corporations and banks in this country invest in COLI (or bank-owned life insurance known as BOLI).

According to the Newport/PLANSPONSOR *Executive Benefits Survey, 2020 Edition*,[1] 63 percent of companies surveyed funded their nonqualified deferred compensation plans with COLI. The companies surveyed included a broad cross-section of public and private for-profit companies from all industries, as well as many large tax-exempt organizations. Nearly two-thirds of the respondents had $1 billion or more in revenue, but 14 percent had under $250 million.

A recent American Bankers Association Banking Journal article[2] stated:

Holding too much cash is taking its toll on banks' net interest margins. . . CFOs are challenged with evaluating alternatives to protect and grow earnings. Significant changes in market conditions, as we are currently experiencing, require changes in strategies—particularly in asset mix. Now may be an excellent time to consider adjusting your asset mix to include a larger allocation of bank-owned life insurance.

This statement also applies to many of our country's businesses, particularly in recent times and a volatile stock market. The article also stated:

According to FDIC data as of Sept. 30, 2020, the cash surrender value of BOLI policies held by U.S. banks grew to $182.2 billion, up from $176.5 billion reported one year earlier. Sixty-six percent of all U.S. banks have recorded BOLI on the Call Report, and 72 percent of all U.S. banks with assets over $100 million and 77 percent over $250 million have BOLI on their Call Reports.

Cash values may be accessed by the company for various business purposes through various tax-efficient means including policy loans or partial surrenders or withdrawals up to basis when available. Repayment of policy loans in cash or through the death benefit results in no income taxes due on the distributions. The company is also the beneficiary on these policies and receives income tax-free death benefits when the executive or key employee dies.

A company would purchase COLI as an alternative investment asset and funding vehicle for various planning strategies including, but not limited to:

- Key person life insurance coverage that provides financial protection to the company in the event of the loss of a top executive, top salesperson, or other key employee, due to a premature death.
- Funding for business succession buy-sell programs (i.e., buy out deceased owner's business interest).
- Funding for executive and employee benefits programs such as:
    - Non-Qualified Deferred Compensation Plans
    - Retention Bonus Plans
    - Endorsement Split Dollar and Death-Benefit Only Plans
- Funding other employee benefits programs, such as supplemental retirement benefits, survivor and disability benefits, and more.

From a financial reporting perspective, cash values are generally classified as an asset of the company on the balance sheet, which may offset accrued liabilities from executive benefit programs and general employee benefits programs. This serves to strengthen the company's balance sheet. In addition, once cash values exceed cumulative premiums paid, the excess is generally treated as income on the company's income statements. Also, the company's receipt of death benefits from the policy is generally treated as gains from insurance on the income statement.

Conclusion

COLI is an effective tool to invest company cash in a tax-deferred growth vehicle with a death benefit component to fund a variety of business-planning needs and strengthen the company's financial statements.

For More Information Contact:

Your Security Mutual Life insurance advisor can help assemble your team and coordinate with your business-planning attorney and tax professional to review your situation and determine if COLI is appropriate for you. Contact your Security Mutual Life insurance advisor today to get the process started.

[1] Newport Group, Inc. "Newport Executive Benefits Survey Details the Latest in NQDC Plans." NewportGroup.com, September 2020. (accessed August 31, 2021). https://www.newportgroup.com/knowledge-center/september-2020-1/newport-executive-benefits-survey-details/

[2] Derks, Ken, and Trey Deupree. "BOLI: A Stable Asset in Unstable Times." ABA Banking Journal, December 16, 2020. (accessed August 31, 2021). https://bankingjournal.aba.com/2020/12/boli-a-stable-asset-in-unstable-times/

The information presented is designed to provide general information regarding the subject matter covered. It is not intended to serve as legal, tax or other financial advice related to individual situations, because each person's legal, tax and financial situation is different. Specific advice needs to be tailored to your particular situation. Therefore, please consult with your own attorney, tax professional and/or other advisors regarding your specific situation.

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Tax-free distributions assume, among other things, that withdrawals do not exceed tax basis, the policy remains in force until death, and the policy is not at policy issue, and does not become post issue, a modified endowment contract (MEC). Distributions from a MEC may be subject to income tax and possible penalties. Please consult with your attorney or tax advisor before acting.

Loans from the policy will reduce the death benefit and cash surrender value and may cause the policy to lapse. Lapse of a policy with a loan may have tax consequences.

SECURITY MUTUAL LIFE
INSURANCE COMPANY OF NEW YORK
SECURITY MUTUAL BUILDING • 100 COURT ST.
P.O. BOX 1625 • BINGHAMTON, NY 13902-1625
607-723-3551 • www.smlny.com

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