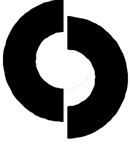

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #848
December 1998
12 USC 24(7)

November 23, 1998

Dear [ ]:

This is in response to your letter of August 13, 1998, concerning a retirement plan established for certain executive officers by your client, [ ] ("the Bank"). OCC examiners have questioned whether one aspect of the plan is in accordance with OCC legal precedent, and you have requested an opinion on this matter. As explained more fully below, it is my opinion that the plan is legally permissible as currently structured.

Facts

According to your letter, the Bank has established a Salary Continuation Plan for two executive officers and a Director Retirement Plan for seven directors. The plans are nonqualified, supplemental retirement plans,[1] and are established through separate contracts with each of the individuals involved. You provided a copy of the contract for the Salary Continuation Plan ("the Plan") with one of the Bank executives as an example, and this letter will therefore use that contract as the basis for discussion. However, it is my understanding that all of the contracts under both of the plans are substantially the same.

[1] The term "nonqualified" means that the plans do not qualify for special federal tax treatment under the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001 *et seq.*, because they are unfunded plans whose primary purpose is to provide deferred compensation for a select group of management or highly compensated employees. *See* 60A Am. Jur. 2d *Pensions and Retirement Funds* §§ 4, 10 (1988).

The Plan obligates the Bank to make post-employment payments -- essentially, retirement or severance benefits -- to the executive or his beneficiary. Specifically, it provides for payments to the executive upon his normal retirement, early retirement, or termination prior to retirement due to change in control of the Bank. In the case of normal or early retirement, payments are to be made in equal monthly installments for a period of 15 years, while in the event of termination due to change in control of the Bank, payment is to be made in a lump sum. In each case, the payment amounts are to be computed from a formula based on the executive's last annual base salary.

The contract also provides that in the event of the executive's death during active employment by the Bank prior to retirement, his designated beneficiary will receive specified payments in equal monthly installments for 15 years. In addition, if he dies after retiring but before receiving all of his salary continuation installment payments (*i.e.,* if he dies less than 15 years after retiring), his designated beneficiary will receive the remaining monthly installment payments to which he would have been entitled.

The Bank has purchased life insurance on the executive, and will use the death benefits that are eventually received under this policy to recover the cost of payments made to him under the Plan. If death occurs under circumstances in which the Plan obligates the Bank to make installment payments to his beneficiary, the Bank will use the insurance proceeds to recover the cost of payments previously made to the executive, if any, and to fund the remaining payments to the beneficiary. The Bank has also purchased life insurance on the other executive and directors with similar benefit plans, and will use it in the same manner.

OCC examiners have drawn attention to the Plan's provisions requiring installment payments to the executive's beneficiary in the event of his death. They cited a 1983 OCC interpretive letter which concluded that, if a national bank is obligated to pay insurance death benefits to an insured employee's beneficiary, the bank cannot receive the insurance proceeds in a lump sum and then pay them to the beneficiary in installments. Rather, the proceeds must be paid over to the beneficiary in a lump sum. You do not believe this letter applies to the Bank's Plan, and have requested our opinion.

Analysis

The OCC's principal issuance on the subject of bank-owned life insurance is OCC Bulletin 96-51 (September 20, 1996). As the Bulletin states, the legal authority for national banks to purchase and hold life insurance for their own account is found in 12 U.S.C. § 24(Seventh), which provides that national banks may exercise "all such incidental powers as shall be necessary to carry on the business of banking." It is the OCC's position that the purchase of life insurance is incidental to banking within the meaning of 12 U.S.C. § 24(Seventh) if the insurance is convenient or useful in connection with the conduct of the bank's business.

The Bulletin lists several specific uses for life insurance that the OCC has found to be incidental to banking, one of which is life insurance purchased "in connection with employee compensation and benefit plans." The OCC has found that salary continuation plans that provide post-retirement benefits for bank officers fall within this category, and thus the purchase of life insurance to fund, or recover the cost of providing, such plans is incidental to banking within the meaning of 12 U.S.C. § 24(Seventh). Letter of Christopher C. Manthey, Senior Attorney, Bank Activities and Structure Division (May 14, 1996) (unpublished).

The examiners have not criticized the general purpose for the Bank's purchase of life insurance, but rather, its use in connection with one aspect of the Plan. Specifically, they questioned that portion of the Plan calling for the payment of benefits to the executive's beneficiary over a 15-year period.[2] A letter to the Bank's board of directors stated that the OCC prohibits arrangements calling for installment payments to a beneficiary, and believes that such payments should be made in a lump sum.

This position is based on a 1983 OCC interpretive letter concerning the use of life insurance in connection with a salary continuation plan for key bank executives. That letter stated that it was intended to outline, in general terms, the OCC's position with regard to such progams. Letter of Peter Liebesman, Assistant Director, Legal Advisory Services Division (April 6, 1983) (unpublished). However, that letter was issued well before OCC Bulletin 96-51, *supra*, which contains the OCC's current general guidance on bank-owned life insurance. Moreover, the letter contains language that appears to be inconsistent with Bulletin 96-51. I therefore conclude that the 1983 letter has been superseded by OCC Bulletin 96-51.

The Plan contract provides that the executive and his beneficiary are general, unsecured creditors of the Bank for payment of the salary continuation benefits. It provides further that any insurance on the executive's life is a general asset of the Bank to which the executive and his beneficiary have no preferred or secured claim. While the Bank has purchased life insurance as a funding or cost recovery vehicle for the Plan, the insurance is not a benefit under the Plan,[3] nor is it a split-dollar policy.[4] The Bank's contractual obligation under the

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[2] As explained earlier, this would occur if the executive died before retiring. The Plan also provides for installment payments to a beneficiary if the executive dies after retirement but before receiving all of his salary continuation payments. This aspect of the Plan was not cited, but presumably the same objection would apply.

[3] The specific focus of the 1983 letter was a plan in which it appears that life insurance was a direct employee benefit, as opposed to a cost recovery vehicle for the bank. In that context, the letter's conclusion that the bank must pay the insurance benefits to the designated beneficiaries in a lump sum rather than installments appears unobjectionable, but that is not the situation in the present case.

[4] A split-dollar policy is one in which the employer and the insured employee share the rights to the policy's cash surrender value and death benefits. Several variations are possible, but in general, upon the employee's death, the employee's beneficiaries receive a designated portion of the death benefits, and the employer receives the remainder. *See generally* appendix to OCC Bulletin 96-51, pages 3-4.

Plan to make installment payments to the executive's beneficiary under certain circumstances is separate and distinct from the insurance, and would exist even if the Bank had not purchased any insurance.

The appendix to OCC Bulletin 96-51 recognizes that life insurance can be used in this way:

> National banks may, as other corporations frequently do, use corporate-owned life insurance (COLI) as a financing or cost recovery vehicle for pre- and post-retirement employee benefits. In these arrangements, banks and other corporations insure the lives of certain employees to reimburse the corporation for the cost of employee benefits. . . . The corporation's obligation to provide employee benefits is separate and distinct from the purchase of the life insurance. The life insurance remains a corporate asset even after the employer/employee relationship is terminated. The employees, whether insured or not, have no interest in the insurance (other than their general claim against corporate assets arising from the corporation's obligation to provide the stated benefits.)

Appendix, page 2.

In the present case, if the executive dies after retiring, having received some or all of his salary continuation payments, the Bank will use the insurance death benefits as a cost recovery device, to recoup the amounts that it has already paid out. If the executive dies prematurely, entitling his beneficiary to receive installment payments, the Bank will use the insurance death benefits as a funding device, a source of funds for the installments that it has yet to pay out. I do not perceive any legal rationale for permitting life insurance to be used as a cost recovery device, but not a funding device, in connection with a bank's independent contractual obligation to make installment payments. Similarly, I see no legal justification to forbid a national bank from entering into an independent contractual obligation to make installment payments to an officer's or employee's beneficiary as part of a permissible employee benefit plan.

Therefore, I conclude that there is no legal objection to the Plan as currently structured, or to the Bank's use of life insurance benefits to fund installment payments required under the Plan. This opinion is based on the information that you provided, and a material change in the facts could require a different conclusion. Also, this letter expresses no opinion on other issues that OCC examiners may have raised with the Bank.

I hope that this has been responsive to your inquiry. If you have further questions, please do not hesitate to contact me at (202) 874-5300.

Sincerely,

/s/

Christopher C. Manthey
Senior Attorney
Bank Activities and Structure Division