

BOLI SUPPORT SERVICES

Pre-Purchase Analysis

Post-Purchase
Risk Management and Reporting

Independent Risk Management Review



TPC CONSULTING

Background:

Interagency Statement on the Purchase and Risk Management of Life Insurance

OCC 2004-56 (December 7, 2004)

“Life insurance holdings can serve a number of appropriate business purposes. Because the cash flows from a BOLI policy are generally income tax-free if the institution holds the policy for its full term, BOLI can provide attractive tax-equivalent yields to help offset the rapidly rising cost of providing employee benefits. Over the past several years, however, a growing number of institutions have aggressively increased their holdings of BOLI. A number of institutions own life insurance with aggregate cash surrender value (CSV) in excess of 25% of capital even though the agencies have previously identified this capital concentration threshold as the level that institutions should consider when establishing internal limits for their BOLI holdings. Some institutions have acquired BOLI as part of a “yield-chasing” asset/liability management strategy in an attempt to increase earnings during the recent period of low interest rates and reduced loan demand. The agencies are concerned that some institutions have committed a significant amount of capital to BOLI without having an adequate understanding of the full array of risks it poses – especially risks that are difficult to measure, such as liquidity, transaction/operational, reputation, and compliance/legal risks. The agencies expect institutions to implement appropriate risk management processes including meaningful risk limits before implementing or adding to a BOLI program.”

Risk Management of BOLI:

Risk assessment and risk management are vital components of an effective BOLI program. In addition to conducting a risk assessment as part of a thorough pre-purchase analysis, monitoring BOLI risks on an on-going basis is important. This risk management should include, but not necessarily be limited to:

- ✓ Identification of which employees are, or will be, insured.
- ✓ Assessment of death benefit amounts relative to employee salaries.
- ✓ Calculation of the percentage of insured persons still employed by the institution.
- ✓ Evaluation of the material changes to BOLI risk management policies.
- ✓ Assessment of mortality performance and impact on income.
- ✓ Evaluation of material findings from internal and external audits and independent risk management reviews.
- ✓ Identification of the reason for, and tax implications of, any policy surrenders.
- ✓ Peer analysis of BOLI holdings.

PRICE RISK: The risk to earnings and capital arising from changes in the value of portfolios of financial instruments.

Specific risks to be analyzed as outlined in OCC 2004-56 should also include:

LIQUIDITY RISK: The risk to earnings and capital arising from an institution's inability to meet its obligations when they come due without incurring unacceptable losses.

TRANSACTION/OPERATIONAL RISK: The risk to earnings and capital arising from problems caused by the institution's failure to fully understand or properly implement a transaction. When it comes to tax and insurable interest issues, "Institutions should have appropriate legal review to help ensure compliance with applicable tax laws and state insurable interest requirements."

REPUTATION RISK: The risk to earnings and capital arising from negative publicity regarding an institution's business practices.

CREDIT RISK: The potential impact on earnings and capital arising from an obligor's failure to meet the terms of any contract with the institution or otherwise perform as agreed.

INTEREST RATE RISK: The risk to earnings and capital arising from movements in interest rates.

COMPLIANCE/LEGAL RISK: The risk to earnings and capital arising from violations of, or nonconformance with, laws, rulings, regulations, prescribed practices, or ethical standards.

Supervisory Expectations:

Interagency Statement on the Purchase and Risk Management of Life Insurance

OCC 2004-56 (December 7, 2004)

"OCC examinations of a national bank's BOLI program will include a review of the risk management framework implemented to identify, measure, monitor, and control risks. Examiners will evaluate the effectiveness of the pre-purchase analysis and the control framework used for the ongoing measurement and management of BOLI risks. In particular, examiners will assess the appropriateness of internal limits, with particular emphasis on the limit for aggregate CSV of BOLI, and evaluate whether or not such limits appropriately address liquidity, reputation, and compliance risk."

Interagency Statement on the Purchase and Risk Management of Life Insurance

OCC 2004-56 (December 7, 2004)

"An institution should be aware that the vendor's financial benefit from the sale of insurance may provide the vendor with an incentive to emphasize the benefits of a BOLI purchase to the institution without a commensurate explanation of the associated risks. Therefore, reliance solely upon pre-packaged, vendor-supplied compliance information does *not* demonstrate prudence with respect to the purchase of insurance."

Office of Thrift Supervision Regulatory Bulletin

RB 32-26 (July 31, 2002)

"Institution management and the board of directors cannot rely solely on a third-party analysis of the benefits of BOLI, such as one that a vendor or carrier of the product may prepare. OTS considers this an inappropriate transfer of the fiduciary responsibilities of the board and management to an outsider with a vested interest in selling product."

Independent Resource:

TPC Consulting is a member of the Pangburn Group and works exclusively with nonqualified executive benefit plans and bank owned life insurance programs. Our clients can be found in all fifty states and include large regional banks, international Fortune 500 Companies, community banks and small family-owned enterprises. We are an independent, privately-owned fee-for-service provider. We are not affiliated with any life insurance company or other financial institution. We do not participate, directly or indirectly, in the sale of life insurance, mutual funds, or any other financial products. The Pangburn Company is a leading provider of state-of-the-art plan administrative services while TPC Consulting provides independent support services for the successful implementation and long-term operation of BOLI programs. Our support services are focused in three primary areas:

1. Pre-purchase analysis
2. Post-purchase risk management and reporting
3. Post-purchase compliance review

Pre-Purchase Analysis:

Banking regulations, specifically OCC Bulletin 2004-56, require banks to perform a comprehensive pre-purchase analysis in order to insure that the purchase of BOLI is consistent with safe and sound banking practices. Regulators have found that the purchase of BOLI is incidental to the business of banking and therefore a permissible investment if it is used to reimburse the bank for the loss of a key executive or purchased in connection with employee compensation and benefit plans:

“National banks may, as other corporations frequently do, use corporate-owned life insurance as a financing or cost recovery vehicle for pre- and post-retirement employee benefits...There are two common methods of financing or effecting cost recovery of employee benefits. The first is the cost recovery method. Under this method, the corporation sustains the cost of providing the employee benefits and the cost of purchasing the life insurance. The corporation holds the life insurance and collects the death benefit to reimburse the corporation for the cost of the benefits and the insurance...The second method of financing employee benefits is known as cost offset. With this method, the corporation projects the annual employee benefit expense associated with the benefit plan. Then, the company purchases life insurance on the lives of certain employees. The amount of insurance purchased is great enough so that the income earned on the cash surrender value offsets the benefit expense.”

Appendix – OCC Bulletin 2004-56

An effective pre-purchase analysis involves the following management actions:

- I. Identify the Need for Insurance and Determine the Economic Benefits and Appropriate Insurance Type
- II. Quantify the Amount of Insurance Appropriate for the Institution’s Objectives
- III. Assess Vendor Qualifications
- IV. Review the Characteristics of the Available Insurance Products
- V. Select Carrier
- VI. Determine the Reasonableness of Compensation Provided to the Insured Employee if the Insurance Results in Additional Compensation
- VII. Analyze the Associated Risks and the Ability to Monitor and Respond to those Risks
- VIII. Evaluate Alternatives
- IX. Document Decision

Regardless of the financing rationale being considered, the bank must complete a comprehensive analysis before purchasing BOLI. The objective of the pre-purchase analysis is to help ensure that the bank understands the risks, rewards, and unique characteristics of BOLI. TPC Consulting, working in cooperation with the bank’s insurance broker, will play an active role in the analytical process. Once a purchase decision has been made and implemented we will also assist in the preparation of a comprehensive compliance manual.

Post-Purchase Risk Management and Reporting:

As part of the regulatory requirement to document its actions, the bank must continue to monitor the purchase decision. In addition to routine services provided as a TPA for strategies involving nonqualified deferred compensation plans, the following BOLI Post-Purchase compliance and risk management services will be provided by TPC Consulting on an on-going basis:

- Suggested General Ledger Entries for both Benefit Accounting and BOLI Accounting
- General Ledger Adjusting Entries for Plan Events
- Detailed Records of all Prior Period Accounting Transactions
- Comprehensive Benefit Plan Administration Manual
- Quarterly Testing for Concentration of Risk Compliance
- Quarterly Testing for Lending Limits Compliance
- Quarterly Social Security Sweeps to Track Deceased Former Employees
- Quarterly Review of Carrier Ratings and Financial Profile
- Automatic E-mail Notification of Change in Carrier Ratings Compiled Every 14 Days
- Periodic Analysis of Peer Group BOLI Holdings
- Periodic Analysis of Percentage of Insured Persons Still Employed
- Updates on Applicable Tax, Accounting and Regulatory Issues
- (800) Phone Access for Bank Management and Plan Participants
- Participant Benefit Statements
- On-Demand Data for Audits
- Assistance in Preparing Responses to IDRs

All records relative to the institution's decision to purchase BOLI will be maintained in a comprehensive BOLI Compliance Manual. The bank is encouraged to work closely with all of its advisors to monitor the purchase decision and product performance in a manner consistent with safe and sound banking practices.

Independent Risk Management Review:

The guidance contained in OCC 2004-56 for the pre-purchase analysis of life insurance applies to all BOLI contracts entered into after December 7, 2004. The guidance concerning the ongoing risk management of BOLI subsequent to its purchase applies to all holdings of life insurance regardless of when purchased. As an independent third party, TPC Consulting is in a unique position to assist institutions that have purchased BOLI in the past to audit and document their compliance efforts and risk management procedures. An analysis of an existing plan may include any or all of the following:

- ❑ A careful review of the institution's pre-purchase analysis
- ❑ A review and recalculation of the specific losses being insured against and/or specific costs to be recovered
- ❑ An analysis of the present value of cash flows (positive and negative)
- ❑ A review of GAAP accounting practices for both BOLI and related benefit plans
- ❑ An assessment of the BOLI vendor
- ❑ A current assessment of BOLI carrier's credit ratings and general reputation
- ❑ A detailed analysis of current BOLI products
- ❑ An analysis of the risks associated with the current BOLI program to include:
 - Liquidity Risk
 - Transaction/Operational Risk
 - Reputation Risk
 - Credit Risk
 - Interest Rate Risk
 - Compliance/Legal Risk
 - Price Risk
- ❑ A review of applicable state insurable interest regulations
- ❑ An analysis of peer group BOLI holdings
- ❑ A review of risk weights assigned to BOLI products
- ❑ A review of nonqualified benefit plan agreements in light of IRC 409A

Fee Schedule:

Fees listed below are estimates only. Exact fees will be determined on a case-by-case basis and will be specified in a detailed service agreement.

Pre-Purchase Analysis

Exact fees will be determined on a case-by-case basis subject to a minimum fee of \$2,000.00.

Post-Purchase Risk Management and Reporting

Annual fee per policy - \$100.00

Minimum annual fee - \$600.00

Independent Risk Management Review

Based on the original date of the BOLI program, the complexity, and the availability of data and documentation, review will be performed at an hourly rate of \$150.00 (subject to a minimum fee of \$2,500.00). Exact fees will be determined in advance and specified in a Letter of Engagement.

NQDC Plan Administration

Annual fee per participant: \$125.00 to \$200.00 (see web site for current fee schedule: www.pangburngroup.com)

NQDC Plan Documents

(included in "set-up" fee)



TPC Consulting

Unique Business Model:

- Independently owned and operated
- Unbiased pre-purchase analysis per regulators (OCC 2004-56)
- Fee-for-service only (not financially dependant on a sales front office)
- Competitive fees
- BOLI and bank sponsored 409A plans only
- Reporting, compliance, and risk management services
- Proprietary state-of-the-art software
- Annual SAS 70 Type II audit
- All services designed from bank & regulatory perspective
- Backed by staff and resources of The Pangburn Group (TPG)
- Unbiased plan design consulting on all types of nonqualified plans
- Comprehensive post-retirement split dollar accounting and reporting
- Actuarial support services

Focus On Community Banks:

- 85% general account BOLI
- TPG has clients in all 50 states
- 450 new bank clients since 2004
- Approximately \$2.1b CSV reported on monthly basis (as of 12-31-08)
- None too small (1 participant) – none too large (1,200 participants)
- Experience fixing, converting or reporting “Index Plans”

Important Trends:

- Rapidly growing number of satisfied clients (high % have dealt with other recordkeepers)
- Increasing number of new clients coming to us through bank referrals and internet
- Increasingly large number of “takeover” plans (80%)
- Larger number of BOLI producers leaving high profile national BOLI marketing organizations and bringing clients to TPC
- High level of client retention
- Negotiating with several BOLI marketing organizations to take over recordkeeping and administration for their clients
- Good relationships with regulators especially OCC (e.g., quarterly conference call)
- Monthly web reporting (updated 90% of plans within 3 working days and 99% in 7 working days)
- Increasingly comprehensive compliance reporting (quarterly)

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OVERVIEW OF RECORDKEEPING & ADMINISTRATION SERVICES

About the Third Party Administrator:	
General Information	
<i>Fee for Service</i>	Yes
<i>Commission Sharing</i>	No
<i>Unbundled Business Model</i>	Yes
<i>Limitation on Plan Size/Funding Methods</i>	No
<i>SAS 70 Type II Certification</i>	Yes
Administration System: Account Balance Plans	
<i>Nonqualified Plan Based Platform</i>	Yes
<i>Administration Software Developed Internally</i>	Yes
Administration System: Non-Account Balance Plans	
<i>FAS 87, 109, 106, 132, 158 Actuarial Database</i>	Yes
<i>Stated Benefit Capabilities</i>	Yes
<i>Formula Benefit Capabilities</i>	Yes
Pre-Sale Consulting Services:	
Consulting Support	
<i>Plan Design Support & Consulting</i>	Yes
<i>Customized Plan Documents</i>	Yes
<i>Limitation on Size of Plan/Asset Funding Strategy</i>	No
<i>Plan Funding Consulting Support</i>	Yes
<i>Compliance Consulting</i>	Yes
<i>Presentation & Proposal Support</i>	No
Sales Support	
<i>Electronic Support (Conference Calls, WebEx, etc.)</i>	Yes
<i>Field Support (On-site visits)</i>	No
Plan Sponsor Services	
Pre-Purchase Services	
<i>Plan Design Support, Modeling, & Consulting</i>	Yes
<i>Participation in Sales Process (visits to the client, etc)</i>	No
<i>Independent Pre-Purchase Analysis Services</i>	Yes
<i>Independent Risk Management Review for existing BOLI</i>	Yes
<i>Review of Pre-Purchase Analysis with Client and Broker</i>	Yes
Comprehensive Accounting Services	
<i>Account Balance Plans</i>	Yes
<i>Monthly, Quarterly or Annual Reporting Cycles</i>	Yes
<i>Non-Account Balance Plans</i>	Yes
<i>Monthly, Quarterly or Annual Reporting Cycles</i>	Yes

Plan Sponsor Services (continued)	
Comprehensive Accounting Services (Continued)	
<i>Bank Owned Life Insurance</i>	Yes
<i>Monthly BOLI Insurance Accounting and Policy Reporting</i>	Yes
<i>Actual Policy Valuation</i>	Yes
<i>Secure Website Access to Reports</i>	Yes
<i>Split Dollar Life Insurance</i>	Yes
<i>Post-Retirement Split Dollar Reporting</i>	Yes
<i>162 Bonus Reporting</i>	Yes
<i>Projection Reporting</i>	Yes
Compliance Reporting	
<i>Ongoing Risk Management and Compliance Reporting</i>	Yes
<i>Quarterly Concentration of Credit Testing</i>	Yes
<i>Quarterly Lending Limit Testing</i>	Yes
<i>Social Security Sweeps</i>	Yes
<i>Review of Carrier Ratings and Financial Profiles</i>	Yes
<i>E-Mail Notifications of Changes to Carrier Ratings</i>	Yes
<i>Periodic Review of Peer Group BOLI Holdings</i>	Yes
<i>Updates on Applicable Tax, Accounting and Regulatory Issues</i>	Yes
<i>Assistance in Drafting a Internal BOLI Policy</i>	Yes
<i>Form W-2/Form 1099 MISC Disclosure Reporting</i>	Yes
<i>SEC Disclosure Reporting</i>	Yes
<i>COLI Best Practices Consent Reporting</i>	Yes
<i>Economic Benefit Reporting</i>	Yes
<i>Online Support</i>	Yes
<i>Direct Communication Link to Plan Sponsor and Administrator</i>	Yes
Miscellaneous	
<i>Dedicated Account Manager</i>	Yes
<i>Toll free number</i>	Yes
<i>Financial / Investment Advice</i>	No
<i>Tax Advice / Planning</i>	No
<i>Ad hoc Reporting</i>	Yes
<i>Trustee Services</i>	No
Plan Participant Services	
Participant Benefit Statements	
<i>Mailed</i>	Yes
<i>Emailed</i>	Yes





Mission Statement

"To provide financial institution management with the requisite tools to maintain prudent oversight regarding the purchase, reporting, and risk management of Bank Owned Life Insurance and the administration of nonqualified executive benefit plans."

THE PANGBURN GROUP

THE PANGBURN COMPANY

TPA for Nonqualified Executive Benefit Plans

TPC CONSULTING

BOLI Compliance and Reporting

PANGBURN TECHNOLOGY

Technology Solutions & Custom Software

TPC ACTUARIAL

Actuarial Consulting for COLI & BOLI

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