

## **GUIDELINES ON CORPORATE OWNED LIFE INSURANCE**

Corporate Owned Life Insurance (COLI) is life insurance a corporate employer buys covering one or more employees. With COLI, the employer is generally the applicant, owner, premium payer and beneficiary of the policy. COLI can be acquired on an individual or group basis and can take many forms. For example, it can be used to indemnify the employer for the loss of earnings or costs of replacing a key employee who becomes disabled or dies, or to finance the cost of a stock redemption agreement or a deferred compensation plan. COLI has also increasingly been used as a financing vehicle for broad-based welfare benefit plans, such as health benefit plans.

This relatively new application of the principals of corporate owned life insurance to retiree health benefits is largely attributable to the promulgation of Statement 106 by the Financial Accounting Standards Board (FASB). Under FASB 106, post-retirement benefits, including retiree health benefits, are required to be accrued as they are earned over the working lifetime of the employee, rather than as they are paid after retirement. Unfunded accrued benefits create a growing balance sheet liability. COLI or a variation thereof, Trust Owned Life Insurance (TOLI), where the insurance is purchased by a trust, typically a VEBA trust established under Section 501(c)(9)IRC, create a balance sheet asset which the employer can use to finance the cost of the benefit.

COLI and TOLI are attractive methods of financing liabilities such as an employer's obligations under a retiree health benefit plan. When for example, retiree health benefits are provided through an insured health benefit plan, the policy's cash values can be used to finance the after-tax cost of the health insurance premiums for the retired employees. When an insured retired employee dies, the policy death benefit allows the company to recover part or all of the costs of the plan. The policy values and death benefit also represent a source of funds which can be used to pay premiums for other employees who are covered under the plan.

When an employer provides health benefits to retired employees on a self-insured basis, the cash values and death benefits of the coverage are used to finance the coverage. Moreover, contributions to the VEBA Trust may, within well defined limits, be deductible to the employer.

Because of COLI's and TOLI's attractiveness in financing an employer's obligation under a plan established to provide broad-based welfare benefits to retirees, there has been increased interest in the use of COLI and TOLI for this purpose. There has also been increased interest in assuring that COLI and TOLI arrangements satisfy insurable interest requirements.

Business entities traditionally have been found to have insurable interests in the lives of their officers, managers and key employees. This is because the business may reasonably expect to benefit from the continuance of their lives or to suffer a loss if these individuals die. Many states have also recognized an insurable interest in the lives of non-key employees, particularly in the context of financing broad-based welfare benefit plans.

Some states have enacted laws that either specifically recognize an insurable interests in a COLI-TOLI arrangement, including those whose purpose is the financing of broad based welfare plan arrangements. Other states have found such insurable interests in their common law; in interpretations of existing statutes and case law without specific COLI-TOLI enabling language.

Citations to state statutes relating to insurable interests of employers in their employees can be obtained by contacting the Legal Division of the NAIC.

States considering a legislative response to insurable interest concerns regarding employers and their employees should consider the following elements for inclusion in their law:

1. The law should recognize that employers have a lawful and substantial economic interest in the lives of key employees and in other employees who have a reasonable expectation of benefiting from an employee welfare benefit plan.
2. Employers should be required to notify eligible employees of their proposed participation in the plan and the employees should be given an opportunity to refuse to participate. On a prospective basis, employers should obtain written consent of each individual being insured. Consent would include an acknowledgement that the employer may maintain the life insurance coverage even after the insured individual's employment has terminated.

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3. An employer shall not retaliate in any manner against an employee or a retired employee for refusing consent to be insured.
4. For non-key or non-managerial employees, the amount of coverage should be reasonably related to the benefits provided to the employees.
5. With respect to employer provided pension and welfare benefit plans, the life insurance coverage purchased to finance the plans should only be allowed on the lives of those employees and retirees who, at the time their lives are first insured under the plan, would be eligible to participate in the plan.

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*Chronological Summary of Actions (all references are to the Proceedings of the NAIC).*

*1993 Proc. 17, 10, 780, 782-783 (adopted).*

*2002 Proc. 3<sup>rd</sup> Quarter 12, 13, 116, 118, 119 (amended and reprinted).*