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Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #926
March 2002
12 USC 24(7)

September 7, 2001

Subject: Variable Life Insurance

Dear [ ]:

This is in response to your recent letter sent by e-mail requesting confirmation that it is permissible for national banks to purchase variable life insurance in connection with employee compensation or benefit plans. Such insurance is permissible, provided that certain OCC requirements are met.

The OCC's current guidance on purchases of life insurance by national banks is contained in Bulletin 2000-23, July 20, 2000. You appear to be familiar with this issuance. As you recognized, the OCC does not permit national banks to purchase life insurance purely as an investment. Rather, as stated in the Bulletin, the purchase must be for a purpose that is incidental to banking. One of the purposes that we have found to meet that standard is insurance purchased in connection with employee compensation or benefit plans. That is, national banks may purchase life insurance in order to fund or recover the cost of compensation or benefits for their employees, officers, or directors. Thus, the quick answer to your question is that it is permissible for national banks to purchase variable life insurance for this purpose, and it does not matter whether the insurance is single premium or annual premium.

However, if the separate account associated with variable life insurance is to contain equity securities, there is a further limitation. This limitation is that the equities in the account must serve to hedge the bank's liability under the compensation or benefit plan that the insurance is intended to fund. As explained on page 13 of Bulletin 2000-23, "an economic hedge exists when changes in the value of the liability or other risk exposure hedged are offset by counterbalancing changes in the value of the hedging instrument." The Bulletin goes on to say:

> An example of such a relationship would be where the amount of the bank's deferred compensation obligation is measured by the value of a stock market index, and the separate account contains a stock mutual fund that mirrors the performance of that index. *If the insurance cannot be characterized as an*

effective hedging transaction, the presence of equity securities in a separate account is impermissible.

OCC Bulletin 2000-23, page 13 (emphasis added). Thus, equity investments can be used in connection with variable life insurance, but only if this hedging requirement is met.

In my opinion, a defined contribution plan could meet this standard, while a defined benefit plan could not. This is because in a defined contribution plan, the amount of the bank's liability depends upon the performance of the plan benchmark — typically, an equity security or an equity market index — making it possible for the bank to purchase a security that will track that benchmark and offset the liability. In contrast, a defined benefit plan obligates the bank to pay a certain amount regardless of the performance of the bank's investments. It is therefore impossible to effectively hedge the bank's exposure.

As you are aware, the Bulletin sets forth a number of due diligence steps that national banks should take in connection with any purchases of life insurance. Please note that for the purchase of variable life containing equity securities, additional due diligence measures are set forth on page 13 of the Bulletin.

It is my understanding that separate accounts can be designed to contain only bank-permissible investments, *i.e.*, Treasury and investment grade fixed income securities. See OCC Interpretive Letter 826, March 17, 1998.[1] In my opinion, that type of separate account product would be permissible in connection with a defined benefit plan because there is no hedging requirement for fixed income investments in a separate account.

To summarize, national banks may purchase variable life insurance for the purpose of funding or recovering the cost of employee compensation or benefit plans. It does not matter whether it is structured as a single premium or annual premium product. If such insurance is to contain investments in equity securities, there is an additional requirement that the securities must be related to the bank's compensation or benefit liability in such a way that their values rise and fall together, so that the insurance can be characterized as a hedging transaction. An example of this would be a defined contribution plan linked to an equity benchmark. However, if variable life is to be used in connection with a defined benefit plan, it is my opinion that the separate account must be limited to bank-permissible (fixed income) investments.

I hope that this has answered your question. Please feel free to contact me again if further questions arise.

Sincerely,

/s/
Christopher C. Manthey
Counsel
Bank Activities and Structure Division

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[1] Available on the OCC web site at www.occ.treas.gov/interp/may98/intmay98.htm.