BASEL III - Effects on BOLI

(Non-Advanced Approach Banks)

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Beginning January 1, 2015, banks with less than $250 Billion in assets will be required to comply with the Basel III minimum regulatory capital ratios and standardized approach for calculating Risk Weighted Assets (RWA). Although the method for determining RWA's is changing, the treatment of BOLI will remain relatively unchanged under the new rules with a few exceptions.

- **General Account –** General Account products are considered "Corporate Exposures" and will continue to be risk-weighted at 100%. This is consistent with historical guidance.

- **Separate Account –** if categorized as a Separate Account product ("Equity Exposure"), the bank will have to use one of the following three methods to risk-weight BOLI:
  - **Full Look-Through Approach –** calculate a risk-weighted asset amount for each of the exposures held by the investment fund.
  - **Simple Modified Look-Through Approach –** set risk-weighting equal to the adjusted carrying value of the equity exposure multiplied by the highest applicable risk weight the fund is permitted to hold (as high as 1,250%)
  - **Alternative Modified Look-Through Approach –** risk-weighting is based on prorating the carrying value of the equity exposure assuming assets are invested first in the highest risk-weighted category up to the investment limit, then continuing to the next highest category, etc...

  For Separate Account products, a look-through analysis was always required. The level of information needed to complete the analysis has expanded. A bank will need to work with the insurance company or fund manager to obtain more asset level information to ultimately risk-weight the underlying assets. Many banks have adopted a risk-weighting standard created and utilized by the Advanced Approach Banks in 2014 to assist with risk-weighting calculation. However, certain information may not be available if the underlying assets are not managed by the insurance company or one of their fund managers. In cases where information is not available, the bank must assess the highest risk-weighting associated with that asset class.

- **Hybrid Account –** Hybrid Account products may be viewed as General Account or Separate Account products based on certain criteria. To be categorized as a Separate Account product, it must meet the following requirements:
  - the account must be legally recognized under applicable law

- the assets in the account must be insulated from general liabilities of the insurance company under applicable law and protected from the insurance company's general creditors in the event of the insurer's insolvency
- the insurance company must invest the funds within the account as directed by the contract holder in designated investment alternatives or in accordance with specific investment objectives or policies
- all investment performance, net of contract fees and assessments, must be passed through to the contract holder, provided that contracts may specify conditions under which there may be a minimum guarantee, but not a ceiling

Currently, the regulations do not specifically address Hybrid Account products. Hybrid Account products provide many features of both Separate Account and General Account products. Although Hybrid Account products will generally meet the first three requirements listed above, the fourth may not always be met. With many Hybrid Account products, the investment performance is not directly passed through to the policy holder. The underlying investment performance of the separate account acts as an index for determining interest crediting rates where losses and defaults are backed by the general account of the insurance company. The policy holder is guaranteed the book value of the assets determined using similar crediting methodologies and interest and mortality guarantees of General Account products. Please refer to your policy contracts to determine if all four requirements are met.

Given there is no specific guidance available on Hybrid Account products, the bank will have to make the determination whether their BOLI should be risk-weighted as either a General Account (corporate exposure) or Separate Account (equity exposure) product. At this time it is our understanding that several Advanced Approach banks have taken the position that the inability to fully realize the investment performance of the assets, shifting the risk to the insurance company, supports the classification of a Hybrid Account product as a corporate exposure with a risk-weighting of 100%. Taking this position would prevent a bank from assessing a less than 100% risk-weighting on the funds it may have allocated to portfolios designed with lower risk-weightings.