# Banks Use Life Insurance to Fund Bonuses

## Controversial Policies on Employees Pay for Executive Benefits, Help Companies With Taxes

### By ELLEN E. SCHULTZ

Banks are using a little-known tactic to help pay bonuses, deferred pay and pensions they owe executives: They're holding life-insurance policies on hundreds of thousands of their workers, with themselves as the beneficiaries.

Banks took out much of this life insurance during the mortgage bubble, when executives' pay -- and the IOUs for their deferred compensation -- surged, and banking regulators affirmed the use of life insurance as a way to finance executive pay and benefits.

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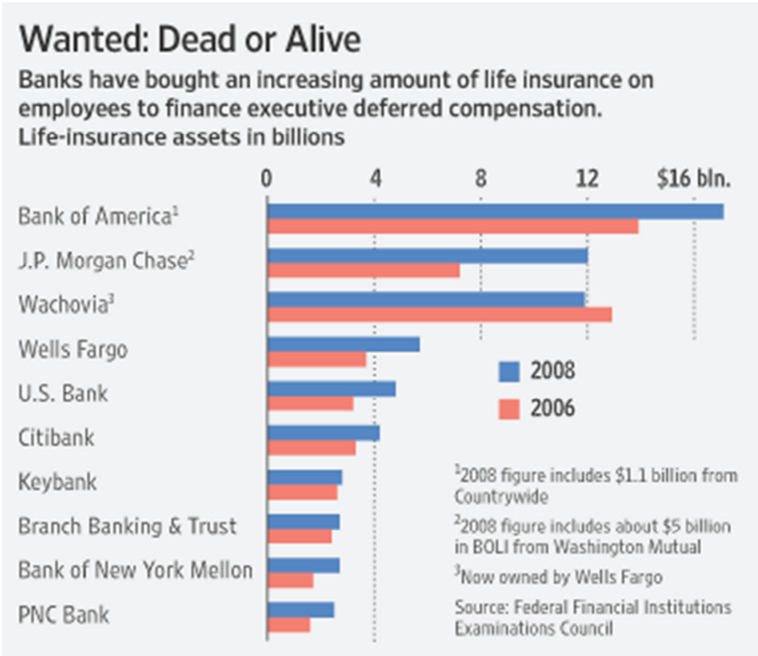
Bank of America Corp. has the most life insurance on employees: $17.3 billion at the end of the first quarter, according to bank filings. Wachovia Corp. has $12 billion, J.P. Morgan Chase & Co. has $11.1 billion and Wells Fargo & Co. has $5.7 billion. (Wells Fargo acquired Wachovia at the end of last year.)

The insurance policies essentially are informal pension funds for executives: Companies deposit money into the contracts, which are like big, nondeductible IRAs, and allocate the cash among investments that grow tax-free. Over time, employers receive tax-free death benefits when employees, former employees and retirees die.

Though not improper, the practice is similar to what is known as "janitors insurance," an insurance-on-employees technique that has long been controversial. Critics say the banks' insurance contracts are a way for companies to create tax breaks for funding executive pensions. And some families have complained that employers shouldn't profit from the deaths of their loved ones.




Efforts to rein in the practice largely have been unsuccessful, including the most recent rules Congress enacted in 2006. The rules limit companies to buying life insurance to just the top third of earners, who must provide consent. But the rules don't apply to life-insurance that employers bought before the August 2006 rules, which cover millions of current and former employees.

Banks are far from alone in buying such company-owned life insurance, or COLI. Thousands of companies do it, including American International Group Inc., Fannie Mae, Freddie Mac, Kimberly-Clark Corp. and Tyson Foods, Inc. But banks have been among the largest players, pumping billions more into new policies since the 2006 rules were put in place.

Last week, the Treasury proposed eliminating companies' ability to deduct interest on loans related to COLI. This would have little impact on banks, which don't borrow money to invest in life insurance. The proposal would also leave untouched the major tax breaks of the practice.

Banks had a total of $122.3 billion in life insurance on employees at the end of 2008, nearly double the $65.8 billion they held at the end of 2004, according to a Wall Street Journal analysis of bank filings. Unlike other companies, banks are required to disclose their total life-insurance holdings in regulatory filings.

In recent years, the Office of the Comptroller of the Currency affirmed that banks can buy life insurance to finance employee benefits. But filings show that executive compensation accounts for most of the benefits.

J.P. Morgan, for instance, had $10 billion in deferred-pay obligations, compared with $1 billion in retiree health obligations at the end of 2008. Offsetting these obligations was $12 billion in bank-owned life insurance, or BOLI. A spokesman for J.P. Morgan confirms the figures.

Citigroup Inc. had $919 million in unfunded retiree-health obligations, $586 million in supplemental executive pension obligations, and roughly $5 billion in deferred compensation. Offsetting these obligations: $4.2 billion in life insurance. A spokesman says Citigroup bought BOLI because it was "an attractive use of capital," and for "the tax-free nature of the death proceeds."

Bank of America doesn't disclose its deferred-compensation obligations, but filings show that at the end of 2008, its retiree health plan had an unfunded obligation of $1.3 billion, and that it owed $1.3 billion in supplemental executive pensions. The bank had a total of $17.1 billion in life insurance, which suggests a substantial deferred-compensation obligation. A BofA spokeswoman declined to comment on the deferred compensation obligation, but in an email said: "Like many companies, Bank of America uses this insurance to help defray the cost of employee benefits."

Companies don't use the policies as piggy banks to pay for compensation and benefits. Rather, they benefit from keeping the money in the contracts: Thanks to accounting rules for life insurance, gains on the investments -- from stocks, hedge funds, bonds and the like -- aren't just tax free, but are reported as income each quarter. Otherwise, companies couldn't add gains from securities as income until they sold them, and they would be taxed.

This income reduces the drag that executive IOUs have on earnings. (Banks owe interest on the deferred pay; and like any other kind of debt, the interest on executive debt lowers earnings.)

Though the investments are illiquid, the banks receive tax-free cash when employees and former employees die. Pacific State Bancorp, of Stockton, Calif., recently reported $2.6 million in income from a death benefit in 2008. The company didn't respond to requests for comment.

A subsidiary of Conseco Inc., Bankers Life & Casualty, which bought life insurance on employees in 2006, received $2.7 million that year from a death benefit, according to filings. A spokesman says the life insurance company bought the insurance "to offset the expense of deferred compensation."

Over the coming decades, banks will receive an estimated $400 billion in death benefits, consultants estimate. The death benefits sometimes are referred to in filings as "mortality dividends" or "yields." Employers track the deaths of former employees by checking Social Security Administration records.

As an incentive to get employees to consent to being covered, some companies offer them a small portion of the death benefit. But the coverage may end when they leave the company.

In December, Irma Johnson accidentally received a check for $1.6 million, from Security Life of Denver Insurance Co., payable to Amegy Bank. According to a lawsuit Mrs. Johnson filed in February in a Houston state court, in 2001 the bank told her husband, Daniel Johnson, a credit risk manager who had survived two brain surgeries, that he was eligible for supplemental life insurance of $150,000, if he signed a consent form authorizing the bank to purchase an insurance policy on his life. Four months later, the bank fired him.

Mr. Johnson died from a brain tumor at age 41 in 2008. His widow and two young children received no life-insurance benefits, which the bank had canceled when Mr. Johnson left. Mrs. Johnson says her husband was cognitively disabled when he signed the consent form.

A spokeswoman for Amegy Bank, a unit of Zions Bancorp, declined to comment on the suit, but said, "Participation in Amegy's BOLI plan was completely voluntary; employees consented to participate."

*—Tom McGinty contributed to this article.*

**Write to** Ellen E. Schultz at ellen.schultz@wsj.com

**Correction**

Bankers Life & Casualty Co. is a life insurance company. A previous version of this article incorrectly referred to the company as a bank.