FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 80-11
January 23, 1980

FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

Joint Notice of Proposed Policy Statement
On Disposition of Credit Life Insurance Income

TO ALL STATE MEMBER BANKS IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

Enclosed is a proposed policy statement of the Federal financial institutions supervisory agencies concerning disposition of income from the sale of credit life insurance related to loans made by supervised institutions.

Those desiring to comment on the policy should send such comments to Interagency Credit Life Income Policy, c/o John J. McCarthy, Deputy Director, Division of Bank Supervision, Federal Deposit Insurance Corporation, Room 5050-A, 550 Seventeenth Street, NW, Washington, D.C. 20429. Comments must be received by March 31, 1980.

Sincerely yours,

Robert H. Boykin

First Vice President

Enclosure

FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL
ON BEHALF OF ITS MEMBER AGENCIES

Joint Notice of Proposed Policy Statement
On Disposition of Credit Life Insurance Income

AGENCIES: The Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Home Loan Bank Board and the National Credit Union Administration.

ACTION: Proposed policy statement; request for comments.

SUMMARY: The Federal financial institution supervisory agencies are proposing to issue a policy statement which would prohibit financial institution insiders from benefiting personally from income derived from the sale of credit life, health or accident insurance sold in connection with loans made by their institutions. The proposed policy statement would require that such income be credited to an institution's own income account or, in the case of a savings and loan association, to its service corporation. In States where insurance laws appear to preclude a financial institution from receiving insurance commissions, the proposed policy statement would require a financial institution that wishes to sell credit life, health or accident insurance to use any other procedure for making insurance available so long as insiders do not personally profit.

EFFECTIVE DATE: Comments must be received by March 31, 1980.

ADDRESS: Comments should be addressed to Interagency Credit Life Income Policy, c/o John J. McCarthy, Deputy Director, Division of Bank Supervision, Federal Deposit Insurance Corporation, Room 5050-A, 550 Seventeenth Street, NW, Washington, DC 20429 (202/389-4283).

FOR FURTHER INFORMATION CONTACT: John McCarthy, Federal Deposit Insurance Corporation, (202) 389-4283; Sandy Greene, Federal Reserve Board, (202) 452-2742; Ford Barrett, Comptroller of the Currency, (202) 447-1896; Larry Berkow, Federal Home Loan Bank Board, (202) 377-6430; and Barry Jolette, National Credit Union Administration, (202) 254-8760.

SUPPLEMENTARY INFORMATION: The Federal financial institution supervisory agencies ("agencies") are aware that it has been a long-standing financial practice in certain parts of the country for officers, directors, principal shareholders (whether individual or corporate), their interests or other affiliates ("insiders") of financial institution to receive, either directly or indirectly, income derived from the sale of credit life, health or accident insurance ("credit life insurance") in connection with loans made by the institutions. Insiders usually receive the income in one of two ways--either by the payment of the insurance commissions directly to the insider or by payment to the insider of additional salary or other form of compensation based upon the amount of insurance business generated.

The agencies believe that the diversion of income from credit life insurance sales to insiders rather than to their financial institutions may constitute an unsafe or unsound financial practice. The reasons for the agencies' concern include the following:

(1) Financial institution officers and directors owe a fiduciary duty to the institution and all its shareholders not to profit personally from an activity involving use of the institution's facilities, personnel, goodwill, or other resources.

(2) As an accounting and operations matter, it appears that income derived from insurance sales would be properly accounted for by crediting it to the financial institution's income accounts, or in the case of a savings and loan association, to its service corporation, and not to insiders, their interests or affiliates. Allowing such income to be diverted without entering the income stream seems contrary to the orderly and systematic accounting of funds that is expected of financial institutions.

(3) Loan officers may be induced to make loans they might not otherwise have considered sound in order to receive the commission on the accompanying insurance sale. This could result in a conflict of interest situation in which a loan officer's credit judgment might be influenced by his or her own desire for personal financial gain.

(4) A loan officer who stands to receive an insurance commission might be induced to persuade a borrower to purchase unneeded or unwanted insurance.

(5) Financial institutions operate largely on public trust and confidence. Arrangements that permit bank insiders to profit at the expense of the institution, its shareholders, or its depositors could undermine that trust and confidence and compromise the integrity of the institutions.

Accordingly, in the interest of preserving the safety and soundness of financial institutions, the agencies are proposing to adopt a policy statement which would prohibit insiders of financial institutions from personally profiting on the sale of credit life insurance and which would require such income to be credited to the financial institutions' income accounts or, in the case of savings and loan associations, to their service corporations.

In the two known States where State insurance laws may preclude a financial institution from receiving credit life insurance commissions (Texas and Oklahoma), a financial institution that wishes to provide credit life insurance would be permitted to use any other procedure for making credit life insurance available (e.g., the group policy-experience refund method or the credit union method), so long as insiders do not personally profit and any income is credited to the financial institution.

The agencies recognize that the practice whereby income derived from the sale of credit life insurance is diverted to insiders is one of long standing in some areas of the country. Therefore, it is the agencies' intention to give financial institutions sufficient time to adjust their activities and arrangements to conform to the provisions of the proposed policy statement. If adopted, the policy statement would provide that financial institutions not now subject to a rule, regulation, or policy statement on credit life insurance income should be in compliance with its provisions within one year following final publication. The proposed policy statement also provides that financial institutions may be excepted from the general rule on a case-by-case basis if a clear hardship exists and satisfactory assurance is provided that compliance will be forthcoming within an appropriate period of time. Given the provision enabling a phase-in of the proposed policy statement's applicability on a case-by-case basis, each agency will have flexibility to handle hardship cases in an appropriate manner.

While comments on all aspects of the proposed policy statement are invited, those addressing the effect of the proposed policy statement on small banks and their shareholders (including bank holding companies) are particularly desired.

The text of the following Proposed Policy Statement is as follows:

PROPOSED POLICY STATEMENT

Disposition of Credit Life Insurance Income

For the purpose of helping to preserve the safety and soundness of financial institutions, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Federal Reserve Board, the National Credit Union Administration 1/ and the Office of the Comptroller of the Currency are adopting the policies set forth below regarding the disposition of income from the sale of credit life, health, and accident insurance ("credit life insurance") related to loans made by federally insured financial institutions.

(1) Individual officers, directors and principal shareholders of a financial institution should not personally profit from the sale of credit life insurance to the institution's loan customers.

(2) As an accounting and operations matter, income derived from credit life insurance sales to loan customers should be credited only to the income accounts of the financial institutions or, in the case of a savings and loan association, to its service corporation, and not to the financial institution's individual officers, directors, principal shareholders, their interests, or other affiliates.

(3) Where State insurance laws or other legal considerations preclude a financial institution from using a particular procedure for selling credit life insurance or from disposing of the income in a particular manner, a financial institution which wishes to provide this service to its loan customers shall seek and utilize an alternative method that complies with 1 and 2 above.

(4) The proper method for the distribution to shareholders or to an affiliated holding company of income derived from credit life insurance or other income sources is through a declaration of dividend in conformity with law, rule, regulation and prudent financial practice.

(5) Financial institutions not now subject to a rule, regulation or policy statement on the disposition of credit life insurance income should be in compliance with 1 and 2 above within one year following publication in the Federal Register of the final policy statement. Modifications beyond that time will be granted only where a clear hardship exists and satisfactory assurance is provided that compliance with 1 and 2 above will be achieved within an appropriate time period.

1/ Federal credit unions are not permitted by law to sell credit life insurance.

(SIGNED)

Theodore E. Allison, Secretary
Board of Governors of the Federal
Reserve System

(SIGNED)

J. J. Finn, Secretary
Federal Home Loan Bank Board

(SIGNED)

H. Joe Selby, Senior Deputy
Comptroller, Office of the
Comptroller of the Currency

(SIGNED)

Hoyle L. Robinson, Executive
Secretary, Federal Deposit
Insurance Corporation

(SIGNED)

Rosemary Brady, Secretary to NCUA
Board, National Credit Union
Administration
BY: Beatrix Fields, Acting
Secretary to NCUA Board