FEDERAL RESERVE BANK OF DALLAS
DALLAS, TEXAS 75222

Circular No. 81-10
January 15, 1981

PROPOSED POLICY STATEMENT

TO ALL MEMBER BANKS AND
BANK HOLDING COMPANIES IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

The Federal Reserve Board is considering the adoption of a policy statement that would generally prohibit individuals associated with financial institutions from personally profiting from the sale of credit life insurance and requires that income from this activity be credited to the financial institution.

Printed on the following pages is a copy of the proposed policy statement recommended by the Federal Financial Institutions Examination Council. If the policy is adopted by the Board, you will be notified.

Sincerely yours,

William H. Wallace

First Vice President

FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

Proposed Policy Statement on Disposition of Credit Life Insurance Income

December 1980

The Examination Council recommends that the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, National Credit Union Administration, and Office of the Comptroller of the Currency adopt a policy statement concerning the disposition of credit life insurance income. The recommended policy statement generally prohibits individuals associated with a financial institution from personally profiting on credit life insurance sales and requires that income from this activity be credited to the financial institution. Special rules apply to bank holding companies and savings and loan holding companies. Institutions not already subject to a rule or policy governing disposition of credit life insurance income would have two years from the date of the policy's publication in the Federal Register to comply. In addition, paragraph 5 of the policy statement provides that further extensions may be granted by an agency to any institution that can show a clear hardship situation.

Principal drafters of the recommended policy statement are: Sandra Greene, Federal Reserve Board; Clint Futrell, Federal Deposit Insurance Corporation; Larry Berkow, Federal Home Loan Bank Board; Layne Bumgardner, National Credit Union Administration; and Ford Barrett, Office of the Comptroller of the Currency.

DISCUSSION

On January 4, 1980, the Federal Financial Institutions Examination Council published for comment a Joint Notice of Proposed Policy Statement on Disposition of Credit Life Insurance Income (45 F.R. 1152). In light of over 600 comments received, the following significant changes have been made in the policy statement being recommended to the five federal financial regulatory agencies represented on the Council.

1. The policy statement has been expanded to cover income from the sale of mortgage life insurance, a form of credit life insurance sold on mortgage loans.

2. A footnote has been added to make it clear that the policy statement does not intend to govern that portion of the insurance premium required to cover the underwriting risk.

3. The policy statement's first paragraph contains a new sentence permitting limited bonuses to be paid to officers and employees for credit life insurance sales. Allowing limited bonuses will respond to the comment voiced by many financial institutions that an incentive is required to motivate a loan officer to sell credit life insurance, while still reducing the potential for abusive sales practices.

4. The final policy statement reaffirms that credit life income should be credited solely to the financial institution's income accounts and not to individual employees, officers, directors, principal shareholders, their interests, or other affiliates. However, an exception allows credit life income to be credited to an affiliate operating under the Bank Holding Company Act or the Savings and Loan Holding Company Act, or to a trust for the benefit of all shareholders, provided that the financial institution is paid "reasonable compensation". This latter condition recognizes both the role of the financial institution in generating credit life insurance sales and the rights of any minority stockholders to share in the benefits of such sales. As a general rule, "reasonable compensation" should amount to a minimum of 20% of the net income attributable to the financial institution's credit life insurance sales. For example, where a bank holding company operates an insurance agency selling credit life insurance to both the bank's customers and to customers of the holding company's finance company subsidiary, the minumum reasonable compensation to the bank would be 20% of the net income from credit life sales related to loans made by the bank. If management feels that less than 20% should be the appropriate measure of compensation, it may discuss the matter with its principal federal regulator.

5. The last paragraph of the policy statement increases the period within which compliance is to be achieved by institutions not now subject to a rule, regulation or policy statement on the disposition of credit life insurance income, from one year to two years. While an additional year may not be necessary for most institutions to comply with the policy, an extra year will ensure that adequate time has been provided for virtually all institutions to be in compliance. The provision for hardship extensions beyond the initial implementation period is retained as well.

With regard to the anticipated effects of the recommended policy statement, the following observations are made.

1. Because the revised policy statement exempts holding companies, except for the requirement that reasonable compensation be paid to the subsidiary financial institution, it is likely that the effect of the policy on the majority of holding companies will be immaterial.

2. Because the policy requires a financial institution to be reasonably compensated for its role in effecting the sale of credit life insurance, it is expected that any burden associated with adjusting operations to comply with the policy statement will be more than offset by benefits to the institution.

3. The majority of individuals associated with financial institutions who currently rely on income from the sale of credit life insurance to supplement salary or dividend income are expected to have little difficulty in adjusting to the policy. Salary or dividends can often be increased by a financial institution sufficiently to replace forgone credit life insurance income. While under certain circumstances a financial institution may be unwilling or unable to replace an individual's lost insurance income with an increase in salary or dividends, where a severe or insurmountable problem is encountered an appeal may be made to the hardship extension provision of paragraph 5.

RECOMMENDED POLICY STATEMENT

Policy Statement
On The Disposition of Income From
The Sale of Credit Life Insurance

For the purposes of helping to preserve the safety and soundness of financial institutions, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the National Credit Union Administration[1/] and the Office of the Comptroller of the Currency establish the policies set forth below on the disposition of income[2/] from the sale of credit life, health, and accident and mortgage life insurance ("credit life insurance") related to loans made by federally insured financial institutions.

1. *Individual employees, officers, directors and as applicable principal shareholders of a financial institution should not personally profit by retaining commissions or other income from the sale of credit life insurance to the institution's loan customers. However, employees and officers may participate in a bonus or incentive plan under which payments based in whole or in part on credit life insurance sales are made in cash or in kind out of the financial institution's funds in an amount not exceeding in any one year 5% of the recipient's annual salary. Such payments may not be made to employees and officers more frequently than quarterly.*

1/ NCUA regulations prohibit federal credit unions and their employees from receiving any remuneration for acting in an agency capacity for a credit life insurance company. Federal credit unions may only accept reimbursement for the actual costs of services performed pertaining to the sale of credit life insurance.

2/ "Income" includes commissions and experience rating credits; it does not refer to that portion of the premium required to cover the underwriting risk.

2. *As an accounting and operations matter, income derived from credit life insurance sales to loan customers should be credited to the income accounts of the financial institution (or in the case of a savings and loan association operating through its service corporation, to the service corporation), and not to the financial institution's individual employees, officers, directors, and as applicable principal shareholders, their interests, or other affiliates. However, such income may be credited to an affiliate operating under the Bank Holding Company Act or the Savings and Loan Holding Company Act or to a trust for the benefit of all shareholders, provided that the financial institution receives reasonable compensation in recognition of the role played by its personnel, premises and good will in credit life insurance sales.*[3/]

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. *In stock institutions the proper method for the distribution to shareholders 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 practices.*

3/ *As a general rule, "reasonable compensation" means an amount equivalent to at least 20% of the affiliate's net income attributable to the financial institution's credit life insurance sales.*

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 two years following publication in the Federal Register of this 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.*