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An M&A Checklist for BOLI, Compensation Programs

By: *Becky Pressgrove* | September 3rd, 2021

As bank M&A activity continues to pick up, it is crucial that buyers and sellers understand the implications of any transaction on bank-owned life insurance portfolios, as well as any associated nonqualified deferred compensation (NQDC) programs, to mitigate potential negative tax consequences.

Identify and Review Target Bank's BOLI Holdings

The first step is for buyers to identify the total cash surrender value of sellers' BOLI portfolio and its percentage of regulatory capital. The buyer should identify the types of products held and the amount held in each of the three common BOLI product types:

- *General account*
- *Hybrid separate account*
- *Separate account (registered or private placement)*

In addition to evaluating historical and current policy performance, the buyer should also obtain and evaluate carrier financial and credit rating information for all products, as well as underlying investment fund information for any separate account products.

Accounting and Tax Considerations

From an accounting standpoint, the buyer should ensure that the BOLI has been both properly accounted for in accordance with GAAP (ASC 325-30) and reported in the call reports, with related disclosures of product types and risk weighting. Further, if the policies are associated with a post-retirement split-dollar or survivor income plan, the buyer should ensure that the liabilities have been properly accrued for.

The structure of the transaction as a stock sale or asset sale is critical when assessing the tax implications. In general, with a stock sale, there is no taxable transaction with regard to BOLI — assets and liabilities "carry over" to the buyer. With an asset sale (or a stock sale with election to treat as asset sale), the seller will recognize the accumulated gain in the policies and the buyer will assume the policies with a stepped-up basis.

Regardless of the type of transaction, the buyer needs to evaluate and address the Transfer for Value (TFV) and Reportable Policy Sale (RPS) issues. Policies deemed "transferred for value" or a "reportable policy sale" will result in taxable death benefits. Prior to the Tax Cuts and Jobs Act, the transfer for value analysis was fairly simple: In a stock transaction, the "carryover basis" exception applies to all policies, whether or not the *insured individual remained actively employed. In an asset sale, policies on insureds who will be officers or shareholders of the acquiring bank will meet an exception.*

The Jobs Act enacted the notion of "reportable policy sales," which complicated the tax analysis, especially for stock-based transactions now requiring much more detailed analysis of the type of transaction and entity types (C Corp vs S Corp). It is important to note that the RPS rules are in addition to the TFV rule.

Review Risk Management of BOLI

The Interagency Statement on the Purchase and Risk Management of BOLI (OCC 2004-56) establishes requirements for banks to properly document both their pre-purchase due diligence, as well as an annual review of their BOLI programs. The buyer will want to ensure this documentation is in good order. Significant risk considerations include carrier credit quality, policy performance, employment status of insureds, 1035 exchange restrictions or fees and the tax impact of any policy surrenders. Banks should pay particular attention to ensuring that policies are performing efficiently as well as the availability of opportunities to improve policy performance.

Identify and Review NQDC plans

Nonqualified deferred compensation plans can take several forms, including:

- *Voluntary deferred compensation programs*
- *Defined benefit plans*
- *Defined contributions plans*
- *Director deferral or retirement plans*
- *Split dollar*
- *Other*

All plans should be formally documented via plan documents and agreements. Buyers should ascertain that the plans comply with the requirements of Internal Revenue Code Section 409A and that the appropriate "top hat" filings have been made with the U.S. Department of Labor.

General Accounting and Tax Considerations

Liabilities associated with NQDC programs should be accounted for properly on the balance sheet. In evaluating the liabilities, banks should give consideration to the accounting method and the discount rates.

Reviewing historical payroll tax reporting related to the NQDC plans is critical to ensuring there are no hidden liabilities in the plan. Remediating improperly reported payroll taxes for NQDC plans can be both time consuming and expensive. Seek to resolve any reporting issues prior to the deal closure.

Change in Control Accounting and Tax Considerations

More often than not, NQDC plans provide for benefit acceleration in the event of a change in control (CIC), including benefit vesting and/or payments CIC. The trigger may be the CIC itself or a secondary "trigger," such as termination of employment within a certain time period following a CIC. It is imperative that the buyer understand the financial statement impact of the CIC provisions within the programs.

In addition to the financial statement impact, C corps must also contend with what can be complicated taxation issues under Internal Revenue Code Section 280G, as well as any plan provisions addressing the tax issues of Section 280G. S corps are not subject to the provisions of Section 280G. For additional insight into the impacts of mergers on NQDC programs, see How Mergers Can Impact Deferred Compensation Plans Part I and How Mergers Can Impact Deferred Compensation Plans Part II.

Becky Pressgrove, CPA, is senior vice president at NFP. She has 27 years of experience with nonqualified benefit, BOLI and COLI programs with primary areas of focus on client service delivery—from developing and leading other professionals charged with insurance and benefit plan administration, accounting, and financial reporting to leading a team of senior advisors providing technical assistance to clients, consultants, and client service personnel on accounting, tax, regulatory and legislative issues.