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COLI MECHANICS: WHY AGGREGATE FUNDING?

Corporate-owned life insurance ("COLI") is a financing alternative widely utilized by public and private companies, financial institutions, banks and insurance companies as a means of financing executive benefit obligations. When companies purchase policies on the lives of their executives – namely, the eligible participants in a deferred compensation plan – they pay the premium, own the cash value of the policy, and become the beneficiary of the insurance.

The majority of COLI acquisitions are structured in a manner referred to as "aggregate funding," which equalizes the COLI premiums or death benefits across the entire population of Plan participants selected to be insureds rather than purchasing policies with premiums and face amounts individually tailored to each executive's liability. *Why is aggregate funding the recommended approach?*

- **Creates a more efficient structure to cover plan liabilities –** An aggregate funding strategy provides for the flexibility to allocate COLI premiums as a whole, which produces more reliable premium streams. If COLI policies were purchased for and linked to each individual participant, it could result in erratic and inconsistent premiums, which can increase costs and make the policies inherently inefficient.
- **Consistency** – Aggregate funding allows a company to structure the COLI in a manner that applies equal premiums or death benefits across all insureds, which eliminates issues/questions as to why a policy on one employee is different than another of comparable age/status.
- **Streamlines insurability –** Aggregate funding enables carriers to issue COLI policies on a Guaranteed Issue basis without the employees/insureds having to provide any medical information. A funding strategy whereby individual policies are purchased on each and every Plan participant may require medical underwriting, a time-consuming and potentially intrusive requirement that introduces the risk of participants being rejected for coverage altogether.
- **Mitigates future changes to eligible pool –** Aggregate COLI funding may reduce the number of policies (both currently and in the future) that need to be purchased to cover plan liabilities. This, in turn, can help a company better manage changes due to participant turnover, and avoid carrying multiple policies on terminated employees or incurring the costs associated with liquidating policies on terminated employees.
- **Designed to help COLI performance through census optimization –** Aggregate funding enables plan sponsors to have some level of control over whom they choose to insure with COLI by allowing them to eliminate higher-risk participants. Rather than having to link coverage to every individual participating in the NQDCP, aggregate funding enables the COLI to be thoughtfully limited to only those NQDCP participants who can help maximize COLI performance.
- **Simplifies administration –** Aggregate COLI funding can help with limiting the number of transactions because re-balancing and re-allocations are completed in the aggregate, not every time an individual changes allocation elections with the Plan.

Nonqualified plans cannot be formally funded without jeopardizing their tax status. In addition to the points outlined above, aggregate funding serves to help ensure that COLI is *informally* funding the benefit liability.