

THE COMMUNITY BANKERS ASSOCIATION OF ILLINOIS

August 4, 2006



Lawrence W. Smith, Chairman
Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

LETTER OF COMMENT NO. 109

Also sent via e-mail to: director@fasb.org

Re: EITF0604; "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements"

Dear Chairman Smith:

The Community Bankers Association of Illinois (hereinafter "CBAI"), representing nearly 500 state-chartered and federally-chartered banks and thrifts throughout Illinois, welcomes this opportunity to comment on the draft abstract for EITF Issue No. 06-04, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." For the reasons discussed below, CBAI strongly objects to both the conclusions embodied in the draft abstract and to the suggestion that those conclusions become effective for fiscal years beginning after December 15, 2006.

The EITF draft abstract's principal conclusion (Paragraph 5)

For purposes of this comment letter, CBAI's objections will focus on Paragraph 5 and Paragraph 6 of the draft abstract. In Paragraph 5, the essence and rationale of the EITF's conclusion on this subject is stated as follows:

"The Task Force reached a [consensus] that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with Statement 106 or Opinion 12 (depending upon whether a substantive plan is deemed to exist) based on the substantive agreement with the employee. The Task Force believed that a liability for the benefit obligation under Statement 106 or Opinion 12 has not been settled through the purchase of an endorsement type policy. The Task Force believed that the purchase of an endorsement type policy does not constitute a settlement since the policy does not qualify as non-participating because the policyholders are subject to the favorable and unfavorable experience of the insurance company."

CBAI urges here that there are two fundamental flaws with the conclusion expressed in Paragraph 5. First, and probably most fundamental, is the assumption throughout Paragraph 5 that there is any "liability" to be recognized by the employer for the postretirement benefits. In Paragraph 1, the EITF noted that "(c)ompanies purchase life

insurance for various reasons that may include protecting against the loss of “key” employees, funding deferred compensation and postretirement benefit obligations....” It should not escape the EITF, for purposes of the draft abstract or otherwise, that first and foremost among the reasons associated with purchasing such insurance contracts is the concept of *shifting the burden of fiscal liability from the party that purchases the policy to the insurer*.

In the case of endorsement split-dollar life insurance contracts, the employer has made a conscious business decision to pay an insurance premium in exchange for the insurance company’s assumption of the liability for the payment of the claim (in this case, the payment of the postretirement benefit payable to the employee’s beneficiary as agreed by the parties). The policy owner (i.e., the employer) is contractually absolved from liability for the payment of the benefits because the policy owner has “purchased” the insurance company’s legal commitment to assume that liability. A contrary conclusion would seemingly negate the purpose or incentive for an employer to purchase any insurance policy. If the “risk” is not assignable to the insurance company, then why purchase the policy? Surely the EITF does not intend for purposes of financial accounting to stand a basic, contractual truth regarding transfer of risk pursuant to an insurance policy on its head.

Recording a liability for the postretirement benefits would not merely defy the fundamental relationship between the insured and the insurer, in this case it would also lead to financial statements of policyholders that misrepresent their actual liability exposure. Of primary concern to CBAI is the financial statement of a community bank or thrift. Many of these financial institutions have made informed business decisions to purchase split-dollar insurance policies for the purposes related to postretirement benefits payable to beneficiaries of officers and directors. To suggest that these employers must now, on their financial statements, declare and account for an imaginary liability that they in truth will not be responsible for paying will have a dramatic and negative impact. If implemented, the draft abstract could potentially wreak havoc with respect to the regulatory capital maintenance requirements that are imposed on banks and thrifts.

Beyond the fact that Paragraph 5 of the draft abstract does not adequately take into account the fundamental nature of the insurance company’s assumption of liability under such a policy and the misrepresentations that would result in employers’ financial statements, there is a second flaw that CBAI asserts in the conclusion expressed in Paragraph 5. The rationale in Paragraph 5 seems to be tied to the idea that the liability has not been “settled” through the purchase of an endorsement split-dollar policy “since the policy does not qualify as non-participating....” This idea assumes that a settlement can only relate to “non-participating policies.”

The “Accounting for Settlement of a Postretirement Benefit Obligation” is addressed in FAS 106’s paragraphs 90 through 95. Paragraph 90 specifies that a settlement occurs in a transaction: (1) that is an irrevocable action; (2) that relieves the employer of primary responsibility for the postretirement benefit obligation; and (3) that eliminates significant risks related to the obligation and the assets used to effect the settlement. Without any

further analysis, it occurs to CBAI that an endorsement split-dollar insurance policy passes these three tests with flying colors. First, the purchase of the policy irrevocably transfers the obligation to the insurer. Although the policy can be terminated by the employer, that fact cannot be the basis for concluding that the action is not an irrevocable transfer. To suggest that the employer's ability to terminate the policy negates the "irrevocable" test and therefore creates an employer liability (due to failure of "settlement") makes no sense, because if the policy is terminated there is no continuing obligation to pay the postretirement benefit.

CBAI understands that the draft abstract is not necessarily basing its conclusion on the "irrevocable" test, so we will move to the second prong of the "settlement" analysis. Does the transaction relieve the employer of primary responsibility for the postretirement benefit obligation? Clearly, it does. As asserted above in this comment letter, there is no practical or legal argument that would justify a conclusion that the endorsement split-dollar policy does not shift the financial burden for payment of the postretirement benefit from the employer to the insurer. In fact, that is the very purpose and nature of such arrangements.

The third prong of the "settlement" analysis is met with equal ease. Not only are "significant risks" related to the obligation and the assets of the employer eliminated, but in fact the employer has insulated itself from *all* risk to its corporate assets for the purposes related to the postretirement benefits.

If all three prongs of the "settlement" definition in Paragraph 90 of FAS 106 have been met, how does the draft abstract conclude that there is no settlement with respect to endorsement split-dollar insurance policies? Apparently, that conclusion is based on the assumption that such contracts must be "non-participating," and so the draft abstract adds a fourth test to the "settlement" analysis that is not disclosed in Paragraph 90. In truth, there is a reference to "nonparticipating insurance contracts" found in Paragraph 90, but that reference is merely an example of a contract that would meet the settlement test. Nothing in Section 90 provides fair notice that there is a new, fourth test that the employer's transaction must satisfy in order to avoid recognition of a liability for a postretirement benefit arrangement. Paragraph 90 is sufficiently thorough in its description of "settlement," to the point that footnote 24 supplements Paragraph 90 by clarifying that the purchase of an insurance contract from an insurance company controlled by the employer cannot be deemed to be a settlement. Again, nothing in FAS 106's paragraph 90 negates "settlement" with respect to endorsement split-dollar insurance contracts.

If the EITF wanted to press the issue that a settlement could only occur when the transaction involved a "non-participating" insurance contract, then the EITF would run directly into a dilemma involving FAS 106's Paragraph 94. Paragraph 94 states that "*(i) if the purchase of a participating insurance contract constitutes a settlement, the maximum gain (but not the maximum loss) shall be reduced by the cost of the participation right before determining the amount to be recognized in income.*" If the purchase of a participating insurance contract constitutes a settlement? Unless the EITF

is prepared to read Paragraph 94 as if those words do not exist, then clearly whether or not the insurance contract is “participating” cannot be an exclusive test that could undermine settlement with respect to endorsement split-dollar arrangements. There are additional, and equally valid, objections to the conclusion stated in Paragraph 5 of the draft abstract. Among those objections is the point that holding the employer accountable as if it were liable for payment of the postretirement benefits would essentially result in duplication of expenses, since the employer is first paying costs related to the insurance policy (designed to relieve the employer of the postretirement payment burden) and second would have to account as if the postretirement benefit were accruing as the employer’s payment responsibility.

The effective date (Paragraph 6)

By this comment letter, and the comment letters submitted by dozens of concerned employers that utilize endorsement split-dollar policies, CBAI has pointed out numerous issues that should raise doubts regarding the analysis that went into the draft abstract and the conclusions that are expressed therein. CBAI strongly urges that the draft abstract be rejected in its entirety, but in any event it should be clear that legitimate questions and concerns have now surfaced and that, if the draft abstract is implemented in even a modified form, the result will have dramatic and unfair consequences for employers (including for banks and thrifts that are members of CBAI). Imposing *any* form of this draft abstract for fiscal years beginning as soon as a few months from now could do real and substantial harm to the financial positions of banks, thrifts and other employers who in good faith entered into endorsement split-dollar arrangements for the purpose of providing postretirement benefits to officers and directors or to their beneficiaries. The draft abstract for EITF Issue No. 06-04 must be carefully reconsidered, and employers must be given adequate time to adjust to whatever determination is made on this issue. Such adjustments cannot realistically be made in a safe, sound and orderly fashion in a few months.

CBAI urges that the December 15, 2006 effective date specified in Paragraph 6 of the draft abstract be rescinded and that no effective date be specified until such time as the EITF has set a timetable to reconsider the conclusions and the impact of this issue. In no event should the implementation be effective prior to fiscal years beginning after December 15, 2007.

CBAI thanks you for your attention to and consideration of these comments.

Sincerely,

Jerry D. Cavanaugh
General Counsel
Community Bankers Association of Illinois