

July 31, 2006

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



LETTER OF COMMENT NO. 40

Dear Mr. Smith,

Clark Consulting appreciates the opportunity to comment on the draft abstract for EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements."

We disagree with the provisions in the proposed consensus as explained below. In addition, if the proposed consensus is finalized we believe additional time should be given for implementation as explained below. Finally, should the proposed guidance be finalized we believe additional guidance should be given on issues arising upon implementation to prevent diversity of practice on those issues.

Initial Premise and Description of Transaction

The proposed consensus and the issue summaries leading up to it imply a premise that the employer has assumed a liability to pay a death benefit for which it acquires a life insurance policy to fund that obligation. Based on that premise, the proposed consensus concludes that the liability is not settled by the acquisition of the policy. The premise is faulty in a number respects.

1. The benefit obligation does not exist prior to entering into the endorsement split-dollar arrangement. Not until the date the insurance company issues the insurance policy, followed thereafter by execution of the endorsement split-dollar agreement and policy endorsement by the employer and the employee, does the employee have any interest in the death benefit of the underlying life insurance policy. Upon execution of those requisite documents, the employee (and the employee's beneficiary) looks solely to the insurance carrier for payment of the benefit. The employer is never obligated to pay a death benefit in a basic endorsement split-dollar arrangement either prior to or upon entering into the split-dollar arrangement. (In the highly unusual instance where an employer contractually promises to back-up or guarantee payment of the death benefit under specified circumstances, the arrangement falls outside the definition of a basic split-dollar life insurance arrangement and should be accounted for in accordance with the terms of the underlying contract.)

2. The abstract incorrectly states, in the description of a basic endorsement split-dollar arrangement in paragraph 2, that "Depending on how the policy is structured, the beneficiary's proceeds are received directly... from the employer (who remits the beneficiary's proportionate share once payment is received from the insurance company)." This is not descriptive of an endorsement split-dollar arrangement. "Endorsement split-dollar" is not a generic term, it is specific to the formal arrangement in which a policy endorsement is executed and becomes an integral part of a life insurance policy directing the insurance company to make split payments of the death benefit according to the terms of the endorsement or by reference to the split-dollar agreement. If there is not a formal endorsement to the policy filed with the insurance carrier directing the split death benefit payment then it is not, by definition, an endorsement split-dollar arrangement. The abstract language cited may be describing some form of death benefit plan but it is not endorsement split-dollar life insurance and portraying it as such fosters an incorrect understanding of the arrangement and, by extension, an incorrect conclusion as to the appropriate accounting treatment.

Application of Settlement Concept

The proposed consensus states that the employer's obligation under the endorsement split-dollar arrangement is not settled because the life insurance policies are deemed to be participating policies and therefore do not meet the criteria for a settlement under existing accounting literature. We believe

that upon examining the full context and intent of the settlement definition in existing literature the postretirement benefit is fully settled by the insurance policy in a basic endorsement split-dollar arrangement.

A basic endorsement split-dollar arrangement is distinctly different than the more typical FAS 106 plans. In the absence of the policy there is no benefit to the employee, the split portion of the policy itself is the benefit. The employee's benefit is determined by and limited to the death benefit gain under the insurance policy. The basic endorsement split-dollar arrangement may define the portion of the death benefit to be split to the employee's beneficiary in a number of ways (fixed amount, multiple of salary, etc.), but further limits the employee amount to the policy death benefit gain at the time of the employee's death. (The death benefit gain is the total policy death benefit in excess of the policy cash surrender value at the time of death – essentially the “term insurance” coverage.) For example, if the defined split-dollar benefit is \$100,000 and the policy death benefit gain at the employee's death is only \$85,000, then the total death benefit paid to the employee's beneficiary will be \$85,000. In the same example, if the policy death benefit gain at the employee's death is \$120,000, then the death benefit paid to the employee's beneficiary will be \$100,000. In the first example the employer's share of the policy death benefit payment from the insurance carrier would be equal to the cash surrender value at the date of the employee's death. In the second example the employer's share of the policy death benefit payment from the insurance company would be the policy cash surrender value at the date of the employee's death plus a death benefit gain of \$20,000. In all cases, the amount payable by the employer to the employer's beneficiary will be zero. In all cases only the insurance company makes payment to the employee's beneficiary.

We believe the basic endorsement split-dollar arrangement does in fact meet the underlying intent of the three-faceted settlement definition included in FAS 106 paragraph 90 as explained below.

(a) is an irrevocable action.

The policy is an irrevocable obligation of the insurance carrier unless the employer acts to cancel the coverage. If the employer elects to cancel the policy the split-dollar benefit is also eliminated under the basic endorsement split-dollar arrangement.

Contrast that result with the more typical FAS 106 plan in which the benefits are payable to the employee under the terms of the plan regardless of whether insurance coverage is in force.

(b) relieves the employer (or the plan) of primary responsibility for a postretirement benefit obligation.

The employer is relieved of all responsibility for paying the postretirement benefit under any and all circumstances in the basic endorsement split-dollar arrangement. The benefit is, by definition, a sharing of the insurance policy death benefit gain at the time of the employee's death, payable by the insurance company directly to the deceased employee's beneficiary.

(c) eliminates significant risks related to the obligation and the assets used to effect the settlement.

The employer has no obligation to pay any benefit in the basic endorsement split-dollar arrangement. The benefit payment is made to the employee's beneficiary by the life insurance carrier and the employer receives the cash value and any remaining residual policy gain. Therefore, there is no employer risk related to the benefit payable to the employee's beneficiary.

The proposed consensus reasons that settlement is not achieved because the policies underlying the endorsement split-dollar arrangement are participating policies. We acknowledge that the policy cash value will grow at varying rates based on future circumstances, principally prevailing market interest rates. However, the cash surrender value is not the asset used to either determine or settle the benefit obligation in the basic endorsement split-dollar arrangement. The cash surrender value asset belongs exclusively to the employer both prior to and upon the employee's death. All or a portion of the death benefit proceeds in excess of cash value (a contingent, unrecognized asset that can only be realized upon the death of the insured employee) is the sole source of the benefit payment by the insurance company to the employee's beneficiary. The performance of the employer's cash value asset does not affect the contingent gain asset in a manner that has any impact on the employer on account of the split-dollar arrangement.

The relevant point is that, unlike insurance policies in more typical applications of FAS 106, the nature of “participation” in a basic split-dollar arrangement is irrelevant to the employer. In all possible outcomes (increase in cash value, decrease in cash value, increase in death benefit, decrease in death benefit or even lapse of the policy) the employer is insulated from any impact relative to the payment of any death benefit to the employee; such

payment obligation is undertaken solely by the insurance carrier and is derived from the insurance gain element of the policy death benefit, if any, at the time of the employee's death.

Qualitative Considerations

We believe that financial statements prepared under the proposed consensus will be misleading to users of the statements.

We believe that accrual of an obligation that will never be paid by the employer under a basic endorsement split-dollar arrangement does not provide useful, relevant accounting information. If such an accrual is required, decision makers will see a significant liability on the balance sheet, leading the user of the financial statements to incorrectly conclude that the employer will need to settle that liability with cash sometime in the future. It strikes us as irrelevant and misleading to record a liability for which the employer has no legal or constructive liability.

We submit that the proposed consensus does not faithfully represent the true economic nature of the basic endorsement split-dollar life insurance arrangement.

Asymmetrical Result

A related concern is that the proposed consensus will result in financial statements that report only "half" of the economics and contract terms of a split-dollar policy. Under the proposed consensus, a liability will be recorded for the employer's inferred obligation to its employee based on accounting models that incorporate assumptions about expected future benefits to the employee. However, the employer's asset - an asset that is inextricably intertwined with and the sole source for that obligation - will be recorded based on an accounting model that is designed to ignore future events. This asymmetry is not consistent with either the form or the substance of a basic endorsement split-dollar arrangement. We acknowledge (but do not agree with) EITF's view that the purchase of a participating policy does not represent a settlement for accounting purposes. We also acknowledge that FASB Technical Bulletin (TB) 85-4 requires that life-insurance policies be recorded at their cash surrender value. But while these individual decisions may be appropriate taken in isolation, we ask that the EITF consider whether the end result of this proposed consensus creates an appropriate accounting framework for the form and substance of an endorsement split-dollar life insurance arrangement.

Accepting a conclusion that the obligation has not been settled does not negate the fact that the arrangement includes an asset that is dedicated to the settlement of the liability. That conclusion also does not necessarily force a particular conclusion regarding the accounting for the dedicated asset. In our view, TB 85-4 is neither an appropriate nor acceptable framework for a participating insurance policy when the arrangement is treated as substantively creating an obligation that is measured based on expected future events.

Duplication of Expense

Accruing the present value of a post retirement death benefit delivered by an insurance policy in an endorsement split dollar arrangement creates a duplication of expense for the employer. The cost of the insurance coverage is already reflected in the net growth of the policy cash values. Using the analogy of an employer's promise to purchase annual renewable term insurance for an employee, the annual premiums would be expensed in the period paid (or for the period covered.) This same expense for insurance coverage occurs as cost of insurance charges in the life insurance policies described in the draft abstract. The cost of insurance is assessed each period against the cash value growth and flows through the employer's income statement. In the term insurance analogy the employer would not accrue the term insurance death benefit in addition to the premium expense, which is what the proposed consensus requires. This duplication of expense misstates the economics of the arrangement and results in a misleading presentation in the employer's financial statement.

OTHER CONSIDERATIONS SHOULD THE PROPOSED CONSENSUS BE FINALIZED

Transition Period

As a service provider to over six thousand endorsement split-dollar arrangements we believe the effective date in the proposed consensus provides inadequate time for the myriad of affected companies to assess their plans, consider their optional courses of action and prepare actuarial calculations of the benefit obligations required under the

proposed consensus. Many of the companies affected by the proposed consensus are financial institutions subject to strict regulatory requirements for capital adequacy ratios. The required implementation of the proposed consensus in the short time frame between final approval and the implementation date as drafted provides inadequate time for those institutions to analyze the impact on capital, which can be substantial, and take corrective action to avoid falling out of regulatory compliance. We suggest that EITF change the implementation date to fiscal years beginning after December 15, 2007.

Accounting for Income Taxes

The income tax accounting for split-dollar arrangements and the related obligation arising from the application of this proposed consensus are likely to be complex. For example, should the obligation accrued for employee benefits be treated as a "non-temporary" difference because of the company's ability and intent to hold the related insurance policy to "maturity" and the resulting non-deductibility of the employee benefit expense on the tax return? We encourage the EITF to provide practitioners with guidance as to the appropriate income tax accounting for these transactions under Statement No. 109, *Accounting for Income Taxes*, so that diversity in practice does not arise.

Cash Flow Statement Presentation

We are uncertain as to the appropriate cash flow statement presentation when the employer's obligation is settled, i.e. upon the employee's death and the insurance company payout of benefits. For example, should the employer impute receipt of the cash from the insurance company and payment to the employee's estate or should this aspect of the transaction be considered non-cash on the basis that the employer is not receiving or remitting the employee-designated benefit? As with income taxes, we encourage the EITF to provide practitioners with guidance as to the appropriate presentation under Statement No. 95, *Cash Flow Statement*, so that diversity in practice does not arise.

Terminology

The proposed consensus contains imprecise language in describing a split-dollar life insurance arrangement. Split-dollar arrangements are applied to life insurance policies. The term "split-dollar policies" or "endorsement split-dollar life insurance policies" would be more accurately stated as "split-dollar arrangements" or "split-dollar life insurance arrangements." That is, the life insurance policy is not a split-dollar policy but rather a life insurance policy subject to a split-dollar arrangement.

Clark Consulting appreciates the opportunity to share our thoughts on this issue with the EITF. We would be happy to discuss them in more detail at your convenience. Further, we would be pleased to attend the next EITF meeting at which this issue will be addressed to respond to any member's questions about the split-dollar arrangements and life insurance policies that might arise during the discussion.

Sincerely,



David W. Clark, CPA (inactive)
Vice President – Senior Technical Advisor
Banking Practice



Bruce Bengtson, FSA
Senior Vice President – Chief Actuary
Banking Practice