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Director Financial Accounting Standards Board
Emerging Issues Task Force
File Reference No. EITF 0604

LETTER OF COMMENT NO.

71

To Whom It May Concern:

This comment is in response to EITF No. 06-4 is composed of three parts: (1) the absence of an employer liability under the typical endorsement method split dollar life insurance agreement; (2) the insistence of the proponents of View A that only a non-participating insurance contract can effectively settle the liability for an endorsement split dollar agreement; (3) the double expensing impact of View A; and (4) the deleterious impact of adoption of View A on employers and employees.

(1) Under the typical endorsement method split dollar plan, any employee right to benefit is predicated upon the existence of the life insurance policy(ies) identified in the agreement. The entire benefit obligation, to the extent a payment is due, is borne by the insurance policy(ies) subject to the endorsement method split dollar agreement.

Thus, it is not possible for the liability for benefit payment to revert to the employer. EITF has taken the position that an endorsement split dollar plan creates a liability (post retirement benefit obligation) that is beamed in some fashion to the employer. EITF maintains the notional liability must be accrued for during the service period because only a certain type of policy can settle the obligation.

(2) Proponents of View A choose to ignore the fact that FAS 106 specifically states that the purchase of a participating policy can settle a post retirement benefit obligation. Those supporting View A assert that only a non-participating contract can satisfactorily settle a post retirement benefit obligation. For most practical purposes, non-participating contracts were made extinct in the late 1970s with the advent of interest sensitive whole life and universal life contracts. These contracts supplanted non-participating whole life products because they provided a similar level of contractual guarantees while providing the potential for policy owner gain through more favorable cost of insurance and interest crediting factors. Today, non-participating whole life products are primary marketed for final expenses in small face amounts to low income individuals on a debit basis. By clinging to a narrow and incomplete reading of FAS 106 and by remaining impervious to changes with respect to insurance products, the proponents of View A appear to be manufacturing a situation requiring expense accruals.

From an operational perspective, universal life (deemed participating by proponents of View A) policies contain guarantees of minimum interest crediting rates and maximum mortality charges. Both participating and non-participating contracts contain similar minimum interest guarantee factors. The guaranteed mortality rates stipulated in both participating and non-participating policies would, in most instances, be based on the same CSO Mortality Table. Given a maximum single premium, minimum death benefit policy design, universal life policies produce guaranteed death benefits that extend to and beyond the normal mortality age of the individual. Thus, to the extent of providing the above death benefit based on the policy

guarantees alone, the contracts are non-participating. To the degree the carrier's interest crediting rates and/or cost of insurance deductions are more favorable than the minimum contractual guarantees, the period for which the death benefit is guaranteed is extended. Item 15 of View A states regarding participating contracts, "the insurer generally has the right to recover unexpected increases in the cost of insurance due to changes in mortality or increased administrative costs." and in doing implies that such increased charges can be applied on a retrospective basis. This is misleading. Universal life policies operate prospectively, i.e. the carrier is limited to recovering such increased costs through future increases in the cost of insurance and administrative costs. Future recovery of these costs is limited by contractual guarantees for the maximum cost of insurance, the maximum administrative costs and the minimum guaranteed interest crediting. Therefore, the initial death benefit and the period for which it was guaranteed remains unaffected by changes on the part of the insurer, thus, enabling the risk transfer from the employer to the insurance carrier to remain intact and guaranteed.

(3) Finally, requiring accruals during the service period results in a double expensing of the liability for which accruals are being made. Under the typical endorsement method split dollar agreement the element of the policy that is being split is the net amount at risk (policy death benefit minus cash surrender value) or pure insurance element of the policy. Each month the current cost of insurance, which represents the value of that month's benefits, is deducted from the policy cash surrender value. Requiring the employer to accrue an additional amount would result in the expensing of the same cost twice.

(4) The adoption of View A would negatively impact the employers by requiring them to record a liability for an amount that will be ultimately reversed. The increased expense will lead many employers to terminate endorsement method split dollar plans for certain key employees or, alternatively, maintain these benefits while cutting plans benefiting rank and file employees. In the final analysis, both parties, employers and employees, will either bear increased costs or experience reduced benefits for the sake of contrived accounting artifices that will decrease accounting accuracy while doing nothing to improve shareholder safety.

Clearly, FASB and the business community at large would benefit greatly from an update of FAS 106 with respect to life insurance matters. FASB may wish to consider retaining legal counsel with expertise concerning split dollar insurance agreements and the liability issues pertaining to them and a product development actuary who could update FASB with respect to contemporary insurance products and nomenclature. Larry Brody with the St. Louis law firm of Bryan Cave is widely regarded as the foremost legal authority on split dollar plans and would be an excellent choice. The product development actuary reviewing this commentary was Miller and Newberg, Inc. of Olathe, Kansas. Their firm or any one of a number of other firms could provide updating relative to contemporary products and standardized insurance industry terminology.

Sincerely,

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