



**Cummings, Ristau & Associates, P.C.**  
CERTIFIED PUBLIC ACCOUNTANTS

4339 Butler Hill Road

St. Louis, Missouri 63128

Phone (314) 845-6050 Fax (314) 845-5902

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



LETTER OF COMMENT NO. 84

RE: EITF Issue No. 06-04

Dear Mr. Smith:

Cummings, Ristau & Associates, P.C. appreciates the opportunity to comment on Emerging Issues Task Force (EITF) Issue No. 06-04, *Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Split-Dollar Life Insurance Arrangements*. We are a local CPA firm based in St. Louis, Missouri serving over 80 financial institutions in our market area. A significant portion of our client financial institutions has postretirement endorsement split dollar arrangements with one or more insured participants.

I have been a practitioner in the accounting profession for the past thirty years and have generally agreed with the consensus opinions on most EITF issues; however, our reading of the Task Force's tentative conclusions on Issue No. 06-04 has left us exasperated. We understand that the effect of the EITF decision, if upheld, would be to require an employer to recognize a liability over the service period required to vest the insured participant in the post retirement/termination split-dollar benefit. Upon the death of the insured participant (when the insurance company would pay the split-dollar death benefit directly to the participant's beneficiary), the employer would take the accrued liability back into income.

Our financial institution clients utilize endorsement split dollar arrangements, the underlying life insurance products for which are single premium policies. The financial institution is the owner and primary beneficiary of the policy and makes the full single premium payment when the policy is issued. Through a written split dollar agreement between the employer and the insured participant, the financial institution agrees to permit the insured participant to name the beneficiary for a portion of the policy death benefits by endorsement to the policy. The agreement specifies that the financial institution's share of the death benefit will be the greatest of a) the total premium paid, b) the policy cash surrender value at the date of the insured's death, or c) the total policy proceeds less a specified amount. The remaining death benefit will be paid to the insured's beneficiary. The policy endorsement is filed with the insurance carrier and contractually obligates the carrier to split the death benefit between the owner (employer) and the insured's beneficiary at the time of the insured's death. The death benefit portion subject to the endorsement is paid directly to the insured participant's beneficiary by the insurance company upon the insured's death.



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Note that the split dollar agreement between the financial institution and the insured employee sets forth the terms of the split dollar arrangement, including the portion of the policy death benefit endorsed to the participant's beneficiary. **It does not, however, contain any provision committing the employer to pay a death benefit to the employee's beneficiary, estate, heirs or survivors.**

The split dollar arrangement typically continues into the postretirement period if the insured employee remains in the employment of the financial institution until a specified date or event, so long as the financial institution continues to own the policy. The financial institution, under the terms of the split dollar agreement, retains the right to surrender the policy and all other policy rights, except the right to name the beneficiary for that portion of the death benefit endorsed to the benefit of the insured participant.

**There is no substantive plan or agreement under which the employer promises to pay a death benefit from its own assets. No such plan or agreement has taken place in past practice or has been communicated or implied by the employer to the employee.**

#### **Which View Do We Support?**

Our comments and conclusions relate to the form of endorsement split dollar arrangement and the underlying single premium life insurance policy described above.

The November 22, 2005 EITF Agenda Committee Report sets forth four Views (A-D) of the issue entitled "The employer's accounting for the deferred compensation or postretirement benefit aspects of a split-dollar life insurance arrangement." With all due respect, we don't believe that any of the four views is totally on point either because of the conclusion set forth in the view or because of the rationale set forth for the conclusion.

As we read the four views from the November 22, 2005 Agenda Committee Report, there appears to be an invalid premise underlying each of these views that the employer has incurred an obligation to pay a death benefit to the participating employee's beneficiary. This benefit promise is not present in the endorsement split dollar arrangements used by our clients. It appears to us that the split dollar insurance arrangement is being confused with a plan in which the employer promises to pay a benefit upon the employee's death and acquires life insurance to indemnify itself against the risk that the employee will die while the benefit promise is in effect. That is not a split dollar life insurance plan in fact or in substance.

For the specific form of endorsement split dollar and the underlying single premium policies subject to the split dollar arrangement described above, we support the accounting conclusion set



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forth in View D from the November 22, 2005 Agenda Committee Report, (“An employer should recognize the change in the cash surrender value or contract value (the life insurance asset) during the period as an adjustment to the premiums paid in accordance with Technical Bulletin 85-4. No liability recognition is required...”), but we do not support the reason given for the accounting result (“No liability recognition is required because the purchase of the insurance effectively settles the obligation.”) We believe that the reason no liability recognition is required is that no liability has been incurred by the employer to begin with. The employer has not undertaken an obligation to pay a death benefit. The employer, by written agreement, is promising only to share with the insured employee a portion of the contingent death benefit gain that will arise upon the employee’s death if the policy is owned by the employer and the split dollar agreement is in effect at the time of the death.

It has been suggested by some that in order to adopt the conclusions of View D from the November 22, 2005 Agenda Committee Report, the benefit “settlement” through insurance must meet the criteria for a settlement set forth in FAS 88. As we noted above, we believe the premise of that interpretation to be faulty; the employer is not settling an existing obligation through the purchase of insurance (as is the case wherein a pension plan obligation is “settled” by purchase of an annuity or in some other manner). In the endorsement split dollar arrangement, the employer does not have a death benefit obligation that it is funding (or settling) through split dollar life insurance; it owns a life insurance policy and it is willing to share a portion of the death benefit gain from the policy with the insured. This distinction is more than semantics and goes to the underlying substantive plan: absent the employer’s ownership of the life insurance policy and the existence of the split dollar agreement and policy endorsement, the participant and the participant’s beneficiary are not entitled to a death benefit. The employer never has a death benefit obligation and the insurance company’s obligation ceases if the policy is surrendered.

The financial institution acquires a single premium life insurance policy because the cash value asset performs well economically relative to other bank-qualified assets. The financial institution is willing to share a portion of the gain contingency (death benefit gain in excess of the policy cash value at the time of the death) with the insured individual. The financial institution’s cash value asset (the policy’s contractual value) is not affected by the split dollar arrangement and will be the same at any point in time regardless of whether the split dollar arrangement is entered into and/or remains in existence. The financial institution’s economic effect of entering into the split dollar arrangement is limited solely to a reduction of the amount to be realized under the gain contingency at the time of the employee’s death. Should the financial institution, for whatever reason, fail to retain the policy, the split dollar arrangement is void and no death benefit obligation exists to the employer or the employee’s beneficiary from any party to the arrangement (employer or insurance carrier).



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The split dollar arrangement does not settle the employer's benefit obligation because the employer has no obligation to pay a benefit; the sharing of the gain contingency is the benefit plan and it is the insurance company's obligation to pay that benefit to the participant's beneficiary. No death benefit obligation exists under the arrangement until the death of the insured employee, and that obligation is the insurance company's obligation under the policy endorsement. The insurance company pays the endorsed share of the death benefit directly to the insured participant's beneficiary upon the insured's death. There is no incremental cost of sharing the death benefit through the split dollar arrangement as evidenced by the fact that the contractual value of the policy to the owner is the same, with or without the split dollar endorsement. Therefore, we believe it is consistent with FAS 106, paragraph 67, that no benefit liability be recognized by the employer under this arrangement.

We know of certain firms that have called for accruing, during the employee's service period to full eligibility, a "carrying cost" for the policy during the postretirement period. We believe this to be a misapplication of cost or expenses as used in the extant literature. Unlike other policy configurations, no further premiums are payable once the single premium payment is made and the financial institution will not incur future premium costs such as might occur using a difference type of insurance such as term life. The only "cost" to the financial institution in this type of split dollar arrangement utilizing a single premium life insurance policy is a reduction of some of the future gain contingency (the death benefit proceeds over and above the already-recognized cash value). The policy contractual value (cash value) will be the same with or without a sharing of a portion of the death benefit gain under a split dollar arrangement. We believe it to be inappropriate to pre-record a reduction of the death benefit gain under a split dollar arrangement. We believe it to be inappropriate to pre-record a reduction of the death benefit gain contingency that itself cannot be recorded until it is realized under GAAP. A simple footnote disclosure of the sharing clearly meets the objectives of both FAS Statement 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions* and FAS Statement 5, *Accounting for Contingencies*.

We likewise believe it inappropriate to accrue over the service period the postretirement policy's internal mortality costs or "cost of insurance" since those costs are an intrinsic element of the future policy cash values, the primary element of which is interest earnings. The cost of insurance and the interest earnings are inextricably related to one another; they do not and cannot exist independently of one another. It is therefore inconsistent to accrue one (the cost element of the future cash value growth) without the other (the interest earnings element of the future cash value growth).

We note that with the diversity of arrangements falling under the common heading of "split dollar," correctly or incorrectly, different accounting could stem from different forms of split dollar



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and from different facts and circumstances. We do not purport to speak of the accounting for all forms of split dollar life insurance arrangements or even for all forms of endorsement split dollar life insurance arrangements. But we do believe that existing GAAP is clear as it relates to the substantive form of split dollar described above.

We believe the information outlined above clearly demonstrates that no liability should be accrued because no liability exists. We understand that the insured employee has received something of value (i.e., the insurance coverage), but the recognition of expense to accrue a liability for this value over the service period, only to take it back into income upon death, appears illogical to us. In fact, if the proposed EITF conclusion is upheld, you can be assured that several employers will take the opportunity to record the retroactive effect of the EITF conclusion to establish the calculated liability, only to subsequently terminate the policies and record additional income. We would think that the Task Force would not want to be a party to this "FASB-sanctioned earnings manipulation."

Additionally, the recording of income upon the insured's death to reverse the liability that the employer doesn't have to pay could also be subject to aggressive interpretation, i.e., when is the earnings process complete to allow for such "revenue recognition." Under the premise that there is nothing more certain than death, should a receivable be established for the same amount as the liability being established, because we know that when we record the liability accrual that we will eventually record this as income, because it is not owed to anyone?

### **Conclusion**

We believe the Task Force has "over-analyzed" this issue and is overcomplicating an issue that isn't that difficult to comprehend. No liability exists and therefore no liability should be recorded. An employer that enters into a basic endorsement split dollar arrangement described above should not account for any postretirement obligation under FAS 106 or APB 12. The policy underlying the split dollar arrangement should be accounted for at its contract value (cash surrender value) as set forth in FTB 85-4.

### **Basis for Accounting Treatment**

Support for this accounting treatment can be found in both FASB Concepts Statement No. 6, *Elements of Financial Statements* (CON 6) and SFAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (FAS 106).



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#### CON 6

CON 6, paragraph 195, states that “to assess whether a particular item constitutes a liability of a particular entity at a particular time requires at least two considerations in addition to the general kinds of evidence just described: (a) whether the entity incurred a responsibility to sacrifice assets in the future and (b) whether all or any of the responsibility remains unsatisfied at the time of assessment.”

In the basic endorsement split dollar arrangement described above, a death benefit will be paid to the employee’s beneficiary at the employee’s death, and it is solely the insurance carrier that is bound to pay that benefit. It is not the employer’s obligation. For the employer, the arrangement does not meet either of the two considerations set out in paragraph 195, required to constitute a liability. The employer does not have a responsibility to sacrifice assets in the future.

The employer does not assume a responsibility to pay a benefit under the basic endorsement split dollar arrangement. No benefit is promised to be paid by the employer prior to entering the split dollar arrangement. Even if it could be construed that the employer incurs a liability at the instant the split dollar agreement is executed, that “momentary liability” is immediately extinguished by the insurance carrier’s obligation under the insurance policy contract and attached endorsement (see paragraph 16 of SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*). The arrangement still doesn’t meet the ongoing test of a liability under CON 6, paragraph 195 that any employer’s responsibility remains unsatisfied; it is fully satisfied.

CON 6, paragraph 36, states that “A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.” In paragraph 40, CON 6 also notes that “...although most liabilities stem from legally enforceable obligations, some liabilities rest on equitable or constructive obligations, including some that arise in exchange transactions.” In the basic endorsement split dollar arrangement described above, the employer does not have either a legal or constructive obligation to pay any benefit under the arrangement.

#### FAS 106

FAS 106, paragraph 67 states “...an insurance contract is defined as a contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium; an insurance contract is



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irrevocable and involves the transfer of significant risk from the employer (or the plan) to the insurance company. Benefits covered by insurance contracts shall be excluded from the accumulated postretirement benefit obligation. Insurance contracts shall be excluded from plan assets...”

In the basic endorsement split dollar arrangement described above, the net insurance covers the benefit to be paid under the arrangement. By contract, the insurance company unconditionally undertakes the legal obligation to provide the specified benefit to the specific insured employee. The contract is irrevocable by the insurance company and transfers all of the benefit risk to the insurance company. Depending upon the terms of the agreement, the employer may be able to revoke the insurance policy coverage by surrender of the policy, but such action would render the arrangement void with no residual risk to the employer, clearly meeting the intent of the insurance contract definition of FAS 106. Since the benefit provided by the arrangement is fully covered by the insurance contract, it should be excluded from the accumulated postretirement benefit obligation. The insurance contract is bifurcated into two distinguishable elements under the split dollar arrangement, the contract value (cash surrender value) and the net insurance (death benefit proceeds in excess of the cash surrender value). The contract value (cash surrender value) is specifically excluded from the arrangement under the split dollar agreement and remains an asset of the employer and should be carried at its contract value (cash surrender value) as set forth in FTB 85-4.

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We appreciate the opportunity to share our opinion on this issue with the EITF.

Very truly yours,

CUMMINGS, RISTAU & ASSOCIATES, P.C.

Mark H. Cummings, Principal

MHC:skc