

2901 Telestar Court • Falls Church, VA 20042 August 4, 2006

Via E-mail to director@fasb.org

Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116



LETTER OF COMMENT NO.

9

Re: File Reference No. EITF0605

Comments on FASB Draft Abstract for EITF Issue No. 06-5

Accounting for Purchases of Life Insurance -- Determining the Amount That Could be Realized in Accordance with FASB Technical Bulletin 85-4,

Accounting for Purchases of Life Insurance

Ladies and Gentlemen:

The Association for Advanced Life Underwriting (AALU) appreciates this opportunity to comment on the Draft Abstract for EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance -- Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance." AALU is a national association of nearly 2,000 advanced life insurance planners. Its members sell and service substantial volumes of life insurance for business continuation, estate and retirement planning, wealth accumulation and transfer, executive compensation, charitable planning and employee benefits for individuals, families, estates, small businesses and corporations.

Prior Comments

Prior to the release of the Draft Abstract, AALU commented in writing to the EITF on Issue 06-5.² For the FASB's convenience, we attach a copy of our previous comment letter, which the present comments reference as appropriate.

Subissues and Proposed Consensuses

FASB Emerging Issues Task Force, Draft Abstract, EITF Issue 06-5, Accounting for Purchases of Life Insurance -- Determining the Amount That Could be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance (the "Draft Abstract").

Letter of June 14, 2006 from Mr. Dermot Healey, President, AALU, to Mr. Lawrence W. Smith, Chairman, Emerging Issues Task Force, attached hereto as Attachment I.

Subissues and Proposed Consensuses

The Draft Abstract subdivides Issue 06-5 into two substantive issues:

Issue 1: Whether a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the *amount that could be realized under the insurance contract* in accordance with FASB Technical Bulletin 85-4 (emphasis in original).

Issue 2: Whether a policyholder should consider the contractual ability to surrender all of the individual-life policies (or certificates in a group policy) at the same time in determining the *amount that could be realized under the insurance contract* in accordance with FASB Technical Bulletin 85-4 (emphasis in original).

According to the Draft Abstract, the EITF tentatively concluded with respect to Issue 1 that --

[A] policyholder should consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract (emphasis in original). The EITF agreed that contractual limitations should be considered when determining the realizable amounts. Those amounts that are recoverable by the policyholder at the discretion of the insurance company should be excluded from the amount that could be realized. The EITF also agreed that fixed amounts that are recoverable by the policyholder in future periods in excess of one year from the surrender of the policy should be recognized at their present value.

With respect to Issue 2, the EITF tentatively concluded that --

[A] policyholder should determine the amount that could be realized under the life insurance contract (emphasis in original) assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy[)]. The EITF also noted that any amount that is ultimately realized by the policyholder upon the assumed surrender of the final policy (or final certificate in a group policy) shall be included in the "amount that could be realized under the insurance contract."

If ratified, these proposed consensuses would be effective for fiscal years beginning after December 15, 2006. The Draft Abstract also proposes two alternatives for transitioning to this effective date:

- a. Treat consensus as a change in accounting principle through a cumulative effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption.
- b. Treat consensus as a change in accounting principle through retrospective application to all prior periods.

AALU Positions Summarized

Substantive Rules. In determining the amount that could be realized under the insurance contract under Technical Bulletin 85-4, a policyholder should take into account not only a policy's basic cash surrender value but also additional amounts included in the contractual terms of the policy. These additional amounts may include items such as the balance of a Claims Stabilization Reserve ("CSR") and refundable DAC tax as of the date of the statement of financial position. The amounts that could be realized (and thus recorded as an asset) also should include amounts obtainable, through waiver of surrender charges or otherwise, upon surrendering individual policies or certificates simultaneously rather than piecemeal. We thus agree with the proposed consensus on Issue 1 and disagree with the proposed consensus on Issue 2. We do agree that, in determining realizable amounts, contractual limitations should be considered and that amounts recoverable more than one year after surrendering a policy should be discounted to present value.

<u>Transition</u>. For the reasons just explained, the proposed consensus on Issue 2 should not be adopted. If adopted, however, then it should be made applicable only to life insurance policies that a policyholder acquires in fiscal years beginning after December 15, 2006. If, however, the FASB will not provide prospective-only relief, then policyholders should be allowed to amortize any cumulative effect adjustment resulting from the adoption of Issue 2 over a period of not fewer than five years.

Comments on Draft Abstract

In these comments, we explain why the proposed consensus on Issue 2 is incorrect and should not be adopted. The Draft Abstract suggests that comments "are most helpful if they identify the issue and the specific paragraph or group of paragraphs to which they relate and clearly explain the issue or question." Accordingly, we direct the present comments to the paragraphs of the Draft Abstract captioned below. In so commenting, we also address the specific questions on which the Draft Abstract requests input.³

³ See Notice for Recipients accompanying the Draft Abstract.

Comments on Draft Abstract Paragraph 6

Artificial Bifurcation of Contractual Provisions

The manner in which the Draft Abstract subdivides Issue 06-5 into Issues 1 and 2 needlessly complicates the analysis required under Technical Bulletin 85-4. The subdivision also creates a formalistic distinction between (i) contractual provisions on simultaneous surrender and (ii) other contractual provisions. This artificial bifurcation has resulted in an incorrect proposed consensus on Issue 2.

Paragraph 2 of Technical Bulletin 85-4 requires a policyholder upon purchasing a life insurance policy to record as an asset the "amount that could be realized under the insurance contract as of the date of the statement of financial position." Both this language and the Comments accompanying Technical Bulletin 85-4 make it clear that the appropriate amount must be determined by considering the terms of the particular insurance contract for which a policyholder seeks to record the correct amount.⁵

We thus submit that a policyholder should record as an asset under Technical Bulletin 85-4 whatever amount the policyholder has agreed with the insurer that the policyholder "could" receive upon surrendering the policy. Depending on the terms of the policy, that amount "could" consist of traditionally identified cash surrender value or it "could" consist of cash surrender value plus some additional agreed amount or amounts. But the determination of what amount to record under Technical Bulletin 85-4 should not depend on how a policy labels any additional available amount. If an insurance contract specifies that a policyholder "could" receive particular amounts (in one category or more than one category) upon surrendering a policy, then the policyholder should record the total of all such amounts as an asset under Technical Bulletin 85-4. Dissecting the fundamental question any more finely unnecessarily pays obeisance to formalism.

Taking into account (in addition to basic cash surrender value) these additional, contractually provided amounts properly reflects the economics of the transaction between the insurer and the policyholder. The cost of obtaining life insurance coverage (i.e., the premiums payable) depends on various factors including estimates of mortality and the features of a particular policy. Because the policyholder has bargained for these provisions (such as a claims stabilization reserve or a refund of DAC tax), which make the policy "more attractive to a policyholder," amounts the policyholder stands to receive under these provisions should be taken into account in booking the asset under Technical Bulletin 85-4.

See Technical Bulletin 85-4, ¶¶ 8-15.

Both the terms of the policy itself and any associated documents (e.g., riders) must be considered.

⁶ EITF Issue Summary No. 1 (May 24, 2006), ¶13.

Director August 4, 2006 Page 5

Amounts Obtainable Upon Simultaneously Surrendering Policies

Commercial Substance. In determining the "amount that could be realized" from multiple individual-life policies (or certificates in a group policy), a policyholder should take into account the contractual ability to surrender all of the policies simultaneously. This conclusion properly reflects the economic reality of purchasing and holding multiple individual policies. As we explained in our comments of June 14, 2006, businesses in many cases purchase large blocks of multiple individual policies in order to finance employee benefits including deferred compensation plans. The policies are purchased on an aggregate funding concept whereby no individual policy is viewed as funding benefits for a particular employee. Rather, in the aggregate, the policies are viewed as funding past, current and sometimes future participants in the deferred compensation or other employee benefit plan. Thus, for accounting purposes, the policies should be viewed as an integrated "block" of assets rather than individual policy assets. The proposal to determine the amount that could be realized under Technical Bulletin on a policy-by-policy basis fails to reflect the commercial substance of the arrangements.

Incorrect Interpretation of Technical Bulletin 85-4. The proposed consensus on Issue 2 would interpret Technical Bulletin 85-4 incorrectly. Taking into account these additional amounts represents the better reading of that primary source. We thus agree with the proponents of "View B" of Issue 2 as expressed in Issue Summary No. 1:

- The amount that could be realized should be determined by taking into account the contractual provisions of the policy including any provisions concerning simultaneous surrender.
- The phrase "could be" in Technical Bulletin 85-4 implies a concept of maximizing the amount to be realized, assuming that a policyholder will always act rationally and surrender the policies in a manner that will provide the maximum payout. In addition, the phrase "could be" anticipates a possible action completely within an actor's control. In this case, a policyholder has an absolute right to surrender policies under conditions enabling the policyholder to obtain the highest possible amount. The language "could be" should be interpreted in a manner reflecting the policyholder's discretion and control.
- Provisions for waiving surrender charges upon simultaneously surrendering all policies should be considered part of the "agreed provisions" considered by the buyer and seller in determining settlement options.

The proponents of "View A" in Issue Summary No. 1 reached the wrong result for various reasons:

• Technical Bulletin 85-4 does not refer to the "unit of account"

- Treating simultaneous surrender of all policies as a gain contingency under FAS 5 does not withstand scrutiny. The surrender of policies simultaneously is no more or less contingent than the surrender of them piecemeal. In either case, the only contingency is that the policyholder must surrender the policy or policies to the insurer. An employer has just as strong a contractual right to surrender policies simultaneously as to surrender them piecemeal. In many if not most cases, a policyholder may obtain additional amounts (through waiver of surrender charges or otherwise) only upon simultaneously surrendering multiple policies within a prescribed number of years after the policies were issued. This time limitation reinforces the incorrectness of treating simultaneous surrender as a gain contingency.
- Nothing in Technical Bulletin 85-4 requires or even suggests determining the "amount that could be realized" based on the frequency or infrequency with which an event may occur.⁷
- It is precisely because Technical Bulletin 85-4 requires the consideration of settlement amounts specified in a contract that contractual provisions concerning simultaneous surrender must be taken into account in determining the amount that could be realized.⁸

Irrelevance of Frequency of Surrendering Policies. In Issue Summary 1, the EITF concluded that "very few individual policies or certificates are surrendered and even fewer group policies (including multiple individual policies with a group rider) are surrendered." From that incorrect conclusion, the EITF reasoned that additional amounts available upon simultaneously surrendering multiple policies or certificates (rather than surrendering them piecemeal) should not be taken into account under Technical Bulletin 85-4. As previously explained, nothing in Technical Bulletin 85-4 suggests that the frequency or infrequency of an event should be taken into account in determining the amount that could be realized. Even if, however, it were appropriate to take into account the projected frequency of an occurrence, policyholders in fact do surrender policies with some frequency and for various reasons.

In fact, COLI policies or certificates usually are surrendered in blocks rather than piecemeal. When a particular insured leaves an entity's employ, the employer is not required to and usually does not surrender the individual policy or certificate covering that particular

In Issue Summary 1, the EITF assumed that very few individual policies or certificates (and even fewer group policies) are surrendered. See Issue Summary 1, ¶11. As explained below, commercial practice does not bear out this conclusion.

⁸ Cf. Issue Summary 1, ¶22, in which the proponents of View A advocated that the reference in Technical Bulletin 85-4 to "settlement amounts specified in the contract ... should preclude the recognition of an amount that potentially may not be realized."

⁹ Issue Summary 1, ¶11.

Director August 4, 2006 Page 7

employee. In most cases, a particular employee's departure will not alter the employer's reasons for having purchased and desiring to maintain a block of multiple individual policies. ¹⁰

In some cases, an employer may conclude that a group of policies no longer fulfills the purposes for which the policies were purchased. The employer may prefer to exchange the policies for another group of policies. However, the employer may not have the ability to structure an exchange so as to qualify for non-recognition of taxable gain or loss. Instead, therefore, of exchanging the policies, the employer may surrender them in the aggregate.

Various timing considerations also may influence an employer to surrender a group of policies or certificates simultaneously. For example, the employer in a particular year may have a need for cash flow that would be fully satisfied only by surrendering all the policies. Similarly, based on an employer's changing tax situation from year to year, the employer may have the ability to absorb a taxable gain in a particular year (upon simultaneously surrendering group policies) that would not been acceptable in a preceding year.

The occurrence of special events also may prompt an employer to surrender multiple policies en masse. For example, the employer may declare bankruptcy. The employer may undergo a merger or acquisition under circumstances rendering an entire group of policies unnecessary.

Comments on Draft Abstract Paragraphs 9-13

According to the Draft Abstract, the proposed consensus on Issues 1 and 2 would be effective for fiscal years beginning after December 15, 2006. The Draft Abstract proposes that policyholders transition to any consensus by employing either of two methods: (a) a change in accounting principle through a cumulative effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods.

For the reasons previously explained, the FASB should not adopt the proposed consensus on Issue 2. If, however, the proposed consensus must be adopted, then the FASB should grant policyholders an option to apply the consensus prospectively.

Either of the proposed transition alternatives would significantly and adversely affect policyholders that have included in recorded assets under Technical Bulletin 85-4 additional amounts obtainable upon simultaneously surrendering policies. As the Draft Abstract observes, there has been diversity in calculating the amount that could be realized under Technical Bulletin

Exceptions may occur in the case of closely held businesses. If an employee critically important to the success of a closely held business departs the company, the company might no longer have any compelling business reason to maintain the policy.

See Internal Revenue Code §1035.

85-4.¹² Policyholders who recorded these additional amounts in good faith relied on a plain meaning of the operative language.

Theoretically, policyholders who recorded these additional amounts could escape adverse consequences of the proposed consensus by surrendering affected policies before the proposed effective date. However, these policyholders may have valid business reasons for preferring to maintain the policies. They may not need the cash flow obtainable upon surrendering the policies and could incur substantial taxable gains upon surrendering them. The effective date and transition rules should not encourage choices and behavior lacking economic sense.

Recently, the International Accounting Standards Board ("IASB") has recognized that new accounting rules affecting current practice warrant delayed implementation. "To accommodate the time required [for 'implementation of new standards into practice'], the IASB intends to allow a minimum of one year between the date of publication of wholly new IFRSs or major amendments to existing IFRSs and the date when implementation is required." In view of the legitimate reliance interest placed on the longstanding accounting rules that Issue 2 proposes to change, prospective transition relief is similarly justified.

For all these reasons, we urge that policyholders be required to apply the proposed consensus on Issue 2 only to life insurance policies acquired in fiscal years beginning after December 15, 2006. An effective date structured in this manner would comport with the manner in which Technical Bulletin 85-4 itself was effective dated. If, however, the FASB will not grant this prospective only relief, then it should allow policyholders the option of transitioning to Issue 2 over a period of time. Under this option, policyholders would be allowed to take into account any required cumulative effect adjustment to retained earnings (or to other components of equity or net assets) on a ratable basis over a transition period of at least five years.

* * * * *

We would be pleased to discuss these comments with any appropriate interested member of the FASB, EITF or staffs. For that purpose, we encourage you to contact either AALU Counsel Gerald H. Sherman, 1700 K Street, N.W., Suite 300, Washington, D.C. 20006; (202) 452-7940, or AALU Vice President of Policy/Public Affairs, Tom Korb, at the above telephone number.

Diant Absulact, ||4.

Draft Abstract, ¶4.

International Accounting Standards Board Press Release, "IASB Takes Steps to Assist Adoption of IFRSs and Reinforce Consultation; No New IFRSs Effective Until 2009" (July 24, 2006).

The provisions of Technical Bulletin 85-4 took effect for insurance policies acquired after November 14, 1985. See Technical Bulletin 85-4, ¶3.

Director August 4, 2006 Page 9

Sincerely,

Dermot Healey

President, Association for Advanced Life Underwriting

Attachment:

Attachment I: Letter of June 14, 2006 from Mr. Dermot Healey, President, AALU, to Mr. Lawrence W. Smith, Chairman, Emerging Issues Task Force



2901 Telestar Court * Fails Church, VA 20042

June 14, 2006

Via E-mail to jerichter@fasb.org

Mr. Lawrence W. Smith, Chairman Emerging Issues Tax Force Financial Accounting Standards Board 401 Metritt 7 Norwalk, CT 06856-5116

Re:

Comments on EITF Issue No. 06-5 and Issue Summary No. 1

Accounting for Purchases of Life Insurance -- Determining the Amount

That Could be Realized in Accordance with FASB Technical Bulletin 85-4,

Accounting for Purchases of Life Insurance

Dear Mr. Smith:

The Association for Advanced Life Underwriting (AALU) takes this opportunity to comment on EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance -- Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance." AALU is a national association of nearly 2,000 advanced life insurance planners. Its members sell and service substantial volumes of life insurance for business continuation, estate and retirement planning, wealth accumulation and transfer, executive compensation, charitable planning and employee benefits for individuals, families, estates, small businesses and corporations.

A. Focus of Comments

These comments address EITF Issue 06-5 as explicated in two documents issued by FASB/EITF staff. These documents consist of (i) the EITF Agenda Committee Report of February 7, 2006, pages 9-15, and (ii) Issue Summary No. 1 dated May 24, 2006 and posted to the EITF's website June 6, 2006.²

Formerly, Issue No. 06-D.

FASB Emerging Issues Task Force, Issue No. 06-5, Accounting for Purchases of Life Insurance — Determining the Amount That Could be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance (hereinafter the "Issue Summary"),

B. Issues

The Issue Summary identifies two substantive issues:

Issue 1: Whether a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the "amount that could be realized under the insurance contract" in accordance with FTB 85-4.³

Issue 2: Whether a policyholder should consider the contractual ability to surrender all of the individual-life policies (or certificates in a group policy) at the same time in determining the "amount that could be realized under the insurance contract" in accordance with FTB 85-4.

In analyzing each of these issues, the Issue Summary discusses two alternative staff positions ("View A" and "View B"). The Issue Summary also discusses two alternatives ("View A" and "View B") for transitioning to any consensus the EITF reaches on substantive Issues 1 and 2.⁴ Finally, the Issue Summary raises the possibility of the FASB's undertaking a project to reconsider FTB 85-4.⁵

C. AALU Positions

AALU urges that the EITF reach the following consensus concerning the foregoing issues:

- > Resolve Issue 1 by adopting View B.
- > Resolve Issue 2 by adopting View B.
- > Allow policyholders to implement this consensus prospectively only unless the policyholder instead elects Transition View A or Transition View B.

In the Issue Summary and thus in this letter, "FTB 85-4" refers to FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance.

To minimize any possible confusion, this letter refers to the identified transition alternatives as "Transition View A" and "Transition View B."

In October 2005 the FASB had directed its staff to research whether to extend the scope of then proposed FSP TB No. 85-4-a beyond life settlement contracts to include all purchases of life insurance accounted for under FTB 85-4. In a letter to the FASB dated January 24, 2006 (copy attached for your convenience), AALU urged the FASB to retain FTB 85-4 outside the realm of life settlement contracts. We understood that the FASB then decided not to add a project to its agenda on accounting for purchases of life insurance other than life settlements. See EITF Agenda Committee Report (February 7, 2006), page 9. For reasons stated below, we continue to believe that the FASB should not reconsider FTB 85-4 other than clarifying the technical issues discussed in the Issue Summary.

> Do not reconsider FTB 85-4.

After discussing typical policy provisions that implicate these issues, we set forth below the rationale for our positions.

D. Typical Policy Provisions

Multiple individual life insurance policies sold to businesses (corporations and other entities)⁶ often include provisions generically referred to as "cash value enhancement riders." Under such riders the insurance carrier agrees to refund amounts that are generally computed as all premiums paid less a pure mortality cost, if all the multiple individual policies subject to the rider are surrendered simultaneously. Typically, but not always, the rider applies only if the policies are surrendered simultaneously during the first three or four years after policy issuance. Essentially, upon such simultaneous surrender, the cash surrender values of the policies are increased as above described. In other words, upon simultaneously surrendering the policies, the policyholder receives the policies' aggregate cash surrender value plus an additional amount that the rider specifies.

Cash value enhancement upon simultaneously surrendered policies may take various forms including waiver of surrender charges that would apply if the policies were surrendered piecemeal. The requirement to surrender all the policies simultaneously is designed to prevent the purchaser from "cherry picking," i.e., retaining policies on unhealthy employees and surrendering only the remaining policies.⁷

In many cases, businesses purchase large blocks of multiple individual policies in order to finance employee benefits including deferred compensation plans. The policies are purchased on an aggregate funding concept whereby no individual policy is viewed as funding benefits for a particular employee. Rather, in the aggregate, the policies are viewed as funding past, current and sometimes future participants in the deferred compensation or other employee benefit plan.

E. Perspective and Suggested Approach

The manner in which the Issue Summary presents and dissects substantive Issues 1 and 2 needlessly complicates the analysis required under FTB 85-4. Paragraph 2 of FTB 85-4 requires a policyholder upon purchasing a life insurance policy to record as an asset the "amount that

As the Issue Summary correctly observes, life insurance policies that business enterprises (other than financial institutions) purchase on the lives of employees traditionally have been known as corporate-owned life insurance ("COLI"), and similar policies that banks and other financial institutions purchase have been known as bank-owned life insurance ("BOLI"). See Issue Summary, §11.

In this respect, COLI and BOLI differ from life settlement contracts, for which the FASB has provided special rules that override FTB 85-4. See FSP No. TB 85-4. For reasons explained in our letter to the FASB of January 24, 2006 (copy attached for your convenience), an owner of COLI or BOLI effectively can realize an amount from the policy only by surrendering it to the insurer.

⁷ This is also known in the life insurance community as exercising "adverse selection" against the issuing company.

could be realized under the insurance contract as of the date of the statement of financial position." Both this language and the Comments accompanying FTB 85-4 make it clear that the appropriate amount must be determined on the basis of the terms of the particular insurance contract for which a policyholder seeks to record the correct amount.

It is also clear that there is a single common denominator serving as a precondition to the "amount" being "realized" in all cases covered by Issues 1 and 2. That precondition is the surrender of the contract to the insurer by and at the sole discretion of the policyholder. In effect, it is only the policyholder that determines whether and when to surrender a policy. It is that determination which triggers the right to a pre-death cash payment.

We thus submit that a policyholder should record as an asset under FTB 85-4 whatever amount the policyholder has agreed with the insurer that the policyholder "could" receive upon surrendering the policy. Depending on the terms of the policy, that amount "could" consist of traditionally identified cash surrender value or it "could" consist of cash surrender value plus some additional agreed amount. But the determination of what amount to record under FTB 85-4 should not depend on how a policy labels any additional available amount. If an insurance contract specifies that a policyholder "could" receive particular amounts (in one category or more than one category) upon surrendering a policy, then the policyholder should record the total of all such amounts as an asset under FTB 85-4.

To dissect the fundamental question any more finely unnecessarily pays obeisance to formalism. Nonetheless, even if the fundamental question is analyzed formally in the detail (in our view, unnecessary and misleading) of Issue 1 and Issue 2 in the Issue Summary, the EITF should adopt View B under each of those issues.

F. Detailed Analysis of Issues 1 and 2

Issue 1: Whether a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the "amount that could be realized under the insurance contract" in accordance with FTB 85-4.

FTB 85-4 clearly requires a holder of a life insurance policy to report as an asset the "amount that could be realized under the insurance contract as of the date of the statement of financial position." It long has been settled that the "amount that could be realized" should be determined by considering the contractual terms of the particular policy to which FTB 85-4 is being applied. If the contractual terms of the particular policy enable a policyholder to obtain additional amounts beyond basic cash surrender value, those additional amounts should be taken into account in measuring the amount of the asset.

[°] FTB 85-4, ¶2.

¹⁰ See FTB 85-4, ¶13.

Taking these additional, contractually provided amounts into consideration properly reflects the economics of the transaction between the insurer and the policyholder. The cost of obtaining life insurance coverage (i.e., the premiums payable) depends on various factors including estimates of mortality and the features of a particular policy. Because the policyholder has bargained for and paid for these provisions (such as a claim stabilization reserve or a refund of DAC tax) which make the policy "more attractive to a policyholder," amounts the policyholder stands to receive under these provisions should be taken into account in booking the asset under FTB 85-4. 12

We concur that FTB 85-4 does not provide prescriptive guidance about the "amount that could be realized beyond cash surrender value." However, as developed previously in this comment letter, we do not agree that FTB 85-4 "only discusses cash surrender value."

According to the Issue Summary, proponents of View A under Issue 1 consider View A consistent with the interpretation provided by the Interagency Statement. Paragraph 16 of the Issue Summary states in relevant part: "The Interagency Statement only addresses cash surrender value and does not consider any additional amounts in the insurance contract for purposes of determining the amount that is realizable under the insurance contract." This assertion misinterprets the Interagency Statement. The section of the Interagency Statement on "Accounting Considerations" begins with the following paragraph:

Institutions should follow generally accepted accounting principles (GAAP) applicable to life insurance for financial and regulatory reporting purposes. Financial Accounting Standards Board (FASB) Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance (TB 85-4), discusses how to account for holdings of life insurance. Under TB 85-4, only the amount that could be realized under an insurance contract as of the balance sheet date (that is, the CSV reported to the institution by the carrier, less any applicable surrender charges not reflected by the insurance carrier in the reported CSV) is reported as an asset. The guidance set forth in TB 85-4 concerning the carrying value of insurance on the balance sheet is generally appropriate for all forms of BOLI. [Emphasis supplied.]

According to this paragraph, charges should be excluded from the amount recorded as an asset under FTB 85-4 only if the charges are not reflected in the reported CSV. If the charges are not

¹¹ Issue Summary, 13.¶

We do agree that nonremote limitations on these amounts and the expected payment pattern should be taken into account in measuring the amount that will be realized. See Issue Summary, ¶13. However, these factors should not, except in extreme circumstances which sharply reduce the value of the amount to be realized, affect the fundamental issue of whether the possibility of receiving a particular item is to be taken into account in applying FTB 85-4.

See Issue Summary, ¶18.

¹⁴ See Issue Summary, ¶15.

Interagency Statement on the Purchase and Risk Management of Life Insurance, FIL-127-2004 (December 7, 2004), referenced by Issue Summary, ¶3.

specifically excluded, then it follows that the charges should be taken into account under FTB 85-4 as the foregoing paragraph interprets the standard and directs holders of BOLI to apply it.

In any event, even if the foregoing paragraph from the Interagency Statement could be interpreted any differently than as just suggested, the Interagency Statement should not be treated as controlling. The Interagency Statement was issued by the Federal Deposit Insurance Corporation and other federal bank regulatory agencies. Authorized to regulate banking institutions, these agencies are not empowered to promulgate generally accepted accounting principles, nor do they particularly have the skill to engage authoritatively in promulgating them. As the Issue Summary correctly observes, the Interagency Statement is not authoritative U.S. GAAP guidance. Thus, the Interagency Agreement affects at most the determination of cash surrender value upon surrendering BOLI, not COLI.

Issue 2: Whether a policyholder should consider the contractual ability to surrender all of the individual-life policies (or certificates in a group policy) at the same time in determining the "amount that could be realized under the insurance contract" in accordance with FTB 85-4.

In determining the "amount that could be realized" from multiple individual-life policies (or certificates in a group policy), a policyholder should take into account the contractual ability to surrender all of the policies simultaneously. Thus, the EITF should resolve Issue 2 by adopting View B.

1. Arguments in Favor of View B

View B reflects the economic reality of purchasing and holding multiple individual policies. As previously explained, the policies typically are purchased on an aggregate funding concept whereby no individual policy is viewed as funding benefits covering a single employee. Rather, in the aggregate, the policies are viewed as funding past, current and sometimes future participants in a deferred compensation plan or other employee benefit plan that the policies are purchased to finance. Thus, for accounting purposes, the policies should be viewed as an integrated "block" of assets rather than individual policy assets.

When multiple individual policies include cash value enhancement riders, the purchaser stands to receive a higher amount upon surrendering all the policies simultaneously compared to the amount obtainable by surrendering the policies piecemeal. This higher amount "could be realized" and, accordingly, should be taken into account under the basic directive of FTB 85-4.

Taking the higher amount into account also comports with the manner in which the FASB resolved comments on the proposed version of FTB 85-4. Responding to comments received, the FASB rejected the notion of reporting investments in insurance contracts based on liquidation values. In rejecting that approach, the FASB explained its reasoning as follows:

Issue Summary, ¶16.

The amount realizable under an insurance investment represents settlement values agreed to by an independent buyer and seller. The variety of yields and contract accumulation patterns available in the insurance marketplace provides the buyer and seller a variety of insurance and settlement options.¹⁷

When multiple individual policies include a cash value enhancement rider, the buyer and seller have agreed to a particular method of determining "settlement value." In accordance with paragraph 2 of FTB 85-4, the parties' contractual agreement to cash value enhancement should be taken into account in determining the amount realizable under the multiple individual policies.

2. Why View A Should be Rejected

Proponents of View A apparently believe that each individual policy should be considered the "unit of account" under FTB 85-4. Nothing in the Technical Bulletin compels that result. To the contrary, taking that position would violate the basic requirement to measure the asset as the "amount that could be realized" under the particular contractual provisions involved.

Proponents of View A are characterized as believing that the surrender of all the policies at the same time resembles a "gain contingency" within the meaning of FASB Statement No. 5, Accounting for Contingencies ("FAS 5"). According to this reasoning, the contingency should not be recognized until it has been satisfied, i.e., until all of the individual policies have been surrendered.

That position should be rejected for various reasons. First, treating a cash value enhancement rider as a gain contingency contradicts the requirement under FTB 85-4 to determine cash surrender value as of the date of the statement of financial position. Second, a policyholder pays higher premiums for a policy providing cash value enhancements compared to a policy offering only the possibility of accumulating cash value. Treating simultaneous surrender as a gain contingency effectively would charge the policyholder "up front" under the basic rule in FTB 85-4 because no "credit" would be given (until surrender) for the higher premiums paid. Finally, a cash value enhancement rider as a policy matter differs fundamentally from a gain contingency. FAS 5 explains: "Contingencies that might result in gains usually are not reflected in the accounts since to do so might be to recognize revenue prior to its realization." That rationale does not apply to additional amounts obtainable upon surrendering policies simultaneously. When a policyholder books a purchase of a life insurance

¹⁷ FTB 85-4, ¶13.

See Issue Summary, ¶20.

See the second sentence of FTB 85-4, ¶2: "The change in cash surrender or contract value during the period is an adjustment of premiums paid in determining the expense or income to be recognized under the contract for the period."

FAS 5, ¶17, recodifying provisions of ARB No. 50.

policy, the policyholder debits the appropriate asset account and credits the account (e.g., cash) from which the policy premium is paid. This entry, while it might affect the amount of costs that are reported, cannot affect revenue recognition.

We agree that FTB 85-4 is limited to the settlement amounts specified in the particular contracts at issue. Nevertheless, FTB 85-4 requires policyholders to report as an asset the "amount that could be realized." We thus agree with paragraph 25 and disagree with paragraph 22 of the Issue Summary.

Finally, the frequency or infrequency with which policies are surrendered does not affect the need for clarification of Issue 2. We thus disagree with the argument in the Issue Summary, ¶21, against providing guidance, In any event, we contest the assertion, made without any factual support, that "[g]enerally, companies do not surrender individual policies." In fact, except where policies have been acquired by life settlement companies, a circumstance separately treated in our letter of January 24, 2006, page 6, surrender of a policy is not an infrequent event, more often occurring in blocks of policies as contrasted to single policy surrenders.

G. Transition Alternative

The Issue Summary proposes two alternatives (Transition View A and Transition View B) under which policyholders would transition to any EITF consensus on Issues 1 and 2. Under Transition View A, the consensus would be applied retrospectively in accordance with FAS 154. Under Transition View B, the consensus would apply prospectively, with a cumulative effect recognized at the date of adoption of the proposed consensus for all existing life insurance contracts currently held.

We suggest an even simpler alternative than Transition View A or Transition View B. Under our proposal, policyholders should be allowed to apply any EITF consensus on substantive Issue 1 and/or Issue 2 prospectively only (without recognizing any cumulative effect) unless the policyholder instead elects Transition View A or Transition View B. This alternative would fully comport with FTB 85-4 itself, which was prescribed to apply prospectively only. We also note that the EITF recently has proposed the alternative of applying prospectively only any consensus on pending Issue 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." The EITF has acknowledged that "diversity" in practice exists concerning both Issue 06-5 and Issue 06-4. Thus, both issues seem equally deserving of an alternative to apply any consensus prospectively only.

Issue Summary, ¶21.

See FTB 85-4, ¶3.

Issue 06-4, Issue Summary No. 1, Supplement No. 1 (May 31, 2006), transition "Alternative C".

Id. at ¶8; Issue Summary, ¶1.

Please note that our proposed transition alternative addresses only substantive Issues 1 and 2. The Issue Summary also discusses the possibility of the FASB's undertaking a project to reconsider FTB 85-4. The effective date and manner of transitioning to any such change would have to be considered separately.²⁵

H. Proposal to Reconsider FTB 85-4

We support the FASB's earlier decision not to open a project that would reconsider FTB 85-4 beyond life settlement contracts. For more than 20 years, FTB 85-4 has provided certainty and predictability. Both insurance companies and policyholders basically understand how to measure the policyholder's investment in an insurance contract. Except with respect to particular technical issues such as those addressed in the Issue Summary, policyholders understand how to determine the amount to book as an asset upon purchasing a contract and how to adjust the asset so as to reflect income or expenses associated with the contract. Alternative methods such as those to which the Issue Summary alludes would introduce unnecessary complexity without improving the accuracy or representational faithfulness of policyholders' financial statements.

The FASB has departed from the basic rule in FTB 85-4 with respect to life settlement contracts. The special circumstances associated with life settlement contracts justify (if not require) special accounting rules. Those special rules, however, would prove unworkable for COLI and BOLI. We explained the reasons for this in our letter to the FASB of January 24, 2006 (copy attached for your convenience). For those reasons, AALU believes that when a person other than the insured owns a life insurance policy and has an insurable interest in the life of the insured, the owner should be required to account for the acquisition and ownership of the policy under the general rule in FTB 85-4. We thus urge the FASB to adhere to its earlier decision against reconsidering FTB 85-4 beyond life settlement contracts.

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We would be pleased to discuss these comments with any appropriate interested member of the EITF or the staff. For that purpose, we encourage you to contact either AALU Counsel Gerald H. Sherman, 1700 K Street, N.W., Suite 300, Washington, D.C. 20006; (202) 452-7940, or AALU Vice President of Policy/Public Affairs, Tom Korb, at the above telephone number.

²⁵ See discussion below under "Proposal to Reconsider FTB 85-4."

See EITF Agenda Committee Report (February 7, 2006), page 9.

FTB 85-4, ¶2, requires: The change in cash surrender or contract value during the period is an adjustment of premiums paid in determining the expense or income to be recognized under the contract for the period.

See FSP No. TB 85-4.

Sincerely,

Dermot Healey

President, Association for Advanced

Life Underwriting

Attachment: AALU letter to FASB of January 24, 2006 concerning scope of proposed FSP No. TB 85-4-a, Accounting for Life Settlement Contracts by Investors