FASB Emerging Issues Task Force

Issue No. 06-10

Title: Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements

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Previously distributed EITF materials: Issue Summary No. 1, dated October 23, 2006

References:

FASB Statement No. 5, *Accounting for Contingencies* (FAS 5)

FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* (FAS 88)

FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (FAS 106)

FASB Statement No. 154, *Accounting Changes and Error Corrections* (FAS 154)

FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance* (FTB 85-4)

FASB Concepts Statement No. 6, *Elements of Financial Statements* (CON 6)

FASB Special Report, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*: *Questions and Answers* (Q&A #9)

APB Opinion No. 12, *Omnibus Opinion—1967* (APB 12)

APB Opinion No. 21, *Interest on Receivables and Payables* (APB 21)

AICPA Statement of Position 96-1, *Environmental Remediation Liabilities* (SOP 96-1)

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

AICPA Issues Paper, *Accounting for Key-Person Life Insurance*, dated October 31, 1984 (AICPA Issues Paper)

International Accounting Standard 19, *Employee Benefits* (IAS 19)

EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" (Issue 06-4)

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" (Issue 06-5)

Background

1. At the November 16, 2006 EITF meeting, the Task Force reached a tentative conclusion on this Issue and directed the staff to proceed with the issuance of a draft abstract for public comment. The draft abstract was posted to the FASB website on December 6, 2006, for a comment period that ended on January 22, 2007.

2. Comment letters received on the draft abstract have been distributed to Task Force members and have been analyzed by the FASB staff. At the March 15, 2007 EITF meeting, the Task Force will have the opportunity to consider these comment letters as it redeliberates the tentative conclusions in the draft abstract and the additional issues raised in this Supplement. The Task Force will then be asked to affirm its tentative conclusion on this Issue as a consensus. However, as a result of the comment letters and informal feedback received on the interpretation of the tentative conclusion included in the draft abstract, the staff has clarified View B of Issue 1 in this Issue Summary Supplement and included an additional view (View B'). View B of Issue 1 requires the recognition of a liability for the postretirement benefit since the employer is the "effective" owner of the insurance policy and remains subject to the risks and rewards of that insurance policy through the collateral arrangement. View B' of Issue 1 differs from View B by requiring that the employer only recognize a liability for a postretirement benefit if the employer agrees to maintain a life insurance policy during the employee's retirement or if the employer agrees to provide the employee with a death benefit since the employer does not own or effectively own the insurance policy. View B' also eliminates the requirement (included under View B of Issue 1) that an employer evaluate the employee loan receivable (that is, the collateral and the recourse provisions) to determine whether a settlement of the postretirement liability has occurred.

Summary of Comment Letters

3. Three comment letters were received on the draft abstract; one from a bank, one from a trade organization, and one from a consumer products company. All of the respondents disagreed with the tentative conclusion reached by the Task Force on Issue 1 regarding whether an entity should recognize a liability for the postretirement benefit for a collateral assignment split-dollar life insurance arrangement (collateral assignment arrangement). In addition, all of

the respondents suggested certain modifications to the tentative conclusion reached by the Task Force on Issue 2 regarding how an employer should recognize and measure the asset in a collateral assignment arrangement.

4. The staff has identified and analyzed the significant comments in the section that follows. While the staff believes that the Task Force considered a majority of these comments during its initial deliberations of this Issue, as well as during its deliberations of Issue 06-4, the Task Force should nevertheless consider these comments in conjunction with its redeliberation of this Issue.

Comment 1—Definition of a Liability

5. The respondents commented that under a collateral assignment arrangement, the employer lacks a present obligation to provide a postretirement benefit to the employee and therefore does not meet the definition of a liability pursuant to CON 6. The staff has provided further analysis in Issue 1 of this Supplement in response to this comment.

Comment 2—Settlement

6. One respondent commented that the purchase of the insurance policy by the employee pursuant to the collateral assignment arrangement effectively settles the employer's liability under the definition of "settlement" in FAS 106. The staff points out that the Task Force discussed this topic during the initial deliberations of this Issue; however, the staff has provided additional analysis in Issue 1 of this Supplement in response to this comment.

Comment 3—Transition

7. One respondent observed that the tentative conclusion reached by the Task Force in this Issue would result in a significant change in current practice and recommended that the Task Force consider providing relief to entities that currently have existing collateral assignment arrangements. The respondent suggested that the Task Force consider a prospective transition methodology whereby the consensus in this Issue would be applied when an entity enters into a new collateral assignment arrangement or, alternatively, a transition methodology similar to that provided in FAS 106 (that is, amortize the transition obligation or asset on a straight-line basis over the average remaining service period of active plan participants (or 20 years, if longer)).

Staff Analysis

8. The staff does not recommend that the Task Force allow prospective application of the consensus on this Issue, nor a transition similar to that provided in FAS 106. The staff believes that it would be unlikely that either of these methods would improve financial reporting since these arrangements typically extend a number of years into the future. Arrangements within an entity would not be consistently reported nor would information be comparable among entities. In addition, the tentative conclusion reached by the Task Force on this Issue provides consistency with the treatment of transition for endorsement split-dollar life insurance arrangements (endorsement arrangements) pursuant to Issue 06-4.

Additional Comment for Consideration

9. Subsequent to the November 16, 2006 EITF meeting, the staff received an observation on the draft abstract that the tentative conclusion reached in Issue 1 and the tentative conclusion reached in Issue 2 may be inconsistent. That is, if the rationale for recognizing a liability for a postretirement benefit obligation for a collateral assignment arrangement is based on the belief that an endorsement arrangement and a collateral assignment arrangement are substantively equivalent, the tentative conclusion reached in Issue 2 is inconsistent with the accounting for asset recognition for an endorsement arrangement (that is, in applying FTB 85-4 and Issue 06-5). Under FTB 85-4 and Issue 06-5, the asset associated with an endorsement arrangement would be recognized based on "the amount that could be realized." The tentative conclusion reached in Issue 2 and presented in the draft abstract, requires the asset associated with a collateral assignment arrangement to be recognized based on the nature and substance of that arrangement. Therefore, an inconsistency arises in applying the tentative conclusion reached in Issue 2 if the employer's analysis determines that the asset should be recognized and measured as a loan receivable from the employee. That determination would indicate that the employer is not the owner of the insurance policy but merely lending funds to the employee. However, the liability for the postretirement benefit obligation is recognized and measured based on the premise that the employer owns the insurance policy (similar to Issue 06-4).

Staff Analysis

10. The staff believes that the tentative conclusions reached in Issues 1 and 2 are not inconsistent since the ownership of the insurance policy is relevant in determining the recognition and measurement of the asset. In an endorsement arrangement, the employer owns the insurance policy and has a direct relationship with the insurance company. Under that type of arrangement, the employer has a right to the cash surrender value[1] of the insurance policy. In a collateral assignment arrangement, the employee (not the employer) owns the insurance policy and uses the insurance policy to collateralize the loan from the employer. The employer's relationship to the insurance policy is dictated by the collateral assignment arrangement. The terms of repayment under a collateral assignment arrangement vary substantially from arrangement to arrangement and do not necessarily result in the employer receiving the cash surrender value of the insurance policy. The staff believes that the tentative conclusion reached in Issue 2 was designed to address different contractual arrangements. For example, if under the repayment terms of the collateral assignment arrangement the employer receives from the employee the amount of premium advanced plus a reasonable interest rate, the asset would be a loan (recognized and measured pursuant to APB 21). If under the terms of the collateral assignment arrangement the employer is due the cash surrender value of the employee's insurance policy, the asset would be the insurance policy (recognized and measured pursuant to FTB 85-4 and Issue 06-5). The staff observes that in instances in which the collateral assignment arrangement is similar to an endorsement arrangement (that is, the asset is the insurance policy), the tentative conclusion reached on Issue 2 with regard to the recognition and measurement of the asset will be consistent with the consensus in Issue 06-4.

Redeliberation of Issue

11. Based on the formal and informal comments received regarding the Task Force's tentative conclusions on Issues 1 and 2, the staff believes that the Task Force should redeliberate the Issue in its entirety. While the staff does not believe that the comment letters raise any new issues that were not previously considered by the Task Force in its deliberations of this Issue or Issue 06-4,

[1] *Cash surrender value* is used in this Supplement to mean the "amount that could be realized" pursuant to FTB 85-4 and Issue 06-5.

the staff does believe that the overall scope of the Issue and the application of View B of Issue 1 require further clarification.

12. As a result, the staff has expanded the Background Section to provide additional distinguishing differences that exist between an endorsement arrangement and a collateral assignment arrangement (included in Exhibit 06-10A) and has included an example with accompanying journal entries (included in Exhibit 06-10B) to assist the Task Force in its redeliberation of this Issue. The staff has also made certain changes to the scope of Issue 1 to clarify when an entity has a postretirement obligation and whether it has been settled, which have been reflected within each of the respective views of the Issue Summary Supplement. To facilitate the Task Force's redeliberation of this Issue, the staff has included as Exhibit 06-10C the draft abstract marked for changes that the staff has determined are not significant enough to warrant specific consideration. The draft abstract reflects the tentative conclusion reached by the Task Force at the November 16, 2007 EITF meeting.

Scope

13. This Issue applies to the recognition of the liability and the related compensation costs for a collateral assignment arrangement that provides a benefit to an employee that extends into postretirement periods. Therefore, this Issue would not apply to a collateral assignment arrangement that provides a specified benefit to an employee that is limited to that employee's active service period with an employer.

14. This Issue also applies to the recognition and measurement of the asset for a collateral assignment arrangement regardless of whether an employer recognizes a liability under this Issue.

Accounting Issues and Alternatives

Issue 1: Whether an entity should recognize a liability for the postretirement benefit associated with a collateral assignment arrangement in accordance with either FAS 106 (if, in substance, a postretirement benefit plan exists) or APB 12 (if the arrangement is, in

substance, an individual deferred compensation contract) based on the substantive agreement with the employee.

View A: An employer should not recognize a liability for the postretirement benefit related to a collateral assignment arrangement.

15. Proponents of View A believe that the employer, under a typical collateral assignment arrangement, lacks a present obligation to provide a postretirement benefit to the employee since the employer is not the "owner" of the insurance policy. These proponents point out that a typical collateral assignment arrangement is an agreement between the employer and the employee whereby (a) the employer agrees to provide a loan to the employee and (b) the employee agrees to purchase an insurance policy with the loan proceeds and use the insurance policy as collateral for that loan. Proponents of View A believe that the insurance policy purchased by the employee creates an obligation for the insurance company, not the employer, and that the present obligation of the employer is limited to loaning funds to the employee. Therefore, these proponents point out that pursuant to paragraph 35 of CON 6, the definition of a liability has not been met. Paragraph 35 of CON 6 states:

> Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. [Footnote references omitted.]

16. Since the collateral assignment arrangement does not create the present obligation of the employer, proponents of View A conclude that the employee loan should be accounted for similar to other employee loans. That is, the employer should recognize a loan receivable asset but no liability is recognized because a loan to an employee does not create a present obligation for the employer.

17. In comparing a collateral assignment arrangement to an endorsement arrangement, proponents of View A believe the two arrangements are substantively different. Therefore, the accounting recognition for collateral assignment arrangements should not be the same as the

consensus in Issue 06-4 for endorsement arrangements. For example, as discussed in Issue 06-4, under an endorsement arrangement, the employer "owns" and controls the insurance policy. Therefore, the employer remains subject to the risks and rewards associated with insurance policy and a settlement of the benefit promised to the employee has not occurred because the significant risks have not been eliminated.

View B: An employer should recognize a liability for the postretirement benefit related to a collateral assignment arrangement in accordance with either FAS 106 or APB 12.

18. Proponents of View B believe that a collateral assignment arrangement creates a postretirement benefit liability requiring the recognition of a postretirement benefit obligation because the employer is the "effective" owner of the insurance policy and remains subject to the risks and rewards of that insurance policy through the collateral assignment arrangement.

19. Proponents of View B believe that a collateral assignment arrangement creates a postretirement benefit obligation because the employer has sacrificed the right to future economic benefits. That is, the employer, in using a collateral assignment arrangement, has facilitated the purchase of an insurance policy through the provision of funds (the loan) to the employee rather than by directly purchasing an insurance policy (such as in an endorsement arrangement or a "keyman" insurance policy), which in substance may provide the same benefit to the employee. These proponents believe that, regardless of the form of the arrangement, the employer has created an obligation to provide a postretirement benefit (for example, insurance protection for the employee's beneficiaries) to the employee. Paragraph 163 of FAS 106, states, in part, that "the Board concluded that the obligation to provide postretirement benefits meets the definition of a liability…." Therefore, the Board decided that if an employer has made a commitment to provide a postretirement benefit, then it must record the related liability.

20. Proponents of View B also point out that even though the employer does not have legal ownership of the insurance policy, the collateral assignment arrangement restricts the employee's use of the loan proceeds and access to the cash surrender value of the insurance policy. For example, under the collateral assignment arrangement, the employee promises to purchase the

insurance policy with the proceeds of the loan and can only purchase the type of insurance policy stipulated in the collateral assignment arrangement. That is, as a precondition of entering into the collateral assignment arrangement, the employee is compelled to use the loan proceeds to purchase an insurance policy. Therefore, proponents of View B point out that even though the insurance policy is owned by the employee, the employer provides the benefit, the means to purchase the benefit, and the means to ensure that the intended benefit is purchased and maintained. Subsequent to entering into the collateral assignment arrangement, the employee is generally restricted in their access to the cash surrender value of the insurance policy. An employee cannot withdraw the cash surrender value without notifying the employer and obtaining the employer's approval and, then, the employee can only withdraw amounts in excess of the required collateral.

21. Because of the restrictions imposed by the collateral assignment arrangement on the use of the loan proceeds, proponents of View B believe that the "employee loan" is not similar to other employee loans. Furthermore, these proponents point out that these employee loans are generally nonrecourse because the employer's interest is secured through the collateral assignment arrangement (which provides the employer with a degree of control over and accessibility to the insurance policy).

22. Proponents of View B believe that the control and restrictions provided by the collateral assignment arrangement result in the effective ownership of the insurance policy by the employer (that is, the employer has effectively purchased the insurance policy). However, these proponents believe that the employer's effective ownership of the insurance policy does not settle (pursuant to FAS 106) the obligation. These proponents observe that a collateral assignment arrangement typically uses a whole-life insurance or universal life insurance policy in the structure of the arrangement. Both types of insurance policies provide a build up of the cash surrender value that can be used as collateral. Under certain whole-life or universal life insurance policy, the insurance company has the right to recover unexpected increases due to changes in mortality or increased administrative costs through the cost of insurance (that is, the owner of the insurance policy is subject to the risks and rewards associated with the insurance policy). For example, the insurance company will either bill the owner of the policy directly for

this amount or deduct it from the account value[2] of the policy. For this reason, these insurance policies can be considered *participating insurance contracts* pursuant to FAS 106, which provides the following definition in its glossary:

> An insurance contract that provides for the purchaser to participate in the investment performance and possibly other experience (for example, morbidity experience) of the insurance company.

23. The Board's intent in FAS 106 is to assert that if an owner of a policy is exposed to experience losses of the insurer, then a settlement has not occurred. Paragraph 373 of FAS 106 states, in part:

> The Board also is aware that some participating contracts may require or permit payment of additional premiums if experience is unfavorable. The Board concluded that if a participating contract requires or permits payment of additional premiums because of experience losses, or if the substance of the contract is such that the purchaser retains all or most of the related risks and rewards, the purchase of that contract does not constitute a settlement.

24. View B proponents do not believe that whole-life or universal life insurance policies can be considered irrevocable because an insurance policy can be cancelled by the employee (however, the employee may be required to obtain the employer's consent prior to cancellation). In addition, the insurance company can cancel the policy if the account value is insufficient to cover the cost of insurance. The glossary of FAS 106 defines settlement as follows:

> An irrevocable action that relieves the employer (or the plan) of primary responsibility for a postretirement benefit obligation and eliminates significant risks related to the obligation and the assets used to effect the settlement.

25. Furthermore, proponents of View B believe that the insurance policies described in FAS 106 as irrevocable are specifically referencing single premium insurance policies. Therefore, these proponents believe any other type of insurance policy aside from a single premium insurance policy would not qualify for settlement accounting under FAS 106. In addition, proponents of

[2] *Account value* refers to the total amount, at a given point in time, of the cash accumulation increased by the collection of premiums and reduced by the cost of insurance. As a point of reference, account value reduced by the surrender charge equals the cash surrender value.

View B also believe that since the employee loan receivable remains collateralized by the insurance policy, the employer remains subject to the risks and rewards associated with the insurance policy, which would not result in a settlement pursuant to FAS 106.

26. In comparing a collateral assignment arrangement to an endorsement arrangement, proponents of View B believe that the two arrangements are substantively the same. Therefore, the accounting recognition for collateral assignment arrangements should parallel the consensus in Issue 06-4 for endorsement arrangements. For example, these proponents note that under both types of arrangements, the employer and the employee benefit from the insurance policy. The employer benefits from the insurance policy by obtaining a guaranteed rate of return, securing a loan receivable, and providing the employee with life insurance protection. The employee benefits from the insurance policy by receiving insurance protection at more favorable terms and obtaining access to the cash surrender value for withdrawals in the postretirement period. While the form of the benefit provided to the employee is different, the objective is the same—the provision of a postretirement benefit facilitated through an insurance policy.

27. View B proponents also believe that similar to an endorsement arrangement, the employer effectively owns the insurance policy and remains subject to the risks and rewards associated with that policy. That is, the employer is obligated to pay the premium under the arrangement and if the employee were to default under its "loan" with the employer, the cash surrender value may not be sufficient to cover the premium paid. Accordingly, proponents of View B believe that similar to the consensus in Issue 06-4, the postretirement obligation would not be settled.

View B': An employer should recognize a liability for the postretirement benefit related to a collateral assignment arrangement in accordance with either FAS 106 or APB 12 if the employer has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit based on the substantive arrangement with the employee.

28. Proponents of View B' agree with proponents of View B in principle—that is, when a postretirement benefit obligation exists in a collateral assignment arrangement, a liability should be recognized. However, View B' proponents believe that collateral assignment arrangements

vary significantly and these arrangements do not always result in a postretirement benefit obligation. Proponents of View B' believe that an employer should only recognize a liability for a postretirement benefit if the employer agrees to maintain a life insurance policy during the employee's retirement or if the employer agrees to provide the employee with a death benefit since the employer does not own or effectively own the insurance policy. These proponents also believe that the collateralization of the employee receivable is not an indicator that the employer has retained the risks and rewards associated with the insurance policy. Therefore, proponents of View B' believe that the substance and nature of the collateral assignment arrangement must be analyzed. If, for example, the employer, under the collateral assignment arrangement, promises to maintain the insurance policy (that is, the employer stands ready to make future premium payments in the postretirement period), these proponents believe that a postretirement benefit has been provided by the employer. Similarly, if the employer, under the collateral assignment arrangement, promises to provide a death benefit (that is, the employer guarantees a minimum amount of death proceeds), these proponents believe that a postretirement benefit has been provided by the employer.

29. In instances in which the employer's promise of benefits does not extend into the postretirement period, proponents of View B' believe the loan amount is a reasonable approximation of the benefit provided by the employer to the employee. That is, they believe that the recognition and measurement of only the asset by the employer appropriately reflects the substance of these arrangements.

30. Proponents of View B acknowledge that the assessment at inception of whether a liability should be recognized for the postretirement benefit of a collateral assignment arrangement is based on the expectations at inception. However, these proponents believe that subsequent changes to the nature and substance of the arrangement may warrant a reassessment of whether a postretirement benefit obligation exists in subsequent periods.

Issue 2: How an employer should recognize and measure the asset in a collateral assignment arrangement.

View A: An employer should recognize and measure an asset based on the amount that could be realized for the underlying insurance policy related to the collateral assignment arrangement.

31. Proponents of View A believe that an endorsement arrangement and a collateral assignment arrangement are economically similar transactions and, therefore, should be accounted for in a consistent manner. They also believe that the amount that could be realized pursuant to FTB 85-4 and Issue 06-5 should be the basis for asset recognition and measurement since it will be used in all cases (except in death) to repay the loan. Finally, proponents of View A point out that in many of these arrangements, the amount due back to the employer is often limited to the cash surrender value on the employee's insurance policy, which is used to collateralize the premiums to the employer. That is, the employer may continue to pay premiums but at some point, the cumulative premiums paid may exceed the cash surrender value on the employees' insurance policy. In this instance, recording an amount due from the employee based on the premiums paid may exceed the amount that is required to be repaid under the collateral assignment arrangement. Therefore, proponents of View A believe that recognition and measurement of the asset at the amount that could be realized pursuant to FTB 85-4 and Issue 06-5 is appropriate.

32. Furthermore, proponents of View A point out that if a conclusion is reached in Issue 1 such that collateral assignment arrangements are determined to be the economic equivalent of an endorsement arrangement (and therefore a liability should be recognized for the postretirement benefit obligation), then View A is consistent with the recognition and measurement of the asset for endorsement arrangements.

33. Opponents of View A counter that requiring the asset to be measured at the amount that could be realized may not represent the substance of the arrangement. For example, in instances in which the collateral assignment arrangement requires repayment of an amount that is different from the cash surrender value (the loan represents only the premium paid by the employer), the cash surrender value may exceed the actual loan amount under the arrangement, which could distort the employer's financial statements. CON 6 defines assets as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." Opponents of View A point out that when the contractual amount due back to the employer is

other than the cash surrender value, the cash surrender value is not a probable future economic benefit and has not been obtained or controlled by the employer through past transactions (and thus does not meet the definition of an asset).

34. Opponents of View A acknowledge that in rejecting this view the asset recognition can deviate from the accounting under an endorsement arrangement. However, these opponents believe that it is appropriate when the collateral assignment arrangement dictates the loan amount and repayment terms.

View B: An employer should recognize and measure an asset based on the loan receivable related to the collateral assignment arrangement discounted pursuant to APB 21.

35. Proponents of View B believe that to the employer, the asset is a loan. Therefore, they believe that the asset should be recognized and measured based on the present value of the loan pursuant to APB 21. Proponents of View B believe that the means by which the employee repays the loan are not relevant to the employer since the employer has a legally enforceable agreement with the employee that stipulates the amount that has been loaned and the repayment terms.

36. Opponents of View B believe that the recognition and measurement of the asset as a discounted loan receivable does not fully represent the economics of the arrangement. Rather, they believe appropriate recognition and measurement would not only discount the loan receivable, but also would incorporate expectations related to the employee surrendering the insurance policy (for example, expectations related to the employee leaving the employer, the employee's ability to pay back the loan, and the employee's expected date of death). Therefore, opponents of View B believe any recognition and measurement of the asset that does not incorporate all expectations is not representationally faithful.

View C: An employer should recognize and measure an asset based on the terms of the collateral assignment arrangement.

37. Proponents of View C believe that the asset should be recognized and measured in a manner consistent with the terms of the collateral assignment arrangement. Since there are numerous contractual variations among collateral assignment arrangements, View C proponents believe requiring one form of recognition and measurement is inappropriate and would lead to inappropriate accounting in certain circumstances. For example, a collateral assignment arrangement may stipulate that the employer is legally required to receive payment from the employee (or the employee's estate) of the premiums paid by the employer with interest. If a decision on this Issue were reached such that the asset is recognized and measured based on the cash surrender value (View A), the asset would represent the cash surrender value and not the substance of the agreement (that is, the premiums due plus interest). In another example, a collateral assignment arrangement may stipulate that the employee's estate must pay the employer the cash surrender value upon the employee's death. If a decision on this Issue were reached such that the asset is recognized and measured in accordance with APB 21 (View B), the asset would represent the loan amount and not the substance of the agreement (that is, the cash surrender value). Therefore, proponents of View C believe that the diversity in the terms of these arrangements requires recognition and measurement that reflects the nature of the arrangement between the employer and the employee based on the amount to which the employer is entitled.

38. Opponents of View C counter that allowing more than one form of recognition and measurement for collateral assignment arrangements will decrease comparability for arrangements that have a similar structure.

View D: An employer should recognize and measure an asset based on the fair value of the receivable related to a collateral assignment arrangement.

39. Proponents of View D believe that the only appropriate measure is fair value. Fair value would incorporate all expectations and scenarios in relation to the repayment of the loan by the employee.

40. Opponents of View D conceptually agree with the goals of fair value, however, they point out that the Task Force had recently considered fair value in relation to the deliberations on Issue 06-5. During those deliberations, Task Force members did not believe that requesting that the FASB add a full-scale project to its agenda that would address fair value with regard to the purchase of life insurance was necessary because of the narrow application of Issue 06-5.

Effective Date and Transition

41. The FASB staff recommends that the consensus on this Issue should be effective for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years. Earlier application is permitted. Entities should recognize the effects of applying the consensus in this Issue through either (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. This transition methodology is consistent with the consensus by the Task Force in Issue 06-4.

42. If an entity chooses to apply the consensus in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings, an entity should disclose the cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position.

43. If an entity chooses to apply the consensus in this Issue as a change in accounting principle through retrospective application to all prior periods, the entity should include the recognition of:

a. The cumulative effect of the change in accounting principle on periods prior to those presented reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented
b. The cumulative effect of the change in accounting principle on retained earnings or on other components of equity or net assets in the statement of financial position
c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the change in accounting principle.

44. If an entity chooses to apply the consensus in this Issue as a change in accounting principle through retrospective application to all prior periods, the following should be disclosed:

a. A description of the prior-period information that has been retrospectively adjusted
b. The effect of the change in accounting principle on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement caption, and any affected per-share amounts for any prior periods retrospectively adjusted
c. The cumulative effect of the change in accounting principle on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

Exhibit 06-10A

BACKGROUND INFORMATION ON COLLATERAL ASSIGNMENT SPLIT-DOLLAR LIFE INSURANCE ARRANGEMENTS

A1. Companies purchase life insurance for various reasons that may include protecting against the loss of "key" employees, funding deferred compensation and postretirement benefit obligations, and providing an investment return. The two most common types of arrangements are endorsement split-dollar life insurance arrangements (endorsement arrangements) and collateral assignment split-dollar life insurance arrangements (collateral assignment arrangements). Generally, the difference between these arrangements is dependent upon the ownership and control of the life insurance policy. In an endorsement arrangement, the company owns and controls the insurance policy, whereas in a collateral assignment arrangement, the employee (or the employee's estate or a trust controlled by the employee, collectively the "employee") owns and controls the insurance policy. The examples discussed below describe the terms of a typical collateral assignment arrangement[3] (refer to Issue 06-4 for the terms of a typical endorsement arrangement):

> An employee purchases a life insurance policy through an arrangement with the employer to insure the employee's life and/or the life of the employee's spouse. In other circumstances, the employer purchases a life insurance policy and transfers ownership of the insurance policy to the employee. In either case, the employee owns the insurance policy and controls all rights of ownership. The employer usually pays all or a substantial part of the premium. The employee irrevocably assigns a portion or all of the death benefits to the employer as collateral for the employer's interest in the insurance policy (the collateral assignment arrangement). Amounts due to the employer vary but, typically, the employer is entitled to receive a portion of the death benefits equal to the premiums paid by the employer or premiums paid plus an additional fixed or variable return on those premiums. Upon retirement, the employee may have an option or be required to buy the employer's interest in

[3] An example arrangement has been provided to facilitate the discussion of this Issue. However, these arrangements are tailored specifically to each employer and, as such, the arrangements can vary significantly.

the insurance policy or transfer the insurance policy to the employer in satisfaction of the outstanding loan.

A2. The FASB staff understands that two key factors have diminished the use of the collateral assignment arrangement. The first factor is as a result of the Internal Revenue Service (IRS) issuance of several notices and regulations between 2001 and 2003 that targeted equity[4] split-dollar arrangements. While endorsement and collateral assignment arrangements can be either equity arrangements or non-equity arrangements, the regulations specifically addressed collateral assignment arrangements in which the life insurance policy collateralized the premiums paid (the employee loan). Collateral assignment arrangements were now subject to complicated tax regulations that significantly reduced (if not completely eliminated) the tax advantages of these arrangements. The second factor was the introduction of the Sarbanes Oxley Act of 2002 (the Act) (for both public and private entities). Many entities have discontinued these programs since these arrangements are considered to be employee loans, which are expressly prohibited under the Act. Entities that continue to maintain these arrangements typically account for them as employee loans and apply the provisions of APB 21. Accordingly, an employer would record a receivable from the employee at a discounted amount for the premiums paid.

A3. During the research and analysis of Issue 06-4, the FASB staff asserted that there was no diversity in practice concerning collateral assignment arrangements, especially in light of the requirements of the Act, which significantly reduced the marketability of this type of arrangement. However, the consensus reached in Issue 06-4 only applied to endorsement arrangements and not collateral assignment arrangements. While the IRS regulations significantly reduced new issuances of the equity type of arrangement, the non-equity type of arrangement could still be utilized. In fact, the non-equity collateral assignment arrangement functions in a manner (from a taxation perspective) similar to a non-equity endorsement arrangement. Since Issue 06-4 created diversity for the recognition of the postretirement benefit obligation between endorsement and collateral assignment arrangements, entities may have an opportunity to structure collateral assignment arrangements with a postretirement benefit

[4] *Equity* refers to the excess of cash surrender value over the amount contractually due the employer (for example, premiums paid) pursuant to the collateral assignment arrangement. The IRS was mainly concerned with the owner of the equity and the timing of the taxation of this amount.

obligation that does not require separate accounting recognition. The issue to be addressed is whether or not a collateral assignment arrangement should record a postretirement benefit obligation based on the terms of the arrangement.

A4. During the EITF Agenda Committee meeting, an Agenda Committee member questioned the accounting recognition of the asset (employee loan) by the employer in a collateral assignment arrangement. As previously discussed, employers that maintain these arrangements consistently account for them as employee loans and apply APB 21. In situations in which an employee surrenders an insurance policy and the cash surrender value is not sufficient to repay the loan to the employer, the present value of the loan may not represent the realizable value of the asset.

Accounting Guidance – Deferred Compensation and Postretirement Benefits

A5. Although neither of the following references is specific to split-dollar life insurance arrangements, APB 12 provides guidance on the accounting for deferred compensation contracts with individual employees if those contracts, taken together, do not constitute a plan. FAS 106 provides guidance on the accounting for postretirement benefits that are part of a plan for retirees, but are not part of a pension plan.

A6. APB 12 requires deferred compensation costs to be recognized over the service period in a systematic and rational manner. At the end of the service period (the full eligibility date as defined in FAS 106[5]), the accrued amount should equal the then present value of the benefits expected to be provided to the employee and the employee's beneficiaries.

A7. Under FAS 106, an employer should recognize and measure the obligation for postretirement benefits based on the actuarial present value of all future benefits attributed to an employee's service rendered to that date. FAS 106 requires an employer to attribute the costs of those postretirement benefits over the required service period.

[5] FAS 106 defines *full eligibility date* as "the date at which the employee has rendered all the service necessary to have earned the right to receive all of the benefits expected to be received by that employee (including any beneficiaries and dependents expected to receive benefits)."

A8. For a collateral assignment arrangement (that is, the type of arrangement described above), the consensus in Issue 06-4 for an endorsement arrangement may result in diversity in practice for economically similar arrangements. Some believe that APB 12 or FAS 106 (if the arrangement is part of a plan, FAS 106 would be applicable, and APB 12 would be applicable otherwise) should be applied and that a liability for the postretirement benefit obligation should be recognized. However, some believe that the employer's advance of premium is simply an employee loan and should not result in the recognition of a liability for a future benefit.

Exhibit 06-10B

ILLUSTRATION OF JOURNAL ENTRIES FOR A HYPOTHETICAL COLLATERAL ASSIGNMENT SPLIT-DOLLAR LIFE INSURANCE ARRANGEMENT UNDER VIEW B AND VIEW B' OF ISSUE 1

B1. The staff has provided the following hypothetical example to assist the Task Force in redeliberating this Issue. This example is based on information that was derived from an actual collateral assignment split-dollar life insurance arrangement (collateral assignment arrangement). The staff is aware that there are more than 50 different types of collateral assignment arrangements and while the example below is intended to represent a typical arrangement, it may not be representative of all types of arrangements.

B2. The journal entries have been presented separately for the application of Issue 1 for both View B and View B'. The journal entries related to the recognition and measurement of the asset under both views presented for Issue 1 are based on the tentative conclusion reached for Issue 2 in the draft abstract, that is, an employer should recognize and measure an asset based on the terms of the collateral assignment arrangement.

Facts

The employer enters into a collateral assignment arrangement with an employee. Under the terms of the arrangement, the employer loans a single amount to the employee's trust. The employee's trust purchases the insurance policy with a single, upfront premium payment and is named the beneficiary of the insurance policy. Upon death or cancellation of the insurance policy, the employee's trust is responsible for distributing the proceeds. Additional facts of the arrangement are as follows:

- The employer loans the employee $5,000,000 with a 5.00% interest rate per annum
- The employee provides a promissory note to the employer in the amount of the loan plus accrued interest
- Upon the receipt of the loan proceeds, the employee's trust is required to use the loan proceeds to purchase a life insurance policy
- Upon the death of the employee, the death benefit proceeds are required to be used first to pay the loan plus accrued interest to the employer and any remaining amounts will be paid to the employee's beneficiaries
- The employee's trust cannot surrender, withdraw cash surrender value from, or pledge the insurance policy

- The employer's recourse on the promissory note is limited to the proceeds of the insurance policy and the employee or employee's beneficiaries have no responsibility or liability with regard to the promissory note (that is, if the insurance policy lapses, the loan will become uncollectible)
- The employer, the employee, and the employee's trust has no obligation to pay premiums to maintain the insurance policy even if the insurance policy will lapse (however, any of these parties can elect to pay additional premium)
- The employer has no legal obligation to pay the employee's beneficiaries the specified death benefit should the insurer default under its obligation
- Mortality assumptions estimate that the employee will die at age 82
- Assume the employee retires at age 62

Analysis of the Postretirement Benefit—View B

B3. The collateral assignment arrangement creates a postretirement benefit obligation for the employer because the employer has facilitated the purchase of an insurance policy and has established effective ownership over the insurance policy. As a result, the employer remains subject to the insurance company recovering unexpected increases due to changes in mortality or increased administrative costs (that is, the owner of the insurance policy is subject to the risks and rewards associated with the insurance policy) through the cost of insurance charged by the insurance company. In addition, since the employer's loan receivable has been collateralized by the insurance policy, a settlement of the liability has not occurred pursuant to Statement 106. Therefore, the employer should recognize a postretirement benefit obligation which reflects the expected cost of insurance for maintaining the insurance policy in the postretirement period.

Analysis of the Postretirement Benefit—View B'

B4. The collateral assignment arrangement does not create a postretirement benefit obligation because no promise has been made by the employer to maintain an insurance policy in the postretirement period. Therefore, under View B', the employer would only be required to recognize the loan with the employee.

Employer's Journal Entries

View B	**View B'**
Day 1	*Day 1*
Insurance asset dr 5,000,000 Cash cr 5,000,000	Employee Loan Receivable dr 5,000,000 Cash cr 5,000,000
To record the insurance asset related to the purchase of the insurance policy pursuant to the collateral assignment arrangement.	To record the amount of the loan to the employee pursuant to collateral assignment arrangement.
End of year 1	*End of year 1*
Insurance asset dr 250,000 Interest income cr 250,000	Employee Loan Receivable dr 250,000 Interest income cr 250,000
To record the accrual of interest at 5% per annum on the employee loan - each year until either the death of the employee or a lapse of the insurance policy.	To record the accrual of interest at 5% per annum on the employee loan - each year until either the death of the employee or a lapse of the insurance policy.
Deferred compensation expense dr 500,000 Postretirement benefit obligation cr 500,000	
To record the postretirement benefit obligation for the year - this same entry would be recorded each year until age 62, the full eligibility date. In this example, this amount relates to cost of insurance during the employee's retirement.	
End of Year 10 - Full Eligibility and Employee Retirement	*End of Year 10 - Full Eligibility and Employee Retirement*
Total postretirement benefit obligation accrued during employee's service 5,000,000	Total postretirement benefit obligation accrued during employee's service 0
End of first year after retirement	*End of first year after retirement*
Insurance asset dr 407,224 Postretirement benefit obligation dr 250,000 Insurance asset-cost of insurance cr 250,000 Interest income cr 407,224	Employee Loan Receivable dr 407,224 Interest income cr 407,224
To record the accrual of interest at 5% per annum on the employee loan and the cost of insurance; which is offset by the postretirement benefit obligation. This journal entry would continue annually until age 82 (however, the accrued interest would continue to increase each year). For simplicity, this example assumes that the postretirement benefit obligation is offset against the cost of insurance in a ratable manner.	To record the accrual of interest at 5% per annum on the employee loan - each year until either the death of the employee or a lapse of the insurance policy.

View B	View B'
Journal entries if employee died one day after retirement	*Journal entries if employee died one day after retirement*
Cash dr 8,144,473 Insurance asset cr 8,144,473	Cash dr 8,144,473 Employee Loan Receivable cr 8,144,473
To record the insurance proceeds received upon the employee's death representing the repayment of the loan. The remainder of the insurance proceeds, if any, would be distributed by the employee's trust to the employee's beneficiaries.	To record the insurance proceeds received upon the employee's death representing the repayment of the loan. The remainder of the insurance proceeds, if any, would be distributed by the employee's trust to the employee's beneficiaries.
Postretirement benefit obligation dr 5,000,000 Income statement cr 5,000,000	
To record the settlement of the postretirement benefit obligation upon death of the employee.	
Journal entries if employee died at age 82-estimated mortality date	*Journal entries if employee died at age 82-estimated mortality date*
Cash dr 21,609,712 Insurance asset cr 21,609,712	Cash dr 21,609,712 Employee Loan Receivable cr 21,609,712
To record the insurance proceeds received upon the employee's death representing the repayment of the loan. The remainder of the insurance proceeds, if any, would be distributed by the employee's trust to the employee's beneficiaries.	To record the insurance proceeds received upon the employee's death representing the repayment of the loan. The remainder of the insurance proceeds, if any, would be distributed by the employee's trust to the employee's beneficiaries.

Exhibit 06-10C

EITF ABSTRACTS **(DRAFT*)**

Issue No. 06-10

Title: Accounting for ~~Deferred Compensation and Postretirement Benefit Aspects of~~ Collateral Assignment Split-Dollar Life Insurance Arrangements

Dates Discussed: November 16, 2006; [March 15, 2007]

References: FASB Statement No. 5, *Accounting for Contingencies*

FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*

FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*

FASB Concepts Statement No. 6, *Elements of Financial Statements*

FASB Special Report, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits: Questions and Answers*

APB Opinion No. 12, *Omnibus Opinion—1967*

APB Opinion No. 21, *Interest on Receivables and Payables*

AICPA Statement of Position 96-1, *Environmental Remediation Liabilities*

AICPA Issues Paper, *Accounting for Key-Person Life Insurance*, dated October 31, 1984

International Accounting Standard 19, *Employee Benefits*

EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements"

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"

ISSUE

1. Companies purchase life insurance for various reasons that may include protecting against the loss of "key" employees, funding deferred compensation and postretirement benefit obligations, and providing an investment return. The two most common types of arrangements are endorsement split-dollar life insurance arrangements and collateral assignment split-dollar life insurance arrangements. Generally, the difference between these arrangements is dependent

* **This draft abstract was exposed for a public comment period that ended on January 22, 2007.**

upon the ownership and control of the life insurance policy. In an endorsement split-dollar life insurance arrangement, the company owns and controls the insurance policy, whereas in a collateral assignment split-dollar life insurance arrangement, the employee (or the employee's estate or a trust controlled by the employee, hereinafter referred to as the "employee") owns and controls the insurance policy.

2. The Task Force reached a consensus on Issue 06-4 that for an endorsement split-dollar life insurance arrangement, an employer should recognize a liability for future benefits in accordance with Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. However, questions have been raised about whether the consensus reached in Issue 06-4 should apply to collateral assignment split-dollar life insurance arrangements. This Issue also addresses the recognition and measurement of the employer's asset in a collateral assignment split-dollar life insurance arrangement.

3. The issues are:

Issue 1— Whether an entity should record a liability for the postretirement benefit associated with a collateral assignment split-dollar life insurance arrangement in accordance with either Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee (consistent with the consensus reached in Issue 06-4)

Issue 2— How an employer should recognize and measure the asset in a collateral assignment split-dollar life insurance arrangement.

Scope

4. The scope of this Issue is limited to the employer's recognition of (a) the liability and the related compensation costs for collateral assignment split-dollar life insurance arrangements that provide a benefit to an employee that extends into postretirement periods and (b) the asset in collateral assignment split-dollar <u>life insurance</u> arrangements. However, the employer's recognition of the liability would not apply to a collateral assignment split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to that employee's active service period with an employer or that has been settled pursuant to Statement 106.

EITF DISCUSSION

5. The Task Force reached a [consensus] on Issue 1 that an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. In determining whether a postretirement benefit has been settled by an insurance contract, an employer should analyze whether the employer remains subject to the risks or rewards associated with the underlying insurance contract (in the postretirement period) that collateralizes the employer's asset. If the employer's asset is collateralized by the employee's (or retiree's) underlying

insurance contract or the recourse nature of the loan is not substantive, then a settlement has not occurred pursuant to Statement 106. The recourse nature of the loan is substantive if the employer has the intent and ability to fully recover amounts due under the collateral assignment split-dollar life insurance arrangement in the event of default by the insurer. For example, if the amounts due under a collateral assignment split-dollar life insurance arrangement are full recourse to the employee (or retiree), but the employer does not intend to seek recovery beyond the life insurance policy, the full recourse collateral provisions of the arrangement would not be substantive and settlement of the postretirement benefit would not have occurred. However, in determining whether the postretirement benefit has been settled pursuant to Statement 106, an employer should evaluate all the available facts and circumstances of these arrangements.

6. On Issue 2, the Task Force reached a [consensus] that an employer should recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. The Task Force observed that in determining the nature and substance of the arrangement, the employer should assess what future cash flows the employer is entitled to, if any, as well as the employee's obligation and ability to repay the employer. For example, if the arrangement limited the amount the employer could recover to the amount of the cash surrender value of the insurance policy held by the employee (or retiree), and if the employer's loan to the employee (or retiree) is greater than the cash surrender value of the insurance policy, at the balance sheet date the employer's asset would be limited to the amount of the cash surrender value of the insurance policy. Conversely, if the arrangement required the employee to repay the employer irrespective of the amount of the cash surrender value of the insurance policy (and assuming the employee (or retiree) is an adequate credit risk), the employer should recognize the value of the loan (including accrued interest, if applicable) considering the guidance in Opinion 21. An employer should evaluate all available information in determining the nature and substance of the collateral assignment split-dollar life insurance arrangement.

Transition

7. The [consensus] in this Issue should be effective for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years. ~~with e~~Earlier application is permitted. Entities should recognize the effects of applying the [consensus] in this Issue through either (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.

8. If an entity chooses to apply the [consensus] in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings, the entity should disclose the cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position.

9. If an entity chooses to apply the [consensus] in this Issue as a change in accounting principle through retrospective application to all prior periods, the entity should include the recognition of:

a. The cumulative effect of the change in accounting principle on periods prior to those presented reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented

b. The cumulative effect of the change in accounting principle on retained earnings or on other components of equity or net assets in the statement of financial position
c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the change in accounting principle.

10. If an entity chooses to apply the [consensus] in this Issue as a change in accounting principle through retrospective application to all prior periods, the entity should disclose the following:

a. A description of the prior-period information that has been retrospectively adjusted
b. The effect of the change in accounting principle on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement caption, and any affected per-share amounts for any prior periods retrospectively adjusted
c. The cumulative effect of the change in accounting principle on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

Board Ratification

11. At its [March 28, 2007] meeting, the Board ratified the [consensus] reached by the Task Force in this Issue.

STATUS

12. No further EITF discussion is planned.