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June 2, 2006

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

Dear Mr. Smith,

Clark Consulting appreciates the opportunity to comment on Emerging Issues Task Force (EITF) Issue No. 06-4, *Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Split-Dollar Life Insurance Arrangements.*

As mentioned in the EITF Agenda Committee's discussion of the issue and in Issue Summary No. 1, there exists much diversity in the form a split dollar arrangement may take. As we listened to the March 16, 2006, EITF meeting it appeared that various members have different understandings of endorsement split dollar, no doubt because of the diversity of split dollar arrangements in practice. We believe the accounting treatment considerations should begin with a precisely defined fact set for a basic endorsement split dollar arrangement with further consideration of how differing provisions might then alter the basic arrangement and its accounting treatment.

Our comments are an attempt to clearly explain basic endorsement split dollar arrangements, the underlying life insurance policy for such an arrangement and how we believe the arrangement should be accounted for under existing GAAP. We will also contrast the basic endorsement split dollar arrangement with other types of death benefit plans and the requisite accounting for such plans. In addition, we will comment on some of the discussion points raised in the March 16th EITF meeting in an effort to clarify what we perceived to be possible misunderstandings about the basic endorsement split dollar arrangement. We will discuss various provisions that may be added on to a basic endorsement split dollar arrangement, some of which would change the accounting treatment and others that would not. Finally, we will address qualitative considerations related to basic endorsement split dollar arrangements.

Basic Endorsement Split Dollar Arrangement

Basic endorsement split dollar arrangements follow the structure set forth in the fact pattern attached as an exhibit to the Issue Summary No. 1, dated February 20, 2006. The key points in the fact pattern are:

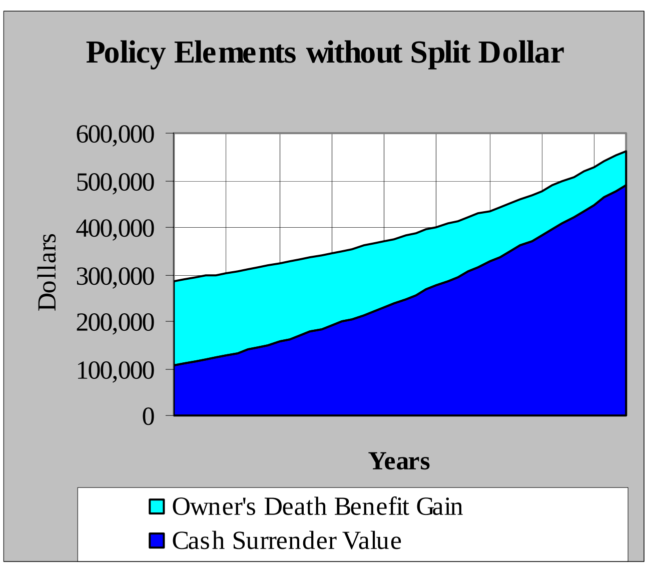
- The employer purchases and owns a life insurance policy on an "employee" (officers and sometimes directors of the employer.)
- By separate written agreement and an endorsement to the policy, the employer and employee agree to split the policy death benefit between the employer and the employee's designated beneficiary.
- The split dollar benefit payable to the employee's beneficiary by the life insurance company is defined as a specified amount or formula amount, limited to the net insurance (defined as the total death benefit proceeds less the cash surrender value at the date of the insured's death.)
- If the policy lapses or is surrendered by the employer, the split dollar arrangement automatically terminates based on the terms of the split dollar agreement and the employer has no obligation to the employee or the employee's beneficiary. The employer retains the right to surrender the policy and thereby terminate the split dollar arrangement at any time without further obligation to the employee or the employee's beneficiary.
- If the employee remains employed by the employer to a specified age or period of service, the split dollar arrangement will remain in place postretirement so long as the employer owns the underlying life insurance policy.

- Upon the employee's death, the insurance company will make the respective death benefit payments directly to the employee's beneficiary and to the employer in amounts equal to their respective interests in the policy death benefit described above. The insurance company, by virtue of the policy endorsement, is contractually obligated to pay the split dollar benefit directly to the employee's beneficiary in an amount determined under the terms of the agreement and included in the policy endorsement. The insurance company is the primary obligor to the employee and is not simply an agent for the company.
- The employer is not required under the split dollar agreement to pay any benefit amount to the employee or the employee's beneficiary out of the employer's assets.
- The extant written plan and the substantive plan are the same.
- The insured employee is part of a select group or highly compensated individual who is fully informed of the exact nature of the arrangement.
- The insurance policy cash surrender value is an asset of the employer and fully subject to the claims of general creditors.

Elements of a Life Insurance Policy Underlying a Basic Endorsement Split Dollar Arrangement

The life insurance policy underlying a split dollar arrangement can take many forms. Some require ongoing annual (or periodic) premium payments for the life of the insured, others employ premium payments for a specified period of years and some utilize a single premium payment approach to acquiring the policy. Regardless of the exact policy design and the form of premium payment, the following two illustrations graphically portray the basic elements of a key person policy (Illustration 1) versus how those elements are "split" in the basic endorsement split dollar arrangement described above (Illustration 2).

Illustration 1. Policy Elements – Key Person Insurance without Split Dollar Arrangement

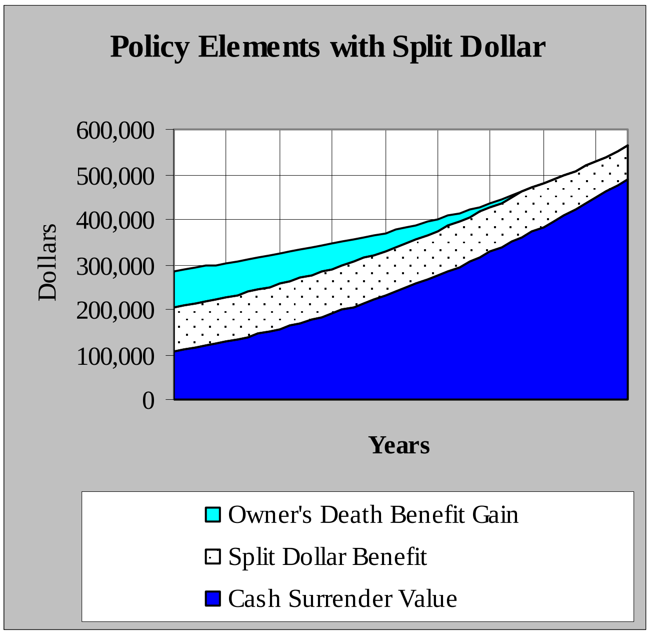


Year in Which Death Occurs	Cash Surrender Value	Owner's Death Benefit Gain	Total Death Benefit
1	104,549	182,117	286,666
5	123,031	176,318	299,349
10	150,548	167,394	317,942
15	183,889	156,895	340,784
20	222,056	143,337	365,393
25	266,054	128,105	394,159
30	316,023	112,125	428,148
35	372,183	97,141	469,324
40	434,925	82,854	517,779

Illustration 1 Notes

- ***There is no split dollar arrangement. The owner is the sole beneficiary of the policy (key person insurance).***
- ***The Total Death Benefit, payable upon death of the insured, is the sum of the Cash Surrender Value plus the Owner's Death Benefit Gain (Net Insurance).***
- ***Cash Surrender Value is the contract value (cash surrender value) of the policy prior to the death of the insured.***
- ***Owner's Death Benefit Gain is the potential gain in excess of the Cash Surrender Value that the policy owner will realize upon the death of the insured.***

Illustration 2. Policy Elements with Split Dollar Arrangement



Year in Which Death Occurs	Cash Surrender Value	Net Insurance: Split $ Benefit	Net Insurance: Owner's DB Gain	Total Death Benefit
1	104,549	100,000	82,117	286,666
5	123,031	100,000	76,318	299,349
10	150,548	100,000	67,394	317,942
15	183,889	100,000	56,895	340,784
20	222,056	100,000	43,337	365,393
25	266,054	100,000	28,105	394,159
30	316,023	100,000	12,125	428,148
35	372,183	97,141	-	469,324
40	434,925	82,854	-	517,779

Illustration 2 Notes

- ***The policy illustrated is the same policy as in Illustration 1.***
- ***Assumes a split dollar arrangement with a stated benefit of $100,000, limited to the Total Death Benefit in excess of Cash Surrender Value at death (Net Insurance).***
- ***Cash Surrender Value is the contract value (cash surrender value) of the policy prior to the death of the insured. This is the minimum amount the employer will receive upon the death of the insured.***
- ***The Net Insurance is split between the insured and the employer. If the Net Insurance is inadequate to cover the stated Split Dollar Benefit at the insured's death (prior to applying the Net Insurance limitation), the Split Dollar Benefit is reduced under the terms of the agreement to an amount not greater than the Net Insurance.***
- ***If the Net Insurance exceeds the Split Dollar Benefit at the insured's death, the employer will receive the Cash Surrender Value plus the Owner's Death Benefit Gain.***

Comparative Observations – Illustrations 1 and 2

- ***The Owner's Cash Surrender Value is not affected by the split dollar arrangement. That is, for a given life insurance policy the Cash Surrender Value is the same whether a split dollar arrangement is entered into or not.***
- ***The Split Dollar Benefit is paid by the insurance company and is limited to the Net Insurance. Therefore, the Owner's Death Benefit Gain is reduced by the split dollar arrangement.***
- ***As the insured approaches the age at the end of the mortality tables the Net Insurance decreases. When the Net Insurance decreases sufficiently, the Split Dollar Benefit will decrease and the Owner's Death Benefit Gain will be reduced to zero.***

Accounting Treatment for Basic Endorsement Split Dollar Arrangement

An employer that enters into a basic endorsement split dollar arrangement described above should not account for any postretirement obligation under FAS 106 or APB 12. The policy underlying the split dollar arrangement should be accounted for at its contract value (cash surrender value) as set forth in FTB 85-4. This treatment is consistent with the net result in View B of Issue Summary No. 1.

Basis for Accounting Treatment

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

CON 6

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

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

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

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

FAS 106

FAS 106, paragraph 67 states "…an insurance contract is defined as a contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium; an insurance contract is irrevocable and involves the transfer of significant risk from the employer (or the plan) to the insurance company. Benefits covered by insurance contracts shall be excluded from the accumulated postretirement benefit obligation. Insurance contracts shall be excluded from plan assets…"

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

Other Types of Death Benefit Plans Confused with Endorsement Split Dollar Arrangements

Some proponents of requiring accrual of the postretirement benefit espoused in View A of Issues Summary No. 1, cite FTB 85-4 and the AICPA Issues Paper, Accounting for Key-Person Life Insurance, (October 31, 1984) to support their position. Those proponents note that life insurance is often purchased "…to fund deferred compensation agreements…" or "…postemployment death benefits…" and that accrual of the postretirement obligation is required in those plans. However, the analogy is not on point since it appears to us that both sources cited are referring specifically to a type of death benefit plan that is fundamentally different than the basic endorsement split dollar arrangement described above. That type of death benefit plan involves only notional or informal "funding" in which the employer directly assumes the obligation to pay benefits from the employer's assets. Life insurance is acquired by the employer as a means of recovering the cost of employee benefits at the death of the insured. The notionally related elements of this arrangement, the benefit promise and the insurance asset, are separate and distinct from one another and can, in fact, occur independently of one another, unlike in the basic endorsement split dollar arrangement. The acquisition of the insurance does not irrevocably remove all risks from the employer. It does not remove the employer's obligation to pay the benefit, but simply provides cash proceeds and death benefit gains for the employer's benefit if the policy is held until the death of the insured. The accounting treatment requiring accrual of the postretirement benefit over the service period, essentially identified in View A of Issue Summary No 1., is appropriate for that type of death benefit plan with accompanying key person life insurance.

It is also noted that Issues Summary No. 1, paragraph 11, acknowledges that this type of death benefit plan, where the employer is the primary obligor, is not the subject of the EITF's consideration because there is no diversity of practice and the postretirement obligation is accounted for in general practice. Unfortunately, however, this paragraph 11 refers to the arrangement as a "split dollar life insurance arrangement whereby the company is the primary obligor for the death benefit…" We believe that statement to be a contradiction in terms adding to the confusion surrounding the nature of split dollar arrangements under consideration. ***If the employer is the primary obligor, it is not a split dollar arrangement.*** Therefore it should not be used as an example in considering the appropriate accounting for basic endorsement split dollar arrangements in which the employer has no obligation to pay the death benefit, whether primary or secondary.

March 16, 2006, EITF Meeting Discussion Points

Employer's Obligation

Some members expressed the belief that the employer is obligated to the employee for benefits beyond the contractual split dollar arrangement. That is, they believe that the employer is responsible for paying a benefit to the employee if the insurance policy is inadequate to provide the specified benefit (a provision that differs from the basic endorsement split dollar arrangement described above) or is cancelled or surrendered prior to the employee's death.

It is possible that a substantive plan or even an extant written plan could contain those employer obligations beyond what might be provided directly by the net insurance under the insurance policy. However, that is not the case in the basic endorsement split dollar arrangement described above. We note that CON 6 addresses such "constructive" obligations in paragraph 40 where it cautions that "To interpret equitable and constructive obligations too narrowly will tend to exclude significant actual obligations of an entity, while *to interpret them too broadly will effectively nullify the definition by including items that lack an essential characteristic of liabilities.*" (Emphasis added.)

If the plan incorporates provisions that obligate the employer beyond the terms of the basic endorsement split dollar arrangement, then the accounting treatment may be different than that for the basic endorsement split dollar arrangement. See further discussion below.

Inadequate Policy Coverage
If a plan includes employer obligations that are not fully covered by the insurance policy then only the benefits that will be provided by the insurance contract should be excluded from the accumulated benefit obligation under FAS 106 or any accrual under APB 12 as amended by FAS 106.

Benefit Obligation after Cancellation
If a plan, extant written or substantive, obligates the employer to pay a death benefit even if the policy is cancelled or otherwise disposed of, then the insurance contract does not meet the definition in FAS 106 because it does not transfer the benefit risk to the insurance carrier and the benefits cannot be excluded from the accumulated postretirement benefit obligation under FAS 106 or any accrual under APB 12 as amended by FAS 106. We believe, however, that few employers take on that obligation either in the extant written plan or in any other manner. Most participants in these endorsement split dollar plans are key executives who clearly understand the nature of the split dollar benefit and the fact that if the policy is not in force on the date of death the benefit will not be paid. (We noted that one EITF member related during the March 16th meeting that he had personally experienced such a plan cancellation without expectation of compensation or further benefit coverage.)

The extant written and substantive plan should be carefully reviewed to determine whether the employer has fully and irrevocably transferred all obligations for plan benefits to the insurance carrier. We do not believe it's reasonable that all basic endorsement split dollar plan accounting be based on those plans in which the employer remains obligated to pay benefits either in excess of the policy coverage or in lieu of the policy if it is cancelled.

All endorsement split dollar arrangements should not be lumped together. Some will qualify as fully relieving the employer of all obligation and therefore not require accrual of any postretirement benefits, others will not.

Policy Assumptions
Some EITF members expressed concern that policy assumptions could be problematic in assessing whether the policy fully relieves the employer of any obligation under the plan. Referring to the Illustrations and assumed fact pattern above, it can be seen that future policy performance is not actually relevant to the determination of whether the policy fully relieves the employer's obligation. If the policy under performs, the cash surrender value will be smaller than projected under the original assumptions. The converse is true if the policy out performs the assumptions. These differences in the contract value (cash surrender value) between assumptions and actual performance will be fully reflected, as they occur, in the financial statements under the accounting set forth in FTB 85-4.

In addition to the differences in the contract value (cash surrender value), the net insurance may be smaller than originally projected if the policy under performs compared to assumptions. In the basic endorsement split dollar arrangement, the split dollar benefit is limited to the net insurance, whatever that net insurance amount is at the time of the insured employee's death. If the net insurance is smaller due to underperformance, then the split dollar death benefit may be reduced to the extent the net insurance limitation comes into effect. The converse is true if the policy out performs compared to assumptions. But the employer does not incur any liability on account of policy performance over or under original assumptions.

Provisions That Differ from the Basic Endorsement Split Dollar Arrangement

Employer Guarantee
An extant written or substantive plan that includes a guarantee that the employer will make up for any benefit shortfall delivered by the insurance policy subjects the employer to risk. Such provisions might take the general form of the following:

a. If the policy is cancelled or lapses the employer will pay the stated benefit from the employer's assets.
b. If the insurance carrier becomes insolvent or fails to honor the insurance contract the employer will pay the stated benefit from the employer's assets.

Plans with this type of employer guarantee of the benefit are tantamount to an employer promise to pay a benefit out of its assets, informally funded with life insurance, and the postretirement benefit obligation should be either partially or fully accrued during the required service period, depending upon the exact nature of the employer's guarantee.

Benefit Amount Not Limited to Net Insurance
A plan that defines the split dollar benefit as a stated or formula amount without limiting the amount to the net amount of insurance may result in a benefit greater than the net insurance. Where the split dollar death benefit exceeds or is expected to exceed the net insurance, different issues are raised about valuation of the employer's insurance asset and or the need to accrue any promise to the employee.

Comparable Coverage Clause
Unlike the basic endorsement split dollar arrangement, some endorsement split dollar arrangements include a provision that once the requisite service period is attained by the insured employee, the employer will not terminate the underlying policy without obtaining comparable life insurance coverage to provide the benefit in the split dollar arrangement. This clause is intended to cover instances where the employer may have reason to substitute a new policy for the original policy, such as moving the coverage to a new carrier if the original carrier becomes less credit-worthy.

This clause is thought by some to mean that the transfer to the insurance company is not irrevocable and therefore does not meet the requirements of FAS 106, paragraph 67, to exclude the split dollar death benefit from the accumulated postretirement benefit obligation. However, the obligation is not revocable by the insurance carrier, as mentioned above. Further, the employer does not incur any liability by changing the insurance asset underlying the split dollar arrangement; the agreement is for comparable life insurance coverage, not a comparable benefit payable by the employer. Therefore, a comparable coverage clause should not impact the accounting for basic endorsement split dollar arrangements.

Mutual Consent to Amend or Terminate
Unlike the basic endorsement split dollar arrangement, some split dollar arrangements include the requirement that the employee and the employer must mutually agree to any amendment or termination of the plan. Such a provision shouldn't impact the accounting described for the basic endorsement split dollar arrangement. It merely means that the employer cannot revoke or amend the arrangement unilaterally.

Option to Purchase Clause
Unlike the basic endorsement split dollar arrangement, some endorsement split dollar arrangements include an option to purchase clause. Under such a clause the employer must offer the employee the option to purchase the underlying policy if the employer is going to cancel or exchange the policy. The purchase price is the contract value (cash surrender value) of the policy at the time of the purchase and the clause gives the insured employee a short window of time to exercise this option to purchase, typically 30 or 60 days.

Some have commented that such a clause means that the arrangement does not irrevocably relieve the employer's obligation for benefits along the same lines as the discussion under "Comparable Coverage", above. For the same reasons set forth in that discussion, this clause should not impact the accounting described for basic endorsement split dollar arrangements.

Qualitative Considerations

FASB Concepts Statement No 2, Qualitative Characteristics of Accounting Information (CON 2) examines characteristics that make accounting information useful. In the initial summary of principal conclusions it notes that "all financial reporting is concerned in varying degrees with decision making (though decision makers also use information obtained from other sources)…The usefulness of information must be evaluated in relation to the purposes to be served, and the objectives of financial reporting are focused on the use of accounting information in decision making. The central role assigned to decision making leads straight to the overriding criterion by which all accounting choices must be judged. The better choice is the one that, subject to considerations of cost, produces from among the available alternatives information that is most useful for decision making."

It goes on to say that the two primary qualities that make accounting information useful for decision making are relevance and reliability. "Relevant accounting information is capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations. Information can make a difference to decisions by improving decision makers' capacities to predict or by providing feedback on earlier expectations."

We fail to understand how accrual of a postretirement death benefit in a basic endorsement split dollar arrangement as described above provides useful, relevant accounting information. If such an accrual is required, decision makers will see a large liability accrued on the balance sheet, leading the user of the financial statements to conclude that the employer will need to settle that liability with cash sometime in the future. Only a footnote, admittedly an integral part of the financial statements taken as a whole, may note that the liability is unequivocally and fully assumed by an insurance company. It strikes us as irrelevant and possibly misleading to record a liability when the employer does not have a legal or constructive liability.

In paragraph 63, CON 2 defines representational faithfulness as "…correspondence or agreement between a measure or description and the phenomenon it purports to represent. In accounting, the phenomena to be represented are economic resources and obligations and the transactions and events that change those resources and obligations." We do not believe representational faithfulness is achieved by requiring an employer to record a liability when the employer does not have a legal or constructive liability.

Need for Resolution

We encourage the EITF to continue to pursue resolution of the accounting for split dollar. While, in our experience, the vast majority of endorsement split dollar arrangements have been and are accounted for essentially under View B of Issue Summary No 1, the correct approach has become controversial and needs guidance in a manner that will be helpful to consistent practice. The uncertainty arising out of this controversy over the correct approach requires timely resolution so that employers and participants can be confident of the ongoing efficacy of these arrangements and financial statement users can base decisions on accounting information that is not only consistent and relevant but characterized by representational faithfulness of the obligation under these arrangements. We respectfully suggest that the EITF settle first on the appropriate accounting treatment of the precisely defined basic endorsement split dollar arrangement and then address those provisions differing from the basic arrangement that might then alter that treatment.

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

Sincerely,

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