CBIZ BENMARK

EITF0604DA

LETTER OF COMMENT NO. 9A

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VIA EMAIL (director@fasb.org)

Director
Financial Accounting Standards Board
Emerging Issues Task Force

File Reference No. EITF0604

To Whom It May Concern:

This comment is in response to the exposed Draft Abstract on EITF Issue No. 06-4. The issue and conclusion are stated as follows:

FASB EITF Issue No. 06-4

Whether the post-retirement benefit associated with an endorsement split-dollar arrangement is effectively settled in accordance with either Statement 106 or Opinion 12 *upon entering into such arrangement.*

FASB EITF Conclusion

The Task force reached a [consensus] that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with Statement 106 or Opinion 12 . . . based on the substantive agreement with the employee. The Task Force believed that a liability for the benefit obligation under Statement 106 or Opinion 12 has not been settled through the purchase of an endorsement type (sic) policy. The Task Force believed that the purchase of an endorsement type policy (sic) does not constitute a settlement since the policy does not qualify as non-participating because the policyholders are subject to the favorable and unfavorable experience of the insurance company.

(FASB EITF Draft Abstract, dated July 6, 2006)

Comment 1 – FAS 106 Analysis

The proponents of View A (the view reflected in the conclusion stated above) reference the definition of "settlement" contained in the Glossary of FAS 106 and emphasize that this definition appears to require "purchasing nonparticipating insurance contracts for the accumulated post-retirement benefit obligation for some or all of the plan participants" for an insurance contract to qualify as such a settlement.[1] Further the EITF's Draft Abstract on EITF Issue No. 06-4, to which this comment is responding, states on page 2 that "the Task Force believed that the purchase of an endorsement type policy (sic) does not constitute a settlement since the policy does not qualify as non-participating because the policyholders are subject to the favorable and unfavorable experience of the insurance company."

In short, the EITF appears to rely exclusively on the premise that only a nonparticipating policy can effectively settle a post-retirement benefit obligation under an endorsement-style split-dollar arrangement. CBIZ/Benmark requests that the EITF reconsider this conclusion because it is in direct contradiction to the specific terms of FAS 106. Participating contracts can also effectively settle this type of obligation.

Paragraphs 90 – 95 detail the requirements of Accounting for Settlement of a Post-retirement Benefit Obligation. Specifically, Paragraph 94 states that "if the purchase of a participating insurance contract constitutes a settlement (refer to paragraphs 67 and 90) the maximum gain (but not the maximum loss) shall be reduced by the cost of the participating right before determining the amount to be recognized in income." Paragraph 94 clearly states that a participating insurance contract can constitute a settlement so long as it qualifies as such under Paragraphs 67 and 90.

Paragraph 67 defines the required elements that must be present in order to qualify as an insurance contract under FAS 106. These elements are:

1. An insurance company undertakes a legal obligation.
2. To provide specified benefits to specific individuals.
3. In return for a fixed consideration or premium.
4. There must be the irrevocable transfer of significant risk from the employer to the insurance company.

Once these elements are complied with, Paragraph 67 requires the "benefits covered by insurance contracts shall be excluded from the accumulated post-retirement benefit." Under this definition, virtually all insurance contracts in existence qualify as "insurance contracts" under FAS 106.

Paragraph 90 requires the following three elements be present in a transaction that qualifies as a settlement of a post-retirement obligation:

1. Must be an irrevocable action;
2. Must relieve the employer of primary responsibility for the the post-retirement benefit obligation; and
3. Must eliminate significant risks related to the obligation and the assets used to effect the settlement.

[1] EITF Issue Summary No. 1, Supplement No. 1, dated May, 31, 2006.

Paragraph 90 then provides examples of transactions that constitute a settlement, one of which is "purchasing long-term nonparticipating insurance contracts." The key point here is that this is an example, not an exclusive list. Indeed, as previously mentioned, Paragraph 94 makes clear that a participating contract may also effectively settle a post-retirement benefit obligation.

Accordingly, the EITF conclusions reached in Paragraph 5 of the Draft Abstract misstate the FASB's own Statements on this issue, and CBIZ/Benmark requests that the EITF fully reconsider these conclusions.

If the EITF and FASB should find this argument persuasive, then it would be necessary to analyze the other elements listed in Paragraph 90 necessary to qualify as a "settlement" under FAS 106.

First, it must be an irrevocable action that settles the obligation. This is distinguishable from an irrevocable benefit. In most arrangements designed by our company, the employee is not entitled to a split-dollar benefit unless there is an insurance policy in force to pay the specified benefit. This does not contractually bind the employer to keep the policy in force, but while the policy is in force, the benefit is owed to the employee. If there is no policy, the agreement terminates and there is no benefit due.

Second, the transaction must relieve the employer of primary responsibility for the post-retirement benefit obligation. Most endorsement split dollar arrangements easily meet this requirement. Most of these arrangements state that the employer never owes any death benefit to the participants. The death benefit will be paid directly from the life insurance company to the participant's beneficiary. These arrangements also typically state if the insurance contract does not exist at the time of death, then no benefit is due the beneficiary. Therefore, not only is the employer relieved of primary responsibility, but they are relieved of all the responsibility for the post-retirement benefit obligation.

Finally, in order to qualify as a settlement, the insurance contract must eliminate significant risks related to the obligation. As stated above, the employer simply has no risk to begin with. All risks – not just significant ones – associated with the split-dollar benefit are covered by the insurance policy. Indeed, it could be argued that since the employer has no obligation to provide the benefit, then the fact that there is a risk that the participating insurance contract will cease to exist because of negative experience by the insurance company is still no risk and thus, significant risks have been eliminated.

However, there is another fact pattern the EITF should consider in this regard. In many cases, endorsement split dollar arrangements are entered into and the insurance contract involved are universal life insurance contracts. As the EITF has stated, the interest crediting rate and the mortality costs inside these participating policies can go up and down based on the experience of the insurance company. Even in a nonparticipating policy, the mortality charges and interest rates fluctuate. However, in many cases, when these participating insurance contracts are considered on a guaranteed basis (the minimum guaranteed interest rate and the maximum guaranteed mortality costs detailed in the policy contract) these insurance contracts will not lapse and thus will continue to provide the benefit until well past the normal mortality age of the insured. Therefore, it seems reasonable to conclude that while the insurance contract may be participating and thus the negative experience of the insurance company would negatively impact the economic performance of the insurance assets, on a guaranteed basis the insurance contract would still be valid and thus continue to eliminate significant risks related to the obligation.

Suggested Alternative and Conclusion

In light of the above, CBIZ/Benmark respectfully urges the EITF and FASB to reconsider their conclusions and allow participating insurance contracts to qualify as settlements under FAS 106 as is clearly anticipated and allowed under the terms of FAS 106, assuming all other requirements are met.

Comment 2 – Double Expense

Irrespective of the FAS 106 analysis above, the recognition of expense required under Issue No. 06-4 would cause the recognition of the same expense twice and thus, cause financial statements to be misleading.

A universal life insurance contract has two basic components – interest credited on the cash value and the cost of insurance. These two elements are added to and deducted from the policy cash value each month. The cost of insurance element is the money retained by the insurance company to allow it to pay the death benefit upon the death of the insured. In essence, the cost of insurance is the present value of the death benefit so that if death occurs at normal mortality the insurance company will have collected sufficient "cost of insurance" to pay the death benefit.

As noted above, this cost of insurance reduces the earnings of the policy each month. Therefore, the employer (owner of the policy) is reducing its earnings by a portion of the present value of the death benefit. Therefore, if the employer is also required to recognize an expense equal to the present value of the portion of the death benefit to be paid to an employer's beneficiary pursuant to an endorsement split dollar arrangement, the employer is in fact recognizing the present value of that piece of the death benefit as an expense twice.

Suggested Alternative

Considering the fact that the expenses required to be recognized in 06-4 are already being recognized via mortality costs in the insurance policy we urge the EITF to reconsider their position. We believe a far more logical approach would be to consider the post-retirement mortality costs to be the cost of the post-retirement benefit provided. Therefore, if the present value of the projected post-retirement mortality costs are recognized during the service period, we believe that revenue and expenses would be properly matched.

Comment 3 – No Expense

One other issue needs to be considered in this analysis. In many cases, on a guaranteed basis, the income in a life insurance policy will exceed the mortality costs in each year through normal mortality. Said another way, it is impossible to incur the mortality costs without also earning income to offset it. Therefore, we believe it is logical under GAAP and the matching principle to consider that all post-retirement costs and income are attributable to the service period and thus, no expense should be recognized preretirement.

Sincerely,

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