AALU WASHINGTON REPORT

ASSOCIATION FOR ADVANCED LIFE UNDERWRITING

Premier analysis of federal legislative and regulatory developments for the nation's 2,000 most advanced life insurance planners, focusing on business, estate, qualified and nonqualified retirement planning.

Counsel

Buchanan Ingersoll & Rooney PC
Gerald H. Sherman
Stuart M. Lewis
Deborah M. Beers
Keith A. Mong

Ricchetti, Inc.
Steve Ricchetti
Jeff Ricchetti

Federal Policy Group
Ken Kies
Patrick J. Raffaniello
Timothy L. Hanford
Jim Carlisle

PricewaterhouseCoopers
William Archer
Donald Carlson

AALU

David J. Stertzer, *Chief Executive Officer*
Tom Korb, *Vice President of Policy & Public Affairs*
Marc R. Cadin, *Vice President of Legislative Affairs*
Jana M. Barresi, *Director of Policy & Public Affairs*

2901 Telestar Court, Falls Church, Virginia 22042
Toll Free: 1-888-275-0092 Fax: 703-641-8119
www.aalu.org

AALU Bulletin No: 07-32 March 19, 2007

Subject: **EITF Adopts Final Consensus Requiring Employers To Record Liabilities for Post-Retirement Benefits Provided Through Collateral Assignment Split-Dollar Life Insurance Arrangements**

Prior AALU Washington Reports: *07-30, 06-144, 06-119*

MDRT Information Retrieval Index Nos.: *2400.00; 6800.00*

SEE THE CIRCULAR 230 DISCLAIMERS APPENDED TO THE CONCLUSION OF THIS *WASHINGTON REPORT*.

Based on public comments received, including AALU's comments, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB") at a meeting March 15, 2007, redeliberated Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements." The Task Force decided, subject to ratification by the FASB, that (i) an employer should recognize a liability for a post-retirement benefit provided through a collateral assignment split-dollar life insurance arrangement if the employer has agreed to maintain the policy during the employee's retirement or provide the employee a death benefit based on the substantive arrangement with the employee; (ii) an employer should recognize and measure its associated asset based on the terms of the collateral assignment arrangement; and (iii) these requirements will take effect for fiscal years beginning after December 15, 2007. The EITF will recommend that the FASB ratify this consensus at the FASB meeting scheduled for March 28, 2007.

A. Background Preceding March 15, 2007 Meeting

EITF Issue No. 06-10 addresses situations in which an employer has entered into a collateral assignment split-dollar ("CASD") life insurance arrangement that, according to its terms, will provide a benefit to an employee or the employee's beneficiaries after the employee has retired (a "post-retirement benefit"). An example would be a death benefit payable upon a retiree's death.

For analytical purposes, the EITF divided Issue 06-10 into two sub-issues:

Issue 1: Whether an entity should recognize a liability for the post-retirement benefit associated with a collateral assignment arrangement in accordance with either FAS 106 (if, in substance, a post-retirement 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.

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

In 2006 the FASB affirmed EITF Issue No. 06-4 requiring that employers generally must record in their financial statements liabilities for post-retirement benefits provided by *endorsement* split-dollar life insurance arrangements. (See our Bulletins Nos. 06-119 and 06-144.) Issue 1 under Issue No. 06-10 essentially poses whether an employer similarly must record a liability when a *CASD* arrangement will provide a post-retirement benefit.

Subject to public comment and ratification by the FASB, the EITF in November 2006 tentatively decided that employers should be required to accrue liabilities under the described circumstances. The EITF also decided tentatively that an employer should measure its loan receivable based on the arrangement's particular terms.

On January 22, 2007, AALU submitted to the FASB written comments addressing EITF's tentative consensus. Based on public comments received from AALU and others, the EITF decided to re-deliberate Issue No. 06-10 at its meeting March 15, 2007. (For additional background preceding the meeting of March 15, see our Bulletin No. 07-30.)

B. Issue 1: Must the Employer Recognize a Liability?

At its meeting March 15, 2007, the EITF determined that an employer must recognize a liability under the described circumstances under View B' of Issue 1:

View B': An employer should recognize a liability for the post-retirement 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.

The Task Force also discussed the nature of the analysis that should be undertaken to determine whether an employer must recognize a liability. In accordance with FASB Statement of Financial Standards No. 106 ("FAS 106"), which Issue 06-10 interprets, the members of the Task Force agreed that the arrangement must be analyzed in its entirety including the plan document, the terms of the underlying life insurance policy, and actual experience even if not documented. FAS 106, *Employers' Accounting for Post-Retirement Benefits Other Than Pensions*, does not specifically address such benefits provided through split-dollar arrangements. However, members of the Task Force observed that this primary source document requires consideration of all the circumstances underlying a post-retirement benefit plan.

One participant at the meeting questioned whether the EITF and the Staff have correctly analyzed Issue No. 06-10. He suggested that their having divided the analysis into Issue 1 and Issue 2 generated confusion. This participant proposed taking a more "holistic" approach of asking whether the employee merely has acted as the employer's agent for investing in the underlying insurance policy. If so, according to this reasoning, the employer would account for the arrangement in the same way as an endorsement arrangement under Issue No. 06-4. In other words, the employer would record a liability representing the obligation to provide a post-retirement benefit and would record an asset representing its effective ownership of the insurance policy.

The entire Task Force, however, continued to support the approach of dissecting the analysis into Issues 1 and 2. Note that except for respecting the form of the transaction, i.e., that the employee owns the policy, this analysis appears to yield the same conclusion as the proposed alternative analysis.

The Task Force requested that the Staff in drafting the final consensus on Issue No. 06-10 clarify some details associated with Issue 1:

- An arrangement should be analyzed the same way whether the underlying life insurance policy requires payment of a single premium or multiple premiums.

- In determining the substance of the arrangement, all available evidence should be considered including the explicit written terms of the arrangement, communications made by the employer to the employee, and the determination of whether the employer or the insurer is the primary obligor for the post-retirement benefit. (The language would be adapted from Paragraph 6 of the Final Abstract of Issue No. 06-04; see our Bulletin Ns. 06-144 and 06-119.)

- Subsequent changes in the nature and substance of an arrangement may require a reassessment of whether a post-retirement benefit obligation exists in subsequent periods. Assume, for example, that it initially is determined that an employer owes an employee no obligation upon the employee's retirement. The employer thus records no liability. However, the CASD arrangement remains in effect during the employee's retirement, and it later is determined that previously paid premiums will not fully cover a benefit payable under the policy. In order to cure the shortfall, the employer newly agrees to pay additional premiums during retirement. Under these circumstances, the need for the employer to record a liability should be revisited.

C. Issue 2: How Should An Employer Recognize and Measure Its Receivable?

Reprising its tentative consensus reached in November 2006, the Task Force unanimously approved View C of Issue 2:

> View C: An employer should recognize an asset based on the terms of the collateral assignment split-dollar life insurance arrangement.

D. Effective Date

The Task Force unanimously adopted its tentative consensus that Issues 1 and 2 should take effect for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years. Employers would be permitted to apply the consensus earlier. Entities would have to recognize the effects of applying the consensus in either of two ways: (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; or (b) a change in accounting principle through retrospective application to all prior periods. The Task Force noted that these decisions comport with the effective date of Issue No. 06-4.

E. Next Step

The EITF considers the decisions it made March 15 its final consensus on Issue No. 06-10. The Task Force, thus, will submit the final consensus to the FASB for its ratification at the FASB's meeting scheduled for March 28, 2007. Although the FASB typically ratifies a consensus of the EITF, the FASB can reject a consensus or require modifications of it.