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Subject: **EITF Adopts Consensuses on (1) Split-Dollar Life Insurance/Post-Retirement Liability and (2) Capitalization of Assets under FASB Technical Bulletin 85-4**

Major References: [*EITF Issue Summary No. 1, Supplement No. 2 for Issue No. 06-4*](#)
 [*EITF Issue Summary No. 1, Supplement No. 1 for Issue No. 06-5*](#)

Prior Washington Reports: 06-103, 06-75, 06-73, 06-71, 06-46, and 06-40

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THE CONCLUSION OF THIS WASHINGTON REPORT.**

At its meeting September 7, 2006, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB") discussed public comments received on two issues: (1) EITF Issue No. 06-4 "Accounting for Deferred Compensation and Post-Retirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" and (2) EITF Issue 06-5 "Accounting for Purchases of Life Insurance -- Determining the Amount that could be Realized in Accordance with FASB Technical Bulletin 85-4 (Accounting for Purchases of Life Insurance)". AALU had submitted comment letters on both issues; see Bulletin No. 06-103. On September 7, the EITF agreed to clarify certain points based on public comments, but the anticipated final consensuses on Issues 06-4 and 06-5 will take the same basic positions as the proposed versions. (See our Bulletins Nos. 06-75, 06-73, 06-71, 06-46, and 06-40.)

I. Issue 06-4: Post-Retirement Benefits and Split-Dollar Life Insurance

A. Background

In general, an employer must accrue the present value of the anticipated costs and liabilities of providing employees benefits that extend into their retirement ("postretirement benefits"). See FASB Statement of Financial Accounting Standards 106 (FAS 106: Employers Accounting for Post-Retirement Benefits Other than Pensions) and APB 12 (Opinion No. 12 of the former Accounting Principles Board). Issue 06-4 raises the question of whether an employer must accrue these amounts when it enters into an endorsement-type split-dollar arrangement designed to provide a post-retirement benefit. The EITF and the FASB tentatively had decided, subject to public comments, that an employer should recognize such a liability because the purchase of an endorsement-type policy does not "settle" the liability. See *Bulletin No. 06-75*. Of the approximately 123 commenters (including AALU) to the FASB, all but two disagreed with the tentative consensus.

B. EITF Discussion and Decision

Notwithstanding the widespread objections, the EITF decided September 7 to adopt the proposed consensus. Based on the discussion, it appears that the Final Abstract of Issue 06-4 will reflect the following refinements.

- An employer must accrue the present value of the anticipated cost of providing whatever post-retirement benefit it has contracted to provide. The Final Abstract thus will not distinguish between Views A and A' (referred to as A "prime") as set forth in Issue Summary No. 1, Supplement No. 2, prepared for the meeting of September 7. Unlike that document, the Final Abstract will not contain detailed journal entries.
- A settlement of a liability requires an irrevocable action. Irrevocability must be analyzed from the standpoint of the employer. Because an employer generally may revoke an endorsement split-dollar policy at any time, such policies generally cannot settle a liability.
- No specific guidance concerning this issue is required under Statement of Financial Accounting Standards 109, *Accounting for Income Taxes*. The general rules of that pronouncement will apply.
- The final consensus will be effective for fiscal years beginning after December 15, 2007. This represents a postponement of one year from the proposed effective date. However, the consensus will not apply "prospectively only". Employers will have to accrue costs and liabilities not only with respect to endorsement split-dollar arrangements entered into after that date, but also to those in place as of that date.

II. Issue 06-5: Amount that could be realized under Technical Bulletin 85-4

A. Background

Purchasers of COLI, BOLI and other life insurance policies are required to account for them under FASB Technical Bulletin 85-4. Under that pronouncement, a policyholder should report as an asset on its periodic balance sheets the "amount that could be realized under the insurance contract". The "amount that could be realized" includes a policy's basic cash surrender or contract value.

Issue 06-5 addresses the extent to which amounts besides cash surrender value should be included in the amount recorded as an asset under Technical Bulletin 85-4. In Issue 06-5, the EITF dissected this inquiry into sub-issues ("Issue 1" and "Issue 2").

1. Should a policyholder take into account any additional amounts included in the contractual terms of an insurance policy?

2. Should a policyholder take into account any additional amounts available upon surrendering multiple policies or certificates simultaneously compared to the aggregate amount that would be received by surrendering them one at a time?

Before soliciting public comments on Issue 06-5, the EITF had answered Issue 1 affirmatively. However, the EITF had decided that additional amounts described under Issue 2 should not be taken into account in applying Technical Bulletin 85-4. See *Bulletin No. 06-71*.

B. EITF Discussion and Decision

At its meeting September 7, the EITF adhered to these proposed conclusions. Without discussing public comments concerning the effective date, the EITF also affirmed its earlier conclusion that policyholders must start following Issue 06-5 for fiscal years beginning after December 15, 2006. Based on the discussion, it appears that the Final Abstract of Issue 06-5 will reflect the following refinements.

- In applying Technical Bulletin 06-5, policyholders should not discount cash surrender value to its present value when the terms of an insurance policy impose delays on surrendering the policy. However, policyholders must disclose restrictions on the ability to surrender in appropriate notes accompanying the balance sheets. Policyholders must discount other contractual amounts (besides cash surrender value) when their payment will be delayed more than one year.
- The term "surrender" under Technical Bulletin 85-4 does not include an exchange of one policy for another policy under Internal Revenue Code §1035.
- In general, it is appropriate to distinguish amounts obtainable upon surrendering the last policy or certificate in a group from amounts obtainable only upon simultaneously surrendering all policies or certificates. The former but not the latter should be taken into account under Technical Bulletin 85-4. To illustrate this distinction, the EITF contrasted two deliberately over simplified examples.

Example 1. An employer purchases a group life insurance policy on 100 employees. Each policy or certificate has a cash surrender value of \$10 (\$1,000 in the aggregate). The policy also includes a claims stabilization reserve (CSR) account. The remaining balance in the CSR is payable in cash upon surrender of the final policy or certificate. The CSR has a balance of \$100. Under these facts, the EITF decided that the policyholder should record \$1,100 under Technical Bulletin 85-4.

Example 2. The facts are the same as in Example 1 except that the policy does not include a CSR. Instead, the policyholder will receive \$100 more if it surrenders all the policies or certificates simultaneously instead of surrendering them individually. This extra \$100 could take the form, for example, of a waiver of surrender charges. The EITF decided that under these facts, the policyholder should record an asset of \$1,000 under Technical Bulletin 85-4. An exception would occur only if the contract provides that the policies or certificates *only* may be surrendered simultaneously. In that case, the policyholder should record an asset of \$1,100.

III. Next Step

EITF staff will revise the Draft Abstracts of Issues 06-4 and 06-5 to reflect decisions made at the meeting of September 7. The EITF then will present the Final Abstracts to the FASB for ratification at its meeting scheduled for September 20, 2006.

AALU would much appreciate receiving from members any judgements they may have respecting the future consequences that EITF's conclusions will generate for the use of life insurance in estate planning and business contexts.

Any AALU member who wishes to obtain a copy of the EITF Issue Summary No. 1, Supplement No. 2 for Issue No. 06-04 and EITF Issue Summary No. 1, Supplement No. 1 for Issue No. 06-05, may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* with your social security number and select *Current Washington Report* for linkage to source material or (3) email Jeff Lavine at lavine@aalu.org and include a reference to this *Washington Report*.

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