

EITF ABSTRACTS

Issue No. 06-4

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

Dates Discussed: March 16, 2006; June 15, 2006; September 7, 2006

References: 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*
APB Opinion No. 12, *Omnibus Opinion—1967*
International Accounting Standard 19, *Employee Benefits*
EITF Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements"

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. One form of this insurance is split-dollar life insurance. The structure of split-dollar life insurance arrangements can be complex and varied.
2. 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 the ownership and control of the life insurance policy. For 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 owns and controls the

insurance policy. Diversity in practice exists primarily in accounting for the deferred compensation and postretirement aspects of typical endorsement split-dollar life insurance arrangements. A typical endorsement split-dollar life insurance arrangement may have the following terms:

An employer purchases a life insurance policy to insure the life of an employee and pays a single premium at inception of the policy. Based on the insurance carrier's experience (for example, mortality) it can either charge or credit the policyholder for the negative or positive experience, respectively. The additional premium or credit is typically effectuated through an adjustment to the cash surrender value of the policy. The employer enters into a separate agreement that splits the policy benefits between the employer and the employee. The employer owns the policy, controls all rights of ownership, and may terminate the insurance policy (and, in turn, the policy benefits promised to the employee). To effect the split-dollar arrangement, the employer endorses a portion of the death benefits to the employee (the employee designates a beneficiary for this portion of the death benefits). Upon the death of the employee, the employee's beneficiary typically receives the designated portion of the death benefits directly from the insurance company and the employer receives the remainder of the death benefits.

The employee's portion of the death benefits is commonly based on one of the following:

- a. Amounts that exceed the gross premiums paid by the employer
 - b. Amounts that exceed the sum of the gross premiums paid by the employer and an additional fixed or variable investment return on those premiums
 - c. The net insurance at the date of death (that is, the face amount of the death benefit under the policy, less the cash surrender value)
 - d. Amounts equal to a multiple of the employee's base salary at retirement or death (for example, twice the employee's base salary).
3. The issue is whether the postretirement benefit associated with an endorsement split-dollar life insurance arrangement is effectively settled in accordance with either Statement 106 or Opinion 12 upon entering into such an arrangement.

Scope

4. The scope of this Issue is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance arrangements that provide

a benefit to an employee that extends to postretirement periods. Therefore, this Issue would not apply to a split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to the employee's active service period with an employer.

EITF DISCUSSION

5. The Task Force reached a consensus that for an endorsement 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 (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. The Task Force believes that a liability for the benefit obligation under Statement 106 or Opinion 12 has not been settled through the purchase of a typical endorsement split-dollar life insurance arrangement. For example, if the employer has effectively agreed to maintain a life insurance policy during the employee's retirement, the cost of the insurance policy during postretirement periods should be accrued in accordance with either Statement 106 or Opinion 12. Similarly, if the employer has effectively agreed to provide the employee with a death benefit, the employer should accrue, over the service period, a liability for the actuarial present value of the future death benefit as of the employee's expected retirement date, in accordance with either Statement 106 or Opinion 12.

6. The Task Force observed that all available evidence should be considered in determining the substance of the arrangement, such as 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 postretirement benefit. For example, if the employer agrees to provide a death benefit to the employee even in the event of default by the insurance company, that would provide an indication that the promise made to the employee is to provide a postretirement death benefit. If the amount of the death benefit is not explicitly tied to an insurance policy, then the amount of the postretirement benefit should also be the amount of the death benefit promised to the employee. Conversely, if the terms of the arrangement are such that the employer has no obligation to the employee upon default of the insurance company, that would provide an indication that the postretirement benefit is a promise to maintain a life insurance policy during the employee's retirement. In determining the appropriate measurement and attribution of the cost and obligation under any particular arrangement, employers should refer to the guidance in Statement 106 or Opinion 12, as applicable.

Transition

7. The consensus in this Issue is effective for fiscal years beginning after December 15, 2007, with earlier application 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, 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.

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 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.

Board Ratification

11. At its September 20, 2006 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

STATUS

12. At the March 15, 2007 meeting, the Board ratified the consensus reached by the Task Force for Issue 06-10. This Issue addresses whether a liability for the postretirement benefit associated with a collateral assignment split-dollar life insurance arrangement should be recognized as well as the recognition and measurement of the related asset for these arrangements.

13. No further EITF discussion is planned.

Suggested Index Entries for Issue No. 06-4, “Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements”

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