

BUSINESS DAY

INSURANCE PLANS OF TOP EXECUTIVES MAY VIOLATE LAW

By TRACIE ROZHON and JOSEPH B. TREASTER AUG. 29, 2002

Billions of dollars in life insurance policies used as compensation for hundreds of top executives -- including Martha Stewart, Ralph Lauren and Ted Turner -- are in jeopardy, largely because of the recently enacted corporate responsibility law.

These special policies, known as split-dollar insurance, can amount to a huge windfall for the executives. In Ms. Stewart's case, for example, her two policies would pay \$27 million when she dies, but she could cash them in during her lifetime for an estimated \$18 million.

In July, Congress passed the Corporate Responsibility Act of 2002, which banned company loans to executives. Now, according to the interpretation of tax lawyers and compensation experts, the

premiums on split-dollar policies could be considered interest-free loans because the corporation is eventually reimbursed.

The uncertainty over the policies has virtually halted their sale, pending clarification by the government.

Split-dollar policies, so called because on paper the company and executive split the benefits, have been a feature of executive compensation for nearly 40 years. Typically, the company pays close to 100 percent of the premiums, which grow tax-free within the insurance policy and over a decade or two become a mountain of cash. When the executive retires, the corporation is repaid -- without interest -- from the cash buildup for the millions it has contributed in premiums.

The policies are set up so that the remaining cash pays for premiums for the rest of the executive's life, leaving the death benefit for his estate. Alternatively, after the corporation has been repaid, the executive can make regular tax-free withdrawals from the policy and spend the money during retirement, although the executive must take care to leave enough cash in the policy to continue paying premiums. If the policy lapses, the loans become taxable.

"Nobody is writing these policies," said Robert C. Slane, president of the Wealth Transfer Group in Altamonte Springs, Fla., which handles policies for the very wealthy. While lawyers and insurance agents are advising clients to withhold further premium payments, lobbyists are trying to have Congress pass an amendment specifically exempting the policies.

"Nobody in his right mind would take a chance on this," said Stephan R. Leimberg, a tax lawyer who publishes newsletters for lawyers, life insurance agents and financial planners. "You don't want to engage in a criminal act inadvertently."

Besides Martha Stewart Living Omnimedia, a broad range of corporations pay split-dollar premiums. At Polo Ralph Lauren, a spokeswoman said the company paid \$3 million in yearly premiums for Mr. Lauren and his wife.

But the policies are not limited to marquee names. Executives at Outback Steak House; Lillian Vernon; Bed, Bath & Beyond; Cendant; CSX; Monsanto; BellSouth; and Starbucks are also offered some kind of split-dollar policies, according to proxy statements.

"It's a waste of assets," said Graef Crystal, a compensation consultant who has written widely on this kind of insurance. "The shareholders are entrusting to the C.E.O. and the board a body of capital to be invested in an advantageous way. So it ends up as a no-interest loan, when the money could have been used to invest in a plant or new equipment."

While split-dollar insurance has always been a quiet kind of perquisite that has benefited executives for decades, its demise could have widespread implications. Insurance agents are looking at a future without their huge split-dollar commissions, insurance companies are expecting declines in revenue, and corporations are beginning to look elsewhere for a way to give tax-free bonuses to their most favored executives.

In the meantime, without premiums being paid, many of the policies could lapse or, at least, decline in value. If executives start cashing out their policies, as tax and compensations experts say is likely, they will be facing huge tax payments.

Lawrence Brody, a tax lawyer and a specialist in these executive insurance policies, estimates that corporations are paying hundreds of millions of dollars annually for billions of dollars of coverage.

"It's a very large market," he said. "Some corporations just provide the benefit for the C.E.O. Others provide for all executives above senior vice president or heads of divisions." Insurance experts say that some corporations pay for their directors and for some of their biggest nonexecutive talent: athletes and movie stars. But this is hard to gauge because only the executives' payments are listed in proxy statements.

It is not known how many public companies -- privately held companies are not affected by the law -- have split-dollar policies for one or more executives. A search of proxy filings with the Securities and Exchange Commission found that more than 700 public corporations are providing some form of split-dollar compensation for executives this year.

But Albert J. Schiff, the president of the Association for Advanced Life Underwriters, estimated that over 1,600 public companies have these policies, which range widely in value. (Estimates vary because companies may refer to such policies under different terms in securities filings.)

Mr. Leimberg, the newsletter publisher, said many tax lawyers and insurance consultants regarded the premiums on split-dollar insurance as interest-free loans because of their structure.

"The employer is laying out money for a benefit for the employee and ultimately the employer is reimbursed," Mr. Leimberg said.

"That looks like a loan. It smells like a loan. It walks like a loan."

Passage of the new law sponsored by Senator Paul S. Sarbanes, Democrat of Maryland, and Representative Michael G. Oxley, Republican of Ohio, was the third blow for frantic accountants and corporate lawyers. Last fall, the Internal Revenue Service signaled its intentions to sharply increase the taxes payable by executives on these policies. But it would allow those established before last Jan. 28, to be taxed at the older, lower rate.

In July, the I.R.S. said it expected to treat all such policies, including those from before Jan. 28, as loans. After the corporations were dealt that blow, "Congress cut the legs off them," one insurance consultant said.

But the principal life insurance trade groups and many consultants argue that Congress did not intend to include the life insurance policies in the ban on loans to executives. As evidence, they say that life insurance is not specifically mentioned in the law.

But Senator Charles E. Schumer, the New York Democrat who wrote the section of the law dealing with executive loans, said through a spokesman that he fully intended to ban the life insurance arrangements.

"There have been abuses of these policies in the past," Mr. Schumer said from Italy, where he was on vacation. "The general view when we passed the law was that this was the type of thing we wanted to eliminate. There was an effort by the life insurance industry to exempt these policies, but we kept them in."

The S.E.C. is responsible for carrying out the law, and its interpretation will be critical. John Nester, a spokesman for the commission, said that it had not issued a ruling and that it had no immediate plans to do so. Privately, someone involved in the passage of the bill predicted that the S.E.C. was likely to uphold Senator Schumer's intentions.

Industry newsletters have been counseling corporations to stop paying premiums immediately, but they suggest that individual executives can legally preserve the policies by paying the premiums themselves.

Another suggestion -- not expected to be greeted with great applause from corporate boards and managements or shareholders -- is that instead of lending the premium money to executives, corporations grant them new jumbo bonuses equivalent to the cost of the premiums, including their tax payments on the new money.

Laura Lewis, a senior lawyer for the American Council of Life Insurers, which represents 400 insurance companies that account for 75 percent of the life insurance sold around the country, said her organization had begun informal talks with S.E.C. officials. Her organization as well as the Association for Advanced Life Underwriting, will also be lobbying the I.R.S., hoping to reverse its designation of the premiums as loans.

"It's the A.C.L.I. position that these plans are not loans covered by the Sarbanes-Oxley loan provision," Ms. Lewis said.

This week, the official reaction from company spokesmen was muted -- and vague.

At Polo Ralph Lauren, Ellen Maguire issued a statement saying that the company was "currently evaluating the policies and the legal requirements and will take such action as may be necessary or appropriate to comply with the legal requirements."

Nina Pawlak at Martha Stewart Living pointed out that Ms. Stewart's policy, like those of hundreds of other executives who set them up before Jan. 28, was grandfathered by the I.R.S.

"But Sarbanes-Oxley may or may not render further premium payments illegal going forward," she said.

Martha Stewart Living's next payment is due in February. Before then, Ms. Pawlak said, lawyers and accountants will decide "whether to unwind the arrangement."