

AMERICAN INTERNATIONAL GROUP, INC.
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Letter of Comment No: 4815
File Reference: 1102-100

June 29, 2004

Ms Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116

RE: Exposure Draft on the Proposed Statement of Financial Accounting Standards, *Share Based payment an amendment of FASB Statements No. 123 and 95*

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Dear Ms. Bielstein:

American International Group, Inc. (AIG) appreciates the opportunity to respond to the Financial Accounting Standards Board (FASB or the Board) on the proposed Statement of Financial Accounting Standards, *Share Based Payment an amendment of FASB Statements No. 123 and 95* (the Exposure Draft or ED). AIG is supportive overall of the FASB efforts to require the recognition of stock compensation expense, but we do have some concerns about the ED as proposed which are discussed in the paragraphs below. The attached also addresses issues raised for comment in the ED.

AIG is the world's leading international insurance and financial services organization, with operations in more than 130 countries and jurisdictions. AIG member companies serve commercial, institutional and individual customers through the most extensive worldwide property-casualty and life insurance networks of any insurer. In the United States, AIG companies are the largest underwriters of commercial and industrial insurance and AIG American General is a top-ranked life insurer. AIG's global businesses also include financial services, retirement services and asset management. AIG's financial services businesses include aircraft leasing, financial products, trading and market making. AIG's growing global consumer finance business is led in the United

and market making. AIG's growing global consumer finance business is led in the United States by American General Finance. AIG also has one of the largest U.S. retirement services businesses through AIG SunAmerica and AIG VALIC, and is a leader in asset management for the individual and institutional markets, with specialized investment management capabilities in equities, fixed income, alternative investments and real estate.

Graded Vesting

We disagree with the ED that would treat each vesting tranche of a single award as separate awards resulting in accelerated expense recognition. We also note that the ED does not adequately recognize why graded vesting appropriately reflects the exchange of employee services over the attribution period. While we appreciate the time value aspect of an option pricing, we would expect that the service rendered by an employee, which generally increases over time or remains at a steady rate in later years would in most cases offset any time value component of the award. This coupled with a number of indeterminate events regarding employee exercise behavior largely argue against any artificial pre-determination of accelerated expense recognition.

We also call to the attention of the Board that in later years the effect of graded vesting with respect to expense recognition will "flatten out." Under the proposal, stock compensation expense would be higher in earlier years and lower in later years. But for many going concern companies that issue stock compensation yearly, the effect is offset largely in the last year of the first grant as later tranches of earlier grants with less expense replace earlier tranches. We, therefore, believe that a ratable attribution, as permitted under SFAS 123, is conceptually a more appropriate approach. Further, as proposed the requirement would be an extremely challenging and administrative burden that would complicate an already overly complex standard. Therefore, we strongly propose that the Board reconsider graded vesting to allow a straight line expense recognition which would meet the Board's goal of simplification of accounting standards and achieves a balance between employee service expense recognition of related stock based compensation and recognizes cost benefit considerations.

Related Parties

As proposed, the ED would require that share based payments to an employee by a related party be accounted for as compensation expense by the employee's Company. Many years ago, related parties that provide for these type of arrangements were set up for legitimate specific commercial purposes that were not intended to circumvent existing accounting requirements. Although we appreciate the Board's concern that the requirements of the ED not be circumvented, we believe that these requirements should not apply to related parties that existed prior to this proposal. Accordingly, we recommend that related parties in existence be "grandfathered" and that the provisions of the ED only relate to **newly** established arrangements between related parties.

Deferred Income Taxes

We are particularly troubled by the asymmetrical treatment that excess tax benefits are afforded under the ED. The Board has concluded that if the tax benefit of a stock award is less than the amount of the related deferred tax asset, the write-off of the deferred tax asset be reflected in the income statement rather than reduce additional paid-in capital to the extent available as required under SFAS 123. Conversely, where excess tax benefits exceed the previously recognized tax asset, the proposed ED would reflect the benefit as additional paid-in capital.

We do not share the Board's view that the income tax deficiencies relate to an individual employee and therefore relate to additional compensation expense, whereas the excess benefits that result from increases in intrinsic value (i.e. excess tax deductions) are due to an equity transaction. Rather, as the Board has observed, changes in the intrinsic value of the instrument which ultimately affect the Company's tax deduction are equity transactions whether there are increases or decreases in the fair value of the instrument and should be afforded the equity treatment that currently exists under SFAS 123.

While we do not agree that the deferred tax asset be re-measured at each reporting date as required under IFRS 2, we would support the current treatment that allows an entity to reduce paid-in capital to the extent available if the tax benefit is less than the amount of the deferred tax asset. Conceptually, the current accounting has considerable merit in that the recognition of the tax effects of stock based awards results in the consistent application of accounting for the income taxes and does not overstate the income tax effects related to stock based awards. If the current proposal remains as outlined in the ED, a Company's effective tax rate could materially change given the tax effects being proposed.

Vested Options That Expire Worthless

The ED would disallow the reversal of stock compensation expense for vested options that expire worthless. While we would agree that employee services exchanged for valuable equity instruments give rise to compensation expense as those services are used, we would modify this axiom to allow a Company, that receives employee services essentially "for free" due to the worthless expiration of share options, to reverse compensation expense and the associated liability that will never be paid. We fail to understand why accounting for stock compensation expense should not result in a reversal of income when the consideration given does not result in settlement and expires worthless. Accordingly, we propose that vested options that expire worthless be reversed from expense at expiration.

Transition

Unvested Portion of Previous Awards

The ED proposes that entities that already apply the fair value method of stock compensation be required to apply the ED to unvested options outstanding at the date of adoption. While the Board reasoned that this will result in greater comparability, we believe that comparability can only be achieved if full retrospective application is required and is not achieved on a partial basis. For those companies that elected the prospective method, this requirement appears to unduly penalize their adoption of a preferable method of accounting and sets a precedent going forward for the adoption of accounting standards to a more preferable method where the effects are to be recognized prospectively. Alternatively, we would recommend that the prospective method continue to be an option.

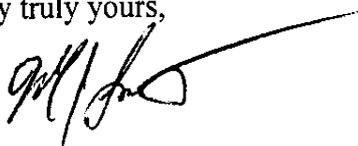
Effective Date

Finally, we disagree with the Board that the allotted time to create, test and rely on a binomial model is sufficient given the complexity of the proposed standard. An extended transition period is warranted given the changes that will be needed to fully comply with all the requirements of the ED. A binomial model that requires a company to calculate employee exercise and termination behavior, graded vesting requirements, and a host of other expected assumptions will require a considerable amount of data mining and adds such a considerable amount of complexity that an extended period is warranted. Underscoring the need for additional time is the requirement of Section 404 of the Sarbanes-Oxley Act of 2002, which requires that management assess the effectiveness of its internal controls. Given the recent rush to issue complex and calculation intensive standards, and the requirements of Section 404, we strongly urge the Board to extend the date of adoption.

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As you move forward with the final issuance of this standard we hope that you will strongly consider our concerns and recommendations. If you have any questions please contact myself, Michael J. Castelli or Anthony Valoroso regarding the contents of this letter, we would be pleased to discuss our comments with the Board or the FASB staff at your convenience.

Very truly yours,



Mr. Howard I. Smith
Vice Chairman, Chief Financial Officer and Chief Administrative Officer

Responses to Issues set forth in the ED

Recognition of Compensation Cost

Issue 1: The Board has reaffirmed the conclusion in Statement 123 that employee services received in exchange for equity instruments give rise to recognizable compensation cost as the services are used in the issuing entity's operations (refer to paragraphs C13–C15). Based on that conclusion, this proposed Statement requires that such compensation cost be recognized in the financial statements. Do you agree with the Board's conclusions? If not, please provide your alternative view and the basis for it.

We agree that employee services received in exchange for equity instruments gives rise to compensation cost that should be recognized in the financial statements of an entity.

Issue 2: Statement 123 permitted enterprises the option of continuing to use Opinion 25's intrinsic value method of accounting for share-based payments to employees provided those enterprises supplementally disclosed pro forma net income and related pro forma earnings per share information (if earnings per share is presented) as if the fair-value-based method of accounting had been used. For the reasons described in paragraphs C26–C30, the Board concluded that such pro forma disclosures are not an appropriate substitute for recognition of compensation cost in the financial statements. Do you agree with that conclusion? If not, why not?

Disclosure is generally not an appropriate substitute for recognition of compensation costs in the financial statements.

Measurement Attribute and Measurement Date

Issue 3: This proposed Statement would require that public companies measure the compensation cost related to employee services received in exchange for equity instruments issued based on the grant-date fair value of those instruments. Paragraphs C16–C19 and C53 explain why the Board believes fair value is the relevant measurement attribute and grant date is the relevant measurement date. Do you agree with that view? If not, what alternative measurement attribute and measurement date would you suggest and why?

We agree with the Board's conclusion that compensation cost related to employee services received in exchange for equity instruments issued should be based on the grant-date fair value.

Fair Value Measurement

Issue 4(a): This proposed Statement indicates that observable market prices of identical or similar equity or liability instruments in active markets are the best evidence of fair value and, if available, should be used to measure the fair value of equity and liability instruments awarded in share-based payment arrangements with employees. In the absence of an observable market price, this proposed Statement requires that the fair value of equity share options awarded to employees be estimated using an appropriate valuation technique that takes into consideration various factors, including (at a minimum) the exercise price of the option, the expected term of the option, the current price of the underlying share, the expected volatility of the underlying share price, the expected dividends on the underlying share, and the risk-free interest rate (paragraph 19 of Appendix A). Due to the absence of observable market prices, the fair value of most, if not all, share options issued to employees would be measured using an option-pricing model. Some constituents have expressed concern about the consistency and comparability of fair value estimates developed from such models. This proposed Statement elaborates on and expands the guidance in Statement 123 for developing the assumptions to be used in an option-pricing model (paragraphs B13–B30). Do you believe that this proposed Statement provides sufficient guidance to ensure that the fair value measurement objective is applied with reasonable consistency? If not, what additional guidance is needed and why?

There is likely to be a range of reasonable estimates, when estimating future employee exercise and termination behavior, as well as future expected volatility. We favor principle-based guidance whereby companies have the flexibility to consider different models rather than being forced into a single model.

Issue 4(b): Some constituents assert that the fair value of employee share options cannot be measured with sufficient reliability for recognition in the financial statements. In making that assertion, they note that the Black-Scholes-Merton formula and similar closed-form models do not produce reasonable estimates of the fair value because they do not adequately take into account the unique characteristics of employee share options. For the reasons described in paragraphs C21–C25, the Board concluded that fair value can be measured with an option-pricing model with sufficient reliability. Board members agree, however, that closed-form models may not necessarily be the best available technique for estimating the fair value of employee share options—they believe that a lattice model (as defined in paragraph E1) is preferable because it offers the greater flexibility needed to reflect the unique characteristics of employee share options and similar instruments. However, for the reasons noted in paragraph C24, the Board decided not to require the use of a lattice model at this time. Do you agree with the Board's conclusion that the fair value of employee share options can be measured with sufficient reliability? If not, why not? Do you agree with the Board's conclusion that a lattice model

is preferable because it offers greater flexibility needed to reflect the unique characteristics of employee share options? If not, why not?

AIG agrees that the binomial lattice approach to valuing employee stock options is an improvement over models such as the Black-Scholes Model. We also believe that the final standard should allow for and encourage the development of more reliable valuation models.

Issue 4(c): Some respondents to the Invitation to Comment suggested that the FASB prescribe a single method of estimating expected volatility or even a uniform volatility assumption that would be used for all companies. Other respondents to the Invitation to Comment disagreed with such an approach. Additionally, some parties believe that historical volatility, which has been commonly used as the estimate of expected volatility under Statement 123 as originally issued, is often not an appropriate measure to use. The proposed Statement would require enterprises to make their best estimate of expected volatility (as well as other assumptions) by applying the guidance provided in paragraphs B24–B26 to their specific facts and circumstances. In that regard, the proposed Statement provides guidance on information other than historical volatility that should be used in estimating expected volatility, and explicitly notes that defaulting to historical volatility as the estimate of expected volatility without taking into consideration other available information is not appropriate. If you believe the Board should require a specific method of estimating expected volatility, please explain the method you prefer.

We believe that the approach as outlined in the ED is consistent with the Board's movement towards principles-based standards. However, we do not believe the final standard should prohibit defaulting to the historical volatility, as there may be cases in which, absent any other information to the contrary, that historical volatility may be the best indicator of the future.

Attribution of Compensation Cost

Issue 9: For the reasons described in paragraphs C89–C91, the Board concluded that this proposed Statement would require a single method of accruing compensation cost for awards with a graded vesting schedule. This proposed Statement considers an award with a graded vesting schedule to be in substance separate awards, each with a different fair value measurement and requisite service period, and would require that they be accounted for separately. That treatment results in a recognition pattern that attributes more compensation cost to early portions of the combined vesting period of an award and less compensation cost to later portions. Do you agree with that accounting treatment? If not, why not?

See our response to this issue in our letter.

Income Taxes

Issue 11: This proposed Statement changes the method of accounting for income tax effects established in Statement 123 as originally issued. Paragraphs 41–44 of Appendix A describe the proposed method of accounting for income tax effects and paragraphs C128–C138 describe the Board’s rationale. That method also differs from the one required in International Financial Reporting Standard (IFRS) 2, Share-based Payment. Do you agree with the method of accounting for income taxes established by this proposed Statement? If not, what method (including the method established in IFRS 2) do you prefer, and why?

See our response to this issue in our letter.

Transition

Issue 13: This proposed Statement would require the modified prospective method of transition for public companies and would not permit retrospective application (paragraphs 20 and 21). The Board’s rationale for that decision is discussed in paragraphs C157–C162. Do you agree with the transition provisions of this proposed Statement? If not, why not? Do you believe that entities should be permitted to elect retrospective application upon adoption of this proposed Statement? If so, why?

See our response to this issue in our letter.

Differences between This Proposed Statement and IFRS 2

Issue 17: Certain accounting treatments for share-based payment transactions with employees in this proposed Statement differ from those in IFRS 2, including the accounting for nonpublic enterprises, income tax effects, and certain modifications. Those differences are described more fully in Appendix C. If you prefer the accounting treatment accorded by IFRS 2, please identify the difference and provide the basis for your preference. If you prefer the accounting treatment in the proposed Statement, do you believe the Board nonetheless should consider adopting the accounting treatment prescribed in IFRS 2 in the interest of achieving convergence?

We have consistently believed that we should not sacrifice high quality U.S. accounting standards to merely achieve convergence. We do not support the accounting as described in IFRS 2.