

June 30, 2004

Director of Major Projects
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

VIA e-mail

Dear Director of Major Projects:

RE: File Reference No. 1102-100

Chicago Consulting Actuaries LLC (CCA) is pleased to submit our comments on the proposed FASB Exposure Draft "Share-Based Payment, an amendment of FASB Statements No. 123 and 95" (1102-100).

CCA performs actuarial valuations for the employee benefit programs of many publicly traded and privately held companies. We assist employers by preparing relevant information for their financial statements, including the fair value of employee share options under FAS 123. We are committed to following best practices when considering market conditions, employee behavior, model choice, and plan structure for our valuations. Our integrity and knowledge in these areas support our continued involvement in employee share option valuation.

While we are not accountants, we do have extensive knowledge of employee benefit programs and the corresponding FASB standards, including FAS 123, and thus feel qualified to offer commentary on the proposed amendment.

Fair Value Measurement

Issue 4(a) (Response): We agree that the proposed statement provides sufficient guidance for the consistent measurement of the fair value of share-based payments in general and of equity share options in particular. All option valuation models attempt to measure the same financial instruments and produce similar values. While there are differences amongst the models, these differences are in the limitations of each model in terms of the option features and types of scenarios they were designed to handle. When applying appropriate models to a given award, there will be little difference in the results of the models. Widely varying fair values for the same option can be attributed to inappropriate assumption setting or model selection, which demonstrates poor application of the modeling process and accounting guidance, not shortcomings of the process itself.

Issue 4(b) (Response): We agree with the Board's conclusion that the fair value of employee share options can be measured with sufficient reliability. Entire industries, such as the insurance industry, are built on measuring and managing future financial contingencies that are at least as complex as employee share options. More specifically, the financial markets use many of the tools proposed in this statement to value both freely traded options and options embedded in other financial instruments. Complex trading and hedging strategies have been developed over the years as market participants have gained more insight and precision in the valuation of options. The fact that this highly developed body of knowledge has not previously been widely used to value employee share options does not mean that such options can not be reliably measured.

Issue 4(c) (Response): We agree with the proposed statement that there should not be a specific required method of estimating expected volatility or a uniform volatility assumption that would apply to all companies. The guidance in this proposed statement for assumption setting is comparable to that used in FAS 87, *Employers' Accounting for Pensions*. In FAS 87, it was noted that to use uniform assumptions for all plans would impair the comparability of financial statements. If different employers used the same assumptions, users of financial statements would have no way of knowing if these assumptions truly reflect the experiences and expectations of each employer. Share price volatilities have and will continue to vary both by company and over time. Imposing more specific guidance than what is already contained within the proposed statement would ultimately diminish the comparability and usefulness of financial statements.

Issue 4(d) (Response): We agree that there are unique characteristics of employee options that affect the fair value of those options. The guidance given in the proposed statement appropriately recognizes those characteristics. In particular, employee exercise behavior and exercise restrictions are significant factors in valuing non-transferable options. The proposed methods of this statement adequately allow for measuring and modeling employee exercise behavior that will vary significantly by company and by employee group within each company.

Issue 5 (Response): We believe that circumstances in which it is not possible to reasonably estimate the fair value of an equity instrument will be extremely rare. Moreover, if key features and assumptions for a particular award cannot be estimated, then no valuation model other than an intrinsic value measurement will be able to value the award. We agree that it would be appropriate to use the intrinsic value method with remeasurement through the settlement date under these unlikely circumstances.

Attribution of Compensation Cost

Issue 8 (Response): We believe the guidance in the proposed statement is sufficient for determining the requisite service period. Explicit and implicit service periods pose little question and the proposed statement is correct in stating that awards with market conditions have service periods that can be derived from the valuation

RE: File Reference No. 1102-100
June 30, 2004
Page 3.

technique used to estimate fair value. In fact, to use a period other than the derived service period for such awards would be inconsistent with the underlying valuation.

While we do agree with the principal of using derived service periods for awards with market conditions, we do not agree that the duration of the most frequent path should be used to determine the requisite service period. In every other aspect of path-dependent option pricing models, weighted-averages using all possible outcomes and probabilities are used to calculate values. To use the duration of a single path to determine the service period for such awards is ultimately inconsistent with the rest of the pricing model. Choosing a single path also raises the question of whether other paths would be appropriate for determining the service period such as the shortest path along which the market condition is met or the longest such path. To be consistent with the pricing models, we believe it is only appropriate to use the average value of the paths to calculate the duration of the requisite service period.

Disclosures

Issue 12 (Response): We believe that the required disclosures are sufficient and meet the objectives set forth in the proposed statement. In addition to covering the broad objectives, the disclosures provide key assumptions used in the measurement of fair value that will promote understanding of presented fair values and comparability of results between different entities.

Thank you for consideration of our comments. We would be happy to discuss our position with you further, if desired. You can contact me at 312-454-8157 or sscrol@chicagoconsultingactuaries.com.

Respectfully submitted,

Sean Scrol, ASA, MAAA
Principal