

June 11, 2004

*Letter of Comment No: 4260
File Reference: 1102-100*

Director of Major Projects
File Reference No. 1102-100
Financial Accounting Standards Board
401 Merritt 7
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Re: Towers Perrin's comments on the Exposure Draft, "Share-Based Payment"

Towers Perrin appreciates the opportunity to provide our comments to the FASB on its recently issued Exposure Draft, "Share-Based Payment". While we generally support the approach set forth in the Exposure Draft, we ask the Board to reconsider certain aspects of the proposed guidance:

Delay effective date of the proposed guidance

We support the Board's intention to adopt final rules as soon as possible, ideally by early in the fourth quarter of 2004. However, the proposed effective date (first quarter 2005) does not provide sufficient lead-time to prepare for compliance with the new rules. We suggest the Board finalize the Standard during 2004 but delay the proposed effective date by one year. Our reasons include:

1. Lattice-type valuation methods can be extremely complex and would require considerable time and effort to implement. Most companies do not have the data necessary to perform such valuations readily available and would need to engage outside valuation experts.
2. Once the final rules are announced, we expect many companies will change their granting practices and, in some cases, terminate existing plans. We question the cost-effectiveness of requiring companies to adopt new valuation approaches for plans that they will soon modify or eliminate. If the Board delays the effective date by one year, companies will avoid these unnecessary valuation costs.
3. Companies that voluntarily adopted FAS 123 using the "prospective" transition method would be adversely impacted to the extent that any pre-adoption options remain unvested when new guidance takes effect. A one-year delay would lessen or eliminate this impact for most of these companies – all of which tried to do the right thing by electing early adoption.

Furthermore, the proposed guidance contains some substantial differences from FAS 123. Thus, a company's experience in preparing FAS 123 footnotes will not materially lessen the burden of implementing new accounting rules.

Simplify attribution provisions

Several provisions concerning expense attribution would create a substantial administrative burden without, in our view, a corresponding improvement in accuracy. We believe that the Board should allow simpler attribution provisions that alter the timing of expense recognition without affecting the total costs. Specific issues include:

1. **Front-loaded expensing for plans with graded vesting:** The proposed guidance would require companies to treat each vesting tranche as a separate grant. This approach would be especially burdensome for plans with frequent vesting periods, such as monthly vesting – which is common for high tech firms. And while this FIN 28 treatment would add substantial complexity to the expense attribution, it would not alter the total expense recognized. We recommend the Board consider permitting a simple weighted-average attribution method for the underlying grant, rather than requiring separate attribution of each tranche.
2. **Estimating award forfeitures:** FAS 123 allows companies to record award forfeitures as they occur; the proposed guidance would require companies to estimate expected forfeitures at the time of grant and true-up for actual forfeitures. We believe this provision would add unnecessary complexity, especially when companies have no sound basis for estimating forfeitures (which is common). We recommend that the Board retain the current provisions of FAS 123 that allow companies to use either method.

In short, we question whether the overall benefits of these complex provisions will justify the increased costs of valuation, and encourage the Board to consider allowing simpler procedures.

Simplify measurement of liability instruments

The proposed guidance would require companies to expense liability instruments on a mark-to-market basis based on their fair value, rather than their intrinsic value. While we appreciate that the proposed guidance may be more theoretically consistent with the fair value measurement basis used for equity instruments, it would increase the burden on – and cost to – companies since awards would have to be valued quarterly during the period they are outstanding. Further, and perhaps more importantly, we expect that a simpler intrinsic value method would result in the same total expense as that generated by the proposed guidance.

Expand allowable transition methods

In light of the Board's concerns about comparability of reported results and a possible "ramp up" effect, we agree with the decision to not allow use of the prospective method. However, we disagree with the proposed transition rules allowing only the use of a modified prospective method, and suggest that retroactive restatement also be allowed.

The retroactive restatement method would provide comparability in the cost recognized by a company, and is consistent with our understanding of the direction the Board plans to take with respect to voluntary changes in accounting policies. We believe both the retroactive restatement and modified prospective methods will support comparability following adoption of the final guidance and we think that both methods should be allowed.

Equalize effect of market-based and performance-based vesting conditions

From a plan design perspective, a desired outcome of the new accounting guidance would be the creation of a “level playing field” that offers similar accounting treatment for all types of plans. The proposed guidance, however, provides that companies reverse the cost associated with grants that fail to vest because of service or performance conditions, but not for grants that fail to vest because of market conditions. We believe this difference in accounting treatment could bias plan design toward the use of service and performance conditions over the use of market conditions.

We both appreciate the Board’s concerns about measurability and consistency in measuring fair value and acknowledge the potential difficulties associated with the direct consideration of performance conditions. However, from a plan design perspective, we believe it is imperative that the accounting guidance provide for similar treatment for all plan types, so as not to bias the design process – either by providing for the reversal of cost for all grants that fail to vest, or by recognizing all substantive characteristics of the grant in determining fair value.

Incorporate reload feature in grant date valuation

The proposed guidance would require companies to treat reload options as a separate grant for expense recognition purposes. We believe this position is inconsistent with the implementation guidance indicating that fair value (i) be “based on established principles of financial economic theory and generally accepted by experts in that field” and (ii) “reflects any and all substantive characteristics of the instrument (except for those characteristics explicitly excluded, such as vesting conditions and reload features).” We believe there exist today accepted methodologies that can be used to determine the grant-date value of reload options (including the effect of the reload feature) just as effectively as they value other types of awards. Therefore, we disagree with the Board’s approach in treating each reloaded grant separately.

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Underlying the Board's efforts in creating this proposal has been the goal to design accounting rules that provide a level "playing field" for all types of plans, which is certainly not the case today. In this regard, the proposed rules would represent a substantial improvement over the current standards.

The proposed rules would create a number of challenges for companies by fundamentally changing the way they think about and use equity-based compensation. They also would change the cost-benefit equation in assessing and evaluating plan design. We believe this would result in the modification of some existing plans and, in a few cases, the elimination of plans that have outlived their usefulness. We do not believe the proposed guidance would lead companies to discontinue effective programs, such as employee stock purchase plans, simply due to expense recognition requirements.

In closing, we commend the Board's effort in upholding its commitment to "getting the accounting right" for option valuation and other matters. Our suggestions outlined in this letter are intended to ease these challenges presented by the proposed guidance, without undermining the basic objectives of the proposal. We hope you will reflect them in your final Standard.

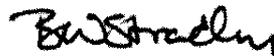
We appreciate the opportunity to share our views. We would be pleased to respond to any questions that you have.

Sincerely,



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