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June 25, 2004

Financial Accounting Standards Board
Suzanne Q. Bielstein
Director of Major Projects
File Reference No. 1102-100
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116

Letter of Comment No: 6387
File Reference: 1102-100

Via e-mail: director@fasb.org

Subject:

Share-Based Payment Exposure Draft

Dear Ms. Bielstein:

Marsh & McLennan Companies, Inc. ("MMC") is a global professional services firm and the parent company of Marsh Inc., the world's leading risk and insurance services firm; Putnam Investments; and Mercer Inc., a major global provider of consulting services including human resource and executive compensation consulting practices.

The purpose of this letter is to respond to the issues contained in the FASB Exposure Draft on accounting for Share-Based Payments and suggest a viable alternative approach that should be fully explored.

General

FASB's independent standard setting process should certainly be protected from undue influence by either the private or the public sector. We believe, however, that members of Congress have raised valid concerns regarding the appropriateness of available valuation methods and the potential reaction to mandatory expensing of employee stock options.

The public policy debate surrounding share-based payments revolves around important issues of workforce incentives and corporate governance. From an accounting perspective, any change from the current accounting for stock options should be reasonable, understandable, reflect real economic values or costs, and be fair across industry standards. It should make financial statements of public companies more transparent and friendlier to all investors, particularly small investors. The proposed methodology does not appear to meet these tests.



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Recognition of Compensation Cost and Fair Value Measurement (*Issues 1, 2 and 4*)

We are most concerned about the complexity and reliability of proposed models to measure the fair value of employee stock options. The valuation techniques identified by FASB do not reflect the fact that the terms of most employee stock options preclude any mechanism to realize value on the date of grant or at any time prior to exercise. In addition, the proposed models generate values that will distort earnings comparisons between companies and, for any particular company, may even have the potential to impede year to year earnings comparability.

While we agree that current accounting for stock options may not be sufficient, expensing fair value as suggested under the exposure draft might actually distort a company's financial statements. A possible alternative approach could be to use fair value to calculate earnings dilution on the date of grant. This approach would reflect employee stock option awards in a similar manner to restricted stock awards. A full value restricted stock award, putting aside dividends, is simply an option with a zero exercise price. If employee stock option awards are recorded similar to full value restricted stock awards (expense is equal to intrinsic value), there would be no expense associated with future appreciation.

Expense would be recorded (the numerator effect) only to the extent intrinsic value would be transferred on the date of grant. Dilution would be recognized (the denominator effect) by adding to diluted shares outstanding on the date of grant the number of equivalent shares/restricted shares the company gives the employee at grant. Although this methodology is dependent upon an estimation of fair value, any inaccuracies are eliminated over time by a company's future stock performance. This true-up mechanism is consistent with accounting principles governing all other estimates in the financial statements. The attached paper further expands on this concept and includes illustrations of its application.

Measurement Attribute (*Issue 3*)

As noted in the attached paper, we believe an estimate of fair value can be used for calculating additional dilution at the date of grant but due to the above noted limitations in proposed valuation techniques, it is distortive to use for expensing.

Interestingly, institutional investors we have talked with have said they are in favor of greater discipline and disclosure around option awards but do not think expensing them, as proposed, represents the proper accounting methodology.



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Employee Stock Purchase Plans (*Issue 6*)

We urge retention of the current exemption for non-discriminatory, broad-based employee stock purchase plans. Unfortunately, broad-based plans will no doubt be the first to be affected if the current exemption is eliminated. Such plans are an excellent way to encourage employee ownership of a company's stock and, in fact, generally receive resounding (i.e., 90%) shareholder approval.

Attribution of Compensation Cost (*Issues 7, 8 and 9*)

We believe the requisite service period is the appropriate basis for attribution and that guidance on estimating the requisite service period is sufficient. We do not agree with the treatment of awards with a graded vesting schedule. That treatment attributes more compensation cost to earlier years of an award when the options generally have little or no true economic value. We would encourage retention of the current rules which allow straight-line recognition instead of mandating the more complex front-loaded accruals.

Income Taxes and Cash Flows (*Issues 11 and 16*)

We would encourage revision of the proposal's asymmetrical effects in treating excess tax benefits and excess tax deficits. We believe both should be recorded through the P&L.

Transition (*Issue 13*)

In the event the proposed method for expensing employee stock options prevails, we believe companies should be allowed to restate options expense retroactively. This restatement would best be accomplished by using the FAS 123 footnote amounts rather than recalculating prior year awards using the new methodology. Interestingly, restatement of prior years is required by the IASB in ED2.

We would be pleased to meet with you to discuss these comments.

Regards,

Enclosure