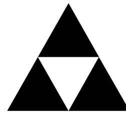

AMERICAN ACADEMY *of* ACTUARIES

April 14, 2006

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Re: File Number S7-03-06; Comments on proposed rule on executive compensation and related-party disclosure

Dear Ms. Norris:

On behalf of the American Academy of Actuaries'[1] Pension Committee, I appreciate the opportunity to submit comments on the Securities and Exchange Commission's (SEC) Proposed Rule on Executive Compensation and Related-Party Disclosure (the 'proposal'). We have significant concerns regarding aspects of the proposed rule addressing defined benefit (DB) and defined contribution (DC) plans, most notably with respect to the determination of current-year compensation.

Consistent disclosure of defined benefit and defined contribution information

Defined benefit and defined contribution plans can both be important components of executive compensation. Although the basic nature of these plans may differ considerably, their inclusion in the proxy disclosures should be as consistent as possible. This is not the case in the proposal. For example, amounts included as "other compensation" are inconsistent across the different types of plans. Under the proposed rules, DB plans must include the change in present value of the entire benefit, which would include the effects of interest and assumption changes on past-service benefits. Similarly, nonqualified DC plans would also have to include as compensation interest on beginning-of-year balances. Conversely, qualified DC plans would include only current year contributions and would not reflect interest on beginning-of-year balances in any way.

Separating current versus past compensation for DB and DC benefits

We believe that the compensation attributable to a year, presented as "other compensation" in the Summary Compensation Table, should reflect the increase in DB and DC benefits attributable to the additional year of service, not the mere passage of time. In a DC plan, this is generally the additional contributions to the account during the year, and should ignore market-related investment earnings on the existing balance. (We acknowledge that some DC plans credit interest at an above-market rate, and agree that the excess interest should be considered as additional compensation. However, we believe the appropriate solution to this issue is for the rule to provide guidance similar to that in the regulations under Internal Revenue Code (IRC) Sec. 3121(v) as to what can be considered a market rate.) A similar concept applies with a DB plan, where the increase in the value of the pension attributable to the additional year of service should be treated as current compensation, but not the interest growth or effect of assumption changes associated with previously accrued benefits.

Except as noted above, the increase in the value of existing DC balances or DB accrued benefits due to the passage of time should not be included as current compensation because the increase in value has little relationship to the decisions/actions taken by the company's compensation committee in the current year, or, for

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[1] The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

that matter, to the executive's service for that year. Such increases in value are likely to have occurred regardless of whether an executive officer or director was still employed, and thus do not seem to be compensation. Disclosure of the increase in the present value of the total DC or DB benefit should be reserved for the supplemental tables.

The following sections provide further detail on our comments.

DC issues

Inclusion of all earnings (as opposed to just earnings above a market rate) on nonqualified deferred compensation in "other compensation" seems inappropriate and inconsistent with the treatment of equity-based elements of compensation that are reported once at grant date fair value and never again reported as compensation. Market-based earnings are more akin to investment returns than compensation and thus should not be included as current compensation. Current compensation should only include current year allocations to the account, as is proposed for qualified DC allocations.

The increase in any nonqualified DC balance, including interest, should be reserved for the supplemental DC table. This would provide the user with adequate information for understanding the company's obligation to the executive, without confusing current compensation with the effect of the passage of time on previously earned compensation. [2]

DB valuation issues

The present value of a DB benefit increases for the following reasons:

1. Additional benefits earned as a result of additional service
2. Additional benefits earned as a result of salary increases
3. Granting of past service benefits
4. The increase in the value of the benefit caused by the passage of time (e.g., reducing the discount period by a year.)
5. Changes in assumptions, most notably the discount rate
6. Actuarial gains and losses (e.g., a reduction in liability because an executive chose not to retire early during the previous year.)

As mentioned above, the increase in the present value of the accrued pension benefit as a whole is not appropriate to include as an element of other compensation in the Summary Compensation Table. This amount can vary dramatically from year to year (and can be negative) based on the impact of assumption changes and emerging experience on past service amounts. We believe that considering this increase to be "current compensation" is inappropriate because it has little relationship to the decisions made by a company's compensation committee in the current year or to the service performed by an executive in the current year. A better measure for "current compensation" would be the present value of the benefit increase that accrued during the year as a result of that year's service, including any effect of an increase in compensation and of any plan amendments (items 1-3 above).

Further, for plans with early retirement subsidies, the value of the subsidy should not "accrue" all at once. Consider a plan that provides unreduced early retirement benefits at 30 years of service. The disclosure of compensation should reflect that this subsidy is earned over 30 years, not during just the 30th year. To do otherwise would understate the compensation earned during the first 29 years, and exaggerate the compensation in the 30th year.

We also suggest that the SEC provide guidance on the actuarial assumptions (interest rates, retirement age, etc.) used to determine the DB amounts in order to enhance comparability across years and across companies. Just

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[2] The employer could theoretically decide to pay the amount of benefit earned each year at the end of the year. From a financing/compensation perspective we note that retaining the liability and paying market interest on it is no different than paying it to the employee and simultaneously having the employee purchase, at market rates, a bond from the employer equal to the amount of the liability. The latter transaction would not be included in compensation, and thus would seem to demonstrate that interest on the liability, whether DB or DC, should not be included in compensation.

as the proposed rule asks registrants to look to their FAS 123R methodology and assumptions for valuing stock options, so it might ask registrants to look to their FAS 87 methodology and assumptions in valuing DB amounts.

Combining this information, we suggest that current compensation should include an amount for DB benefits that parallels the "service cost" concept under FAS 87. Service cost is the value of the additional year of service on benefits based on reasonable assumptions, including assumptions about early retirement. Companies could look to their FAS 87 valuations for this information, or use another reasonable approach if still representationally faithful. Note, however, we would encourage that service cost be determined on an accumulated benefit obligation (ABO), not projected benefit obligation (PBO), basis so that future compensation increases are recognized when earned and not anticipated in advance (as they are with PBO). Current compensation would then also include any prior service cost created during the year.

We emphasize that this view is consistent with our recommendation that the amount of increase in DC benefits that is included as "other compensation" represent the effect of the additional year of service (i.e., the current allocation). This does not include any change in the present value of past service benefits (i.e., income on the existing balance), as such changes do not reflect compensation for services.

DB disclosure issues
To the extent that the Summary Compensation Table includes, for DB benefits, only the increase in value attributable to the additional year of service and increase in compensation, it may be useful to provide information about the change in the value of the full DB benefit in the supplemental DB table. This would also be consistent with the treatment of the DC benefits.

Accordingly, the Retirement Plan Potential Annual Payments Table could show, as proposed, the benefit in the form elected by the executive at both the earliest (presumed most valuable) and normal retirement ages. The supplemental DB table could be expanded to show the present value of the accrued benefit at the beginning of year, the change in that value due to the passage of time (i.e., the effects of interest, assumption changes, and experience), the increase in value due to an additional year of service and compensation increases (and plan amendments, if any), and the resulting present value of the accrued benefit at the end of the year. This expansion would be consistent with the approach used for the supplemental DC table.

The present values shown would not be based exclusively on the early and normal retirement benefits shown because various assumptions about timing would be embedded in the actuarial calculations of present value. However, it is hoped that providing information about both the potential payments and the expected values would provide the clearer, more complete picture that the Commission desires.

We should add that it is possible to not only have different benefit elections across plans, but also different elections within plans for different years' accruals. As such, we believe the Retirement Plan Potential Annual Payments Table could prove to be so complicated as to render it nearly useless to many readers of this information. To the extent the table is expanded to include the change in present value of any DB benefits, the Commission might consider whether the payments table could be simplified. For example, all benefits could be reduced to a common form, such as a life annuity, which would then allow aggregation of plans (while we are suggesting that payments should be converted to one common form for purposes of showing annual payments, we reiterate that the value of alternative benefit forms would be included in aggregate compensation). Or, a narrative disclosure explaining the key benefit provisions underlying the present-value calculations could prove to be more useful than disclosure of many different amounts in many different forms.

Change in control
In addition to the DB and DC issues above, we also note that change in control provisions can be quite complicated. An extensive description and quantification of all the relevant impacts would require significant effort and could still leave most users with little ability to assess the value. We would suggest that this section be limited to benefits that are not included elsewhere in the proxy and to enhancements to benefits that are included elsewhere. For example, if executives received only their accrued pension benefits regardless of the reason for separation, no other information would be included in this section. If, however, enhancements were granted upon change in control, those enhancements would need to be described and quantified here.

Members of the committee appreciate the opportunity to submit comments on the SEC's proposed rule on executive compensation and related-party disclosure. If you have any questions or would like to discuss the comments detailed in this letter, please contact Heather Jerbi, the Academy's senior pension policy analyst (202.785.7869; Jerbi@actuary.org).

Sincerely,

James F. Verlautz, MAAA, EA, FCA, FSA
Chairperson, Pension Committee
American Academy of Actuaries