I am in absolute agreement with the need for greater clarity in reporting executive compensation. However, many of the proposed new rules, as currently articulated, will serve to obfuscate the true compensation and the cost of providing such compensation.

The proposed disclosure of earnings on nonqualified deferred compensation plans is problematic. This is only relevant in those situations where the company, at its own cost, is the source of the accretion of the participant's notional account. As currently proposed, it will thoroughly distort compensation in the most widely utilized form of non-qualified defined contribution plan (so-called non-qualified 401(k) mirror plans). These plans allow participants to make hypothetical investments according to one or more reference funds or benchmarks. The reference funds' performance is not necessarily indicative of compensation or the employer's cost of providing compensation. In periods when the benchmark (e.g., S&P 500) elected by the participant (or stipulated by the plan) is down, the participants' overall compensation will be understated because the negative return will serve as an offset against legitimate forms of compensation. In periods when the reference fund's performance is up, it may appear as though the participant's compensation is excessive, even if the employer incurs no cost whatsoever in connection with the notional increase in the participants account balance. This is the case with most of these plans because sponsoring employers invariably use some form of hedging mechanism to mitigate market risk.

This leads to my second concern with your proposed rule changes. You fail to require disclosure with respect to the cost of providing these executive benefits. In the type of plan identified above (i.e., non-qualified 401 (k) mirror plan), the cost of providing benefits is more relevant to shareholders than the rise or fall of a given participants' hypothetical account. I suggest you include an estimated cost of providing each benefit plan. The cost could be expressed as a dollar average per participant or could be disclosed on some other basis (total cost per annum borne by the company). Perhaps it would suffice to require an estimated cost for providing each plan along with a list of the elements taken into consideration when computing cost and brief explanation of the methodology employed. I suggest you consult a study prepared by the Department of Labor (Pension and Welfare Benefits Administration) in 1998 titled Study of 401(k) Plan Fees and Expenses. The study was focused on the myriad hidden costs that get passed along to plan participants, often under the guise of “free” or low cost plan record keeping services. The study documents numerous disturbing practices in the “qualified plan” arena with an extraordinarily wide range of costs – even for plans of similar size. If divergent costs, replete with abusive pricing are rampant within the highly regulated, full disclosure, fiduciary obligation environs of qualified retirement plans, one can only wonder about what lies beneath the surface of the largely unregulated, non-fiduciary arena of non-qualified executive retirement plans. Although cost shifting to participants was the DOL's concern within the study, the reverse is often the case with non-qualified plans. Shining light in this arena will ultimately deliver far greater value to shareholders and regulators alike.

My last observation is that disclosure of all premiums paid on life insurance for the executive will often distort compensation too. While I am in no way a proponent of Split Dollar insurance plans, the premium paid under such an arrangement has very little to do with either the compensation received by the participant or the cost incurred by the employer. This entire area has been thoroughly vetted by the Internal Revenue Service in recent years and the new regulations have finally put an end to abusive forms of Split Dollar (in which cash values were allowed to grow on the executive's personal balance sheet without current, proportionate income tax recognition). The present laws and regulations give detailed instructions regarding the precise measure of compensation to be recognized by the executive (its imputed value). Why deviate from the tax laws when disclosing compensation? If the concern here is the cost of compensation incurred by the employer, your proposal is still misguided. Premium paid by no means equals cost with respect to permanent life insurance products. FASB Technical Bulletin 85-4, the GAAP accounting convention for cash value life insurance, provides a rigorous and precise method for computing and disclosing cost (or gain) in a given period.

Once again, disclosing the cost undertaken by employers to sponsor a given benefit plan is of vital importance and should be required.

Matt Schoen

(203) 227-7074 ext. 355

mbschoen@coliaudit.com