

# COUNCIL OF INSTITUTIONAL INVESTORS

Suite 500 • 888 17<sup>th</sup> Street, NW • Washington, DC 20006 • (202) 822-0800 • Fax (202) 822-0801 • [www.cii.org](http://www.cii.org)

---

## Via Email

May 5, 2008

Russell G. Golden  
Chairman  
Emerging Issues Task Force  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, Connecticut 06856-5116

*Re: File Reference No. EITF0705*

Dear Mr. Golden:

I am writing on behalf of the Council of Institutional Investors, an association of more than 135 public, corporate and union pension funds with combined assets of over \$3 trillion (“Council”). The Council appreciates the opportunity to comment on the Financial Accounting Standards Board’s (“FASB”) Emerging Issues Task Force (“EITF”), Draft Abstract, EITF Issue 07-5, “Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity’s Own Stock” (“Draft”).

Our comments on the Draft are limited to “Example 17.”<sup>1</sup> That example describes the accounting by a company for the issuance of a “security to investors for purposes of establishing a market-based measure of the grant-date fair value of a grant of employee stock options.”<sup>2</sup> The analysis contained in the example concludes that such a security is “not considered indexed to the entity’s own stock” and, therefore, must be accounted for as a derivative instrument.<sup>3</sup>

The Council is aware that Zions Bancorporation (“Zions”) has issued a security—Employee Stock Option Appreciation Rights Securities (“ESOARS”)—that may have been the impetus for Example 17 of the Draft. We, therefore, would like to share with the EITF and the FASB the following information we have obtained about Zions’ ESOARS. In summary, that information indicates that Zions’ ESOARS do not establish a valid market-based measure of the grant date fair value of employee stock options. We offer such information with the hope that it may be of some benefit to the EITF, the FASB, and other interested parties in better understanding Zions’ ESOARS for purposes of evaluating Example 17 of the Draft and for purposes of evaluating other financial accounting and reporting issues that may arise as a result of Zions’ ESOARS or similar securities.

---

<sup>1</sup> Financial Accounting Standards Board Emerging Issues Task Force (“EITF”), Draft Abstract, EITF Issue 07-5, at 13, <http://www.fasb.org/eitf/0705DA.pdf>.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

As background, in light of the Council's policy supporting the expensing of stock options,<sup>4</sup> since 2006 the Council has been monitoring the implementation of Statement of Financial Accounting Standards No. 123, *Share-Based Payment* (revised 2004) ("Statement 123R").<sup>5</sup> In early 2007, we became aware from press reports that Zions had requested the views of the staff of the Securities and Exchange Commission's ("SEC's") Office of the Chief Accountant as to whether the price obtained for the auction of ESOARS could be used as an estimate of fair value for purposes of Statement 123R.<sup>6</sup>

In response to Zions' request to the SEC staff, the Council commissioned leading valuation expert Stephen A. Ross and his colleagues at Compensation Valuation Inc. ("CVI") to prepare an analysis evaluating whether Zions' ESOARS was a reliable tool for determining the fair value of employee stock options. CVI's resulting March 30, 2007 report ("CVI Report"), attached to this letter, reached the following conclusion:

. . . the ESOARS product is too flawed to serve as a reliable valuation tool for FAS 123R purposes. While the tracking security itself is imperfect but not unreasonable, in combination with the auction mechanism and surrounding conditions and incentives, the design serves primarily to produce a predictably downward biased result.<sup>7</sup>

The CVI Report also offered several "major modifications" designed to remedy the defects with Zions' ESOARS including: (1) significantly increasing the issuance size and eliminating the artificial restrictions on bidders and holders of Zions' ESOARS; and (2) reversing the Zions' ESOARS auction so that Zions (and other companies valuing their employee stock options) must purchase (rather than sell) the ESOARS from third party suppliers.<sup>8</sup> The CVI Report notes that

. . . [w]ithout remedies or alternatives such as those proposed above, the ESOARS price should not be accepted by auditors nor certified by senior executives as correctly measuring the cost of a company's ESOs.<sup>9</sup>

Shortly after the completion of the CVI Report, Mr. Ross (via teleconference), a representative of the CFA Institute, and I met with the SEC staff to discuss the CVI Report.

---

<sup>4</sup> The Council of Institutional Investors ("Council"), Corporate Governance Policies 5.8(c) (Updated Apr. 11, 2008), <http://www.cii.org/UserFiles/file/council%20policies/CII%20Corp%20Gov%20Policies%204-11-08%20Final.pdf>.

<sup>5</sup> Share-Based Payment, Statement of Fin. Accounting Standards No. 123(R) (Fin. Accounting Standards Board Oct. 1995), [http://www.fasb.org/pdf/aop\\_FAS123R.pdf](http://www.fasb.org/pdf/aop_FAS123R.pdf).

<sup>6</sup> See Letter from Jeff Mahoney, General Counsel, Council, to Conrad Hewitt, Chief Accountant, Securities and Exchange Commission ("SEC") 1 (Feb. 5, 2007), <http://www.cii.org/UserFiles/file/resource%20center/correspondence/2007/02-05-07%2520ltr2conradhewitt.pdf>.

<sup>7</sup> Zions Bancorporation ("Zions") ESOARS: An Evaluation, Compensation Valuation, Inc. 6 (Mar. 30, 2007) [hereinafter *CVI Report*]; see also William Ortner et al., Equity Compensation and the Capital Markets, Citigroup Corporate and Investment Banking 19 (Aug. 15, 2006) (Zions' ESOARS result . . . "in the 'market' bid for the instrument certainly being a lowball one.").

<sup>8</sup> CVI Report, *supra* note 7, at 6-8.

<sup>9</sup> *Id.* at 8.

May 5, 2008

Page 3 of 3

On October 17, 2007, notwithstanding our discussions with the SEC staff about the conclusions contained in the CVI Report and Zions' failure to adopt any of the modifications set forth therein, the SEC Chief Accountant publicly released a letter to Zions indicating that the SEC staff did not object to Zions' view that a May 2007 auction of ESOARS could be used to value underlying employee stock options granted to Zions' employees.<sup>10</sup> The Council strongly disagrees with the SEC staff's conclusion on this matter and is committed to continuing to advocate for a high quality, credible, and unbiased implementation of the fair value measurement requirements of Statement 123R.

Thank you again for the opportunity to comment on the Draft. Please feel free to contact me with any questions.

Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney".

Jeff Mahoney  
General Counsel

Attachment

---

<sup>10</sup> Letter from Conrad Hewitt, Chief Accountant, Office of the Chief Accountant, SEC, to Mr. James G. Livingston, Vice President, Zions 1 (Oct. 17, 2007) (on file with Council).