



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

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Sir David Tweedie
International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH

14 March 2003

Reference: Exposure Draft ED 2 Share-based Payment

Dear Sir David

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the Exposure Draft on Share-based Payment. The Committee has a strong interest in promoting transparent and high quality financial statements by banks and believes that the Exposure Draft includes many useful proposals.

Please find our comments in the attached note. The Committee's Accounting Task Force, chaired by Prof Arnold Schilder, Executive Director of De Nederlandsche Bank, has prepared the note. The Basel Committee has approved this note, and trusts that you will find its comments useful and constructive.

If you have any questions regarding our comments, please feel free to contact Prof Schilder (+ 31 20 524 3360), or Bengt A Mettinger at the Basel Committee Secretariat (+ 41 61 280 9278).

Yours sincerely,

William J. McDonough

Annex

Basel Committee Comments on IASB Exposure Draft ED2 Share-based Payment

1. Introduction

The Basel Committee on Banking Supervision¹ (the Committee) has long recognized the importance of transparency – facilitated by sound accounting and disclosure – in promoting effective market discipline, which comprises one of three pillars of the Committee's proposed New Basel Capital Accord.

The Committee commends the IASB (the Board) for taking the lead in establishing a comprehensive accounting standard for reporting share-based transactions. The Committee is largely limiting its comments to the employee compensation part of the proposal, as banks only rarely barter their equity with third parties for goods and services.

2. Expensing Employee Share-based Payment

For quite some time there has been acrimonious debate as to whether companies should be required to expense employee share-based compensation. A mix of conflicting views and interests as well as complex technicalities has fuelled the debate.

Against this backdrop, an emerging consensus appears to have developed amongst users of published financial reports that companies should expense employee share-based compensation. In response, many major corporations around the world have announced that they will "voluntarily" expense employee share-based compensation. However, this diversity in practice coupled with the use of a variety of methodologies to calculate the expense has resulted in comparability issues among companies' published financial statements. Hence, the Committee finds the Board's exposure draft to be valuable in promoting transparency and further comparability in financial reporting.

3. Valuation

As noted in the explanatory sections of the exposure draft, the Board found valuation issues to be the most challenging aspect of developing the proposal. This is not surprising given the inherent complexity of valuing non-traded financial instruments, especially ones as

¹ The Basel Committee on Banking Supervision is a committee of banking supervisory authorities, which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. It usually meets at the Bank for International Settlements in Basel, where its permanent Secretariat is located.

complicated as employee stock options. Ultimately it appears that the Board decided to incorporate only general valuation guidance out of practical considerations.

While the Committee recognizes some of the appeal of issuing more general guidance initially, we believe additional guidance is needed. Accordingly, we recommend that the Board include employee share-based compensation issues in its future financial instrument valuation projects as a way of enhancing the standard and improving comparability in financial reporting.

In particular, the Committee notes that the inputs to the models used to value employee share-based compensation are generally subjective. Moreover, unlike other financial instrument models, it will only rarely be possible, by the nature of the underlying instruments, to compare the results of these models with actual market transactions.