



News Release

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Actuaries to Tackle Stock Option Valuations

Task Force Launched to Examine How Actuarial Science Can Help

(Washington, D.C. - June 23, 2004) On March 31 the Financial Accounting Standards Board (FASB) released a proposed statement on *Share-Based Payment*, which spurred the **American Academy of Actuaries** to create a group to study the issue of stock option expensing. The Stock Options Task Force will examine the application of actuarial science to the valuation of stock options.

“Calculating the value of stock options resembles the valuation processes actuaries currently use with pensions, retiree life and health, and other long-term compensation and benefit plans,” said **Thomas S. Terry, chairperson of the Academy Task Force** and president of Chicago Consulting Actuaries.

“We believe these actuarial methodologies and disciplines will be very effective in the valuation of stock option programs.”

The Academy neither supports nor opposes the expensing of stock options, nor has it taken a position on the proposed legislation currently in Congress. “We believe there are sound actuarial methods and principles that lend themselves to the valuation of stock options that need to be examined, irrespective of any proposed legislative activity,” said **Kenneth A. Kent, the Academy’s Vice President of Pensions** and Principal with Mercer Human Resource Consulting.

In developing methodologies to value stock options, actuaries will draw on these relevant areas of expertise:

- 1) **Measuring financial contingencies.** While much of the compensation value of a stock option grant is immediate, the cash value is not known for years. Actuaries are expert in measuring the financial impacts of long-term financial contingencies.
- 2) **Choice of methods.** Actuaries are expert at modeling the short- and long-term financial implications of alternative valuation methods, and making comparisons and grasping the nuances among different methods.

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- 3) **Setting assumptions.** Assumptions need to be set based in part on past experience and with a view of future trends. This process is central to the work of actuaries.
- 4) **Data analysis.** Actuaries are expert at determining the data needs of a technical valuation process – from requesting the appropriate data, to reconciling and summarizing such data. Actuaries are also expert at working with the subtle issues of data quality.
- 5) **Documentation.** Actuaries are experienced at documenting processes, assumptions, methods, data sources, and results of complex computations. Actuaries are accomplished at providing documentation and communicating financial results to employers, auditors and others.
- 6) **Communicating to decision-makers.** Actuaries are expert at the communication of challenging technical content, and putting the technical content within the broader framework of compliance with applicable standards.
- 7) **Practice standards.** The Actuarial Standards of Practice apply to the work of virtually all actuaries in the U.S. and offer the public the necessary assurances of quality and consistency in all their financial valuation work.

The task force will apprise FASB, the Securities and Exchange Commission, Congress, and other interested parties of its on-going work. “Our intention is to help resolve the technical valuation issues in expensing stock options. It will be up to the FASB, with input from others, to determine the allowable methods for stock option expensing,” said Terry.

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To arrange an interview or for further information please contact Tracey Young at 202-785-7872, or go to the Academy Web site at www.actuary.org

The American Academy of Actuaries, headquartered in Washington, D.C., is the nonpartisan public policy organization for the U.S. actuarial profession. The Academy provides independent analysis to elected officials and regulators, maintains professional standards for all actuaries, and communicates the value of actuarial work to the media and the public.