

International Cooperative & Mutual Insurance Federation
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Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Date 30 July 2004

Dear Sir David,

Comments on International Accounting Standards Board's (the IASB's) Exposure Draft - Amendments to IFRS 3 Business Combinations – “*Combinations by Contract Alone or Involving Mutual Entities*” (referred to as the proposed amendments).

We are pleased to comment on the proposed Amendments.

The International Cooperative & Mutual Insurance Federation (ICMIF) is a trade association that represents 144 mutual and cooperative insurance groups in 69 countries which includes over 400 insurance entities in 85 countries. Founded in 1922 and currently based in the UK many of our members are large groups where business combinations are regular occurrences. Sometimes these business combinations are straight forward acquisitions but sometimes they are better suited to mergers.

The current climate in the mutual insurance world is that many small mutuals will over the next ten years need to merger with each other in order to survive as new regulations from the IASB, namely IFRS 4, and from the European Union with Solvency II affect their ability to write business. Consolidation in many countries where small mutuals provide vital services to communities and in the areas of social exclusion, will be forced on the smaller mutuals. Countries such as UK (with Friendly societies), Germany, France, Canada (farming mutuals), USA (farming mutuals) and Netherlands where there are hundreds of small mutuals will be forced into consolidation in order to survive.

With this background any legislation that impedes or inhibits the ability of these small mutuals to merge and consolidate will be counter productive not only to the mutuals but also to the fabric of societies in those countries. Any legislation that imposes willingly or not further costs on small mutuals could be condemning those companies.

It is for these reasons that ICMIF strongly disagree with the proposed amendments.

**Consensus of the task force
on the response to the consultation
on the IASB Exposure Draft on the Amendment to the IFRS 3 on Business
Combinations – “Combinations by Contract Alone or Involving Mutual Entities”.**

The task force included experts from the following organisations:

- ICMIF (International Cooperative & Mutual Insurance Federation)
- CCACE (Coordinating Committee of the European Cooperative Organisations)
- ACME (European Association of Insurance Cooperatives and Mutuals)

The Exposure Draft puts forward the suggestion to include combinations by contract alone or involving mutual entities (cooperatives and mutuals) under the scope of IFRS 3 and to apply a specific purchase method for all such transactions. The latter is different from the one that will apply to all other enterprises.

We understand some of the concerns that have led to the IFRS3 standard on Business Combinations that discards the method of pooling of interests, and linked to non-mutual entities (conventional companies). However, we are of the opinion that the Amendment to IFRS 3 is not appropriate to mutual entities, and reflects neither their juridical nature nor their economic reality. Eliminating the pooling of interest method and replacing it with a less appropriate one is no improvement as far as mutual entities are concerned in fact it may well prove to be a significant disadvantage to mutuals. The proposed purchase or acquisition method applied to mutual entities raises many new questions. In business the reality is that combinations of mutual entities accounted for by applying the purchase method mentioned in IFRS 3 and in its amendment proposal do not reflect the economic reality. We are thus under the obligation to oppose the proposed amendment.

We therefore request the IAS Board to maintain the IFRS 3 as was passed in March 2004, and to apply the accounting method of pooling of interest to mutual entities until proper guidelines are issued.

The IFRS 3 standard was passed in March 2004, only four months ago, when due thought was given to the exclusion of mutual entities and joint ventures from the standard. Technical difficulties to include mutual entities in IFRS 3 appear already in the basis for conclusions of the Proposed Amendments to IFRS 3 (see BC7). While joint ventures continue to be scooped out from the IFRS 3 and thus from the stable platform until proper guidelines are ready, mutual entities would be scooped in under the proposed Amendment. Similar to the case of joint ventures, an interim proposal with already identified protracted practical difficulties do not appear to be the adequate solution as far as mutual entities are concerned.

The IASB should explore all possibilities to reflect the economic reality of mutual entities in order to find effective solutions, for which we offer our full cooperation. If the need for a specific working group on mutual entities should be considered? We are fully open to further dialogue.

Finally, please allow us to insist also on the specificity of the mutual entities compared to conventional enterprises, and in particular when treating their framework for co-operating through various ways (through a legal merger, a contractual arrangement, a cooperative of cooperatives and so on). While in the conventional enterprise shareholders look for “value

creation”, namely the maximum shareholder value, in the cooperative and mutual world the objective is to optimise the services provided to members-owners of mutual entities.

By principle, the combination between mutual entities can never be conducted as a sale of the member shares (a 'share deal'). This is because the purpose of a cooperative and a mutual is to “meet [its members] common economic, social and cultural needs and aspirations” (ILO Recommendation 193). In contrast to the purchase of the majority of common stock in a conventional corporation, the situation by which an acquirer obtains control by purchasing more than half of the voting rights cannot occur in mutual entities, because the principle of "one-person-one-vote" prohibits one person to take control of the majority of the voting rights. Member shares are not transferable to non-members. Moreover, member shares are issued and redeemed on a nominal basis, and therefore do not have a market value which an acquirer would be willing to pay. Shares issued to members of the combined entity do not reflect any kind of purchase price or cost of the combination. Any kind of purchase method depending on measuring the cost of the combination leads to serious practical problems if applied on mutual entities (cooperatives and mutuals).

Mutuals and cooperatives do not seek special treatment but similarly do not expect legislation to disadvantage the business model particularly in the area of consolidation that will become increasingly important to our business sector. As you can see there are many reasons not to include mutual and cooperative entities in IFRS 3 and we ask that you seriously consider our request to delay such a decision and consult with the mutual and cooperative business world to attain a solution that can work for all.

Kind regards

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International Cooperative and Mutual Insurance Federation
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Comments of ICMIF on proposed Amendments to IFRS 3 Business Combinations

Question 1

The Exposure Draft proposes:

(a) to remove from IFRS 3 the scope exclusions for business combinations involving two or more mutual entities and business combinations in which separate entities are brought together to form a reporting entity by contract alone without the obtaining of an ownership interests

(b) to require the acquirer to measure the cost of a business combination as:

i. the aggregate of the following amounts when the combination is one in which the acquirer and acquiree are both mutual entities:

the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities; and

the fair value, at the date of exchange, of any assets given, liabilities incurred or assumed, or equity instruments issued by the acquirer in exchange for control of the acquiree

Therefore, goodwill would be recognised in the accounting for such transactions only to the extent of any consideration given by the acquirer in exchange for the control of the acquiree.

ii. The net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities when the combination is one in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest. Therefore no goodwill would arise in the accounting for such transactions. Is this an appropriate interim solution to the accounting for such transactions until the Board develops guidance on applying the purchase method to such transactions as part of a subsequent phase of its Business Combinations project? If not, what other approaches would you recommend as an interim solution to the accounting for such transactions, and why?

Responses to question 1

It is indeed difficult to determine who is the acquirer and acquiree in the cases of mergers of cooperatives and/ or mutuals, as compared with the cases for listed companies.

However, the main issue is not the difficulty to identify who should be the acquirer and acquiree, but the fact that due to the juridical nature of mutual entities, such legal figure of acquirer is not applicable. Indeed in many countries it is actually not legal to merge two mutual insurers together thus forcing a consolidation to go down the acquirer and acquiree route. This however is a debate for another time but nonetheless important to point out.

The application of the purchase method would entail, sooner or later, a true transfer of shares and legal notification to a notary, dissolve the property of a cooperative and invert the decision-making powers by concentrating them at the top head unit.

Members' shares in cooperatives and mutuals, when these do exist, are non-transferable and nominal, with all members enjoying equal voting rights.

It is not possible, in general, to legally acquire a cooperative or mutual or to directly transfer the members' shares (in the case of cooperatives), at least not before the entity is demutualised and turned into a conventional enterprise. Only then can it be acquired legally, a case that falls out of the scope of "business combination" of mutual entities, and therefore out of the scope of the proposed Amendment.

In many mutual insurers the ownership is unique to that business. For instance in life insurance mutuals it can be a certain product such as with profits that attracts membership rights. Some mutuals apportion membership votes according to premiums paid and not one member one vote as is traditionally the case. These variations lead to complex solutions for business combinations not accounted for within the proposed amended IFRS 3.

There is thus no exchange of consideration in mergers except for the financial compensation among the members' shares.

In the case of contractual groups, there is no transaction taking place, but a contractual agreement between two parties to share control of certain assets and/or activities, based on democratic and voluntary decision-making. (The use of the term "control" should not be equalled to the IASB content of the concept as it is being worked out at the moment). The result of a Business Combination of mutual entities linked together through a contractual group is not the control of an entity onto another, but rather two entities which control, under conditions of equal power, certain assets and activities in common.

Contractual groups do not lead to hierarchical control and concentration of capital. Their logic is of co-operation for specific socio-economic functions, and to ensure the long-term sustainability of the latter. When new cooperatives enter the group, they democratically decide to join in, in the same way as their founding members previously decided democratically to constitute the cooperative. Such joining in is motivated by a socio-economic function that the group performs. This can in no way be assimilated to a purchase, nor can it justify the utilisation of the purchase method.

It is not possible to control a cooperative entity by purchasing the majority of its members' share capital (such shares are not transferable) and there are limits to members' voting power (principle of "one person one vote"), even if one member has more shares than another member.

In the special method for measuring the cost of the combination, different from the one to apply to all other enterprises, it has been proposed that there will be no good will. This interim proposal should not be applied, and a proper method for accounting co-operation and mergers of equals should be studied and worked out.

Nobody has been able so far to define an appropriate accounting methodology for the combinations of mutual entities, although there is the mention to "fresh start accounting", a project that would start in the near future. The IASB should look at all alternatives, even others than the fresh start accounting, to find out an appropriate long-term solution that respects the legal nature of cooperatives and mutuals, and reflects their economic reality. We are ready to provide any information and to take part in any working group on this topic.

The hypothesis that there may be an advantage stemming from additional information for would-be members of cooperatives and/or mutuals participating in co-operative mergers and/or contractual co-operation, obtained through measuring the acquired enterprise on the basis of fair value, will not compensate the high costs to obtain such fair value. It is therefore requested to maintain the utilisation of the book value, unless a more appropriate new method is found.

The proposed amendment would contradict existing national legislation, some of which recently passed. After one year of work between specialists in accountancy and in cooperative law, the French CNC – National Accounting Council- stated the impossibility to consolidate the accounts of cooperatives and created the method of the "combination of accounts", due to the fact that the individual members have no right to the cooperative reserves, and to the principle of "one person one vote" that prevents control in the capitalistic notion of such terminology.

Most Business Combinations of mutual entities, because of their very nature, may identify with the method of Pooling of Interest. The latter accounting method appears in conformity with their specific

nature and should remain in force for them until an alternative method that takes into account their specific legal nature and economic reality is found.

Question 2

The Exposure Draft proposes that no amendments be made to the transitional and effective date requirements in IFRS 3. This would have the effects set out in paragraph 6(a) – 6(c) above on the accounting for business combinations in which the acquirer and acquiree are both mutual entities or in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest.

Is this appropriate? If not, what transitional and effective date arrangements would you recommend for such business combinations and why?

Responses to question 2

The date proposed in the Exposure Draft means the retroactive application of the standard, something that is not legally acceptable.

Hasty regulatory changes just four months after the approval in March of the IFRS 3, that might be possibly approved by the IASB at the end of 2004, provides neither time for adaptation (costly and time consuming) nor a stable regulatory environment that may deliver the benefits of trust and reliability.

The arrangement proposed is Interim (temporary) even though it may require changing laws in many countries in the world and statutory changes for cooperatives. Moreover, it would require changes to existing contracts among mutual entities all over the world. This is neither appropriate nor efficient. It also pre-empts the outcome of an adequate and stable solution for the long term.

We therefore request the non-application of the IFRS 3 to mutual entities until proper guidelines and adequate accounting solutions and time frame are set. The amendment proposed should not be included within the stable platform. Meanwhile, as long as there are other norms still in effect or in force, there shall be no legal vacuum.

It must be noticed that the vast majority of mutual entities are not-listed companies and that many of them are also SMEs. (The IASB wants to engage in drafting norms for all SMEs in the world in the near future).

The Interim arrangement proposed in the ED utilises key terms whose definitions are being redefined (e.g. business, control, consolidation, purchase and acquisition, good will- see for example two IASB Board Decisions on International Financial Reporting Standards Update of May and June 2004 on the IASB website). We believe that it would be more appropriate for the IASB to work out proper guidelines on the basis of clear and ascertained concepts.

Until the appropriate solutions are found, we recommend to continue with the pooling of interests and the net book value methods for mergers and contractual combinations among mutual entities (cooperatives and mutuals).