



**ASSOCIATION ACTUARIELLE INTERNATIONALE  
INTERNATIONAL ACTUARIAL ASSOCIATION**

July 30, 2004

Ms. Annette Kimmit  
Senior Project Manager  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom  
(Email:CommentLetters@iasb.org)

Dear Ms. Kimmit:

**Re: IAA comments on Exposure Draft of Proposed Amendments to IFRS 3,  
*Combinations by Contract Alone or Involving Mutual Entities***

In response to the request for comments to the IASB's Exposure Draft of Proposed Amendments to IFRS 3, *Combinations by Contract Alone or Involving Mutual Entities*, I am pleased to transmit on behalf of the International Actuarial Association (IAA) a draft of our comments and recommendations.

To summarize our comments, the IAA recommends that the IASB reconsider the nature of business combinations involving two or more mutual entities, particularly those involving a merger of equals, either in a subsequent stage of the joint IASB/FASB Business Combination project or the Insurance Contracts phase 2 project and should permit both pooling method and purchase method prior to the completion of these deliberations. We are concerned that the use of the purchase method in these cases may not provide superior financial statement information, i.e., such information may not properly convey the economic reality of such a merger. We therefore recommend the deferral of the proposed treatment of such mutual entities, i.e., maintain the exclusion in ED3 for the time being for these entities, until these issues can be satisfactorily concluded. We hope that you find our attached comments of value.

These comments have been prepared by a committee of the IAA, the members of which are listed by name and association in the Appendix to this submission. The IAA member associations are also listed in the Appendix.

Yours sincerely,

Yves Guérard  
Secretary General

Attachment: IAA comments

**IAA Comments on  
the IASB's Exposure Draft of Proposed Amendments to IFRS 3  
*Combinations by Contract Alone or Involving Mutual Entities***

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**THE INTERNATIONAL ACTUARIAL ASSOCIATION**

The International Actuarial Association (the "IAA") represents the international actuarial profession. Our fifty Full Member actuarial associations represent more than 95% of all actuaries practicing around the world. The IAA promotes high standards of actuarial professionalism around the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within, or likely to have an impact upon, the areas of expertise of actuaries.

We are not a trade association and do not represent the interests of either clients or employers. As actuaries, we have developed significant experience and expertise in the assessment of the value of contingent cash flows. Using this experience, actuaries will, as a profession, continue to try to provide assistance to those involved in the enhancement of financial reporting standards to make them more useful to the users of financial statements.

The IAA appreciates this opportunity to provide input to the IASB with regards to its Exposure Draft of Proposed Amendments to IFRS 3, *Combinations by Contract Alone or Involving Mutual Entities*. We continue to commend the IASB for its efforts to develop a high quality and globally accepted set of international financial reporting standards.

These comments have been prepared by the Insurance Accounting Committee of the IAA, the members of whom are listed by name and association in the Appendix to this brief. The Full Member associations of the IAA are also listed in the Appendix.

**IAA COMMENTS**

As we commented in our response to ED3, the predecessor to IFRS 3, we believe that the elimination of the pooling method has and will result in increased comparability in financial reporting. However, we also commented that the IASB should consider whether the pooling method might remain appropriate in the rare cases in which an acquirer cannot be identified, particularly in the case of two or more mutual (non-shareholder) insurers that can represent a merger of equals, where policyholders of each entity retain full and equal voting or "ownership" rights in the merged entity. Note that in a number of cases the purchaser can be identified, e.g., in the takeover of General American by MetLife in the U.S. in 1999, but that is not indicative of the normal situation.

Although the IASB reaffirmed its conclusion set out in paragraphs BC54 and BC55 of IFRS3, which states that the pooling method does not provide any superior information than the purchase method, we are concerned that the use of the purchase method in the cases indicated above might not provide superior financial statement information. In fact, such information may not properly convey the economic reality of such a merger.

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Accordingly, the IAA recommends that the IASB reconsider the nature of such business combinations involving two or more mutual entities either in a subsequent stage of the joint IASB/FASB Business Combination project or the Insurance Contracts phase 2 project and should permit both pooling method and purchase method prior to the completion of these deliberations. During those deliberations, consideration should be given to developing clear criteria to be used to determine where it might be appropriate to apply something other than the purchase method.

The reasons we believe that the IASB should consider this issue carefully and permit both methods during this period include the following:

1. The measurement of the cost of a business combination can prove to be problematic when the combination involves two or more mutual insurance entities with no clear purchaser.
  - Such transactions do not normally involve the payment of a reliably measurable consideration or purchase price (as stated in BC7 of the ED). Hence, no calibration to the market may be readily available.
  - Although possibly a temporary condition regarding liabilities for insurance contracts and investment contracts including discretionary participation features, the measurement method for determining fair values has not yet been determined in IFRS. Consequently, this should be addressed during either a subsequent stage of the Business Combinations project or phase 2 of the Insurance Contracts project.
2. Under IFRS 4, which permits various measurement methods, the measurement approach proposed in the ED is unclear and, lacking further guidance, could be expected to be applied in an inconsistent basis.
  - Although the ED assumes the use of fair values at the time of the combination, it is unclear under IFRS4 and many existing local accounting rules how the net amount of assets and liabilities are accounted for at the time of the transaction, not to mention subsequent measurement, particularly for the large amount of participating business likely to be in force in the combined entities.
  - Inconsistent measurement of the liabilities of the two or more insurers involved (possibly with similar contracts issued at the same time) for each portion of a reporting entity is likely to generate misleading values in the financial statements.
3. The nature of a business combination involving two or more mutual insurance entities might be different in substance from an acquisition.
  - Control of a mutual insurer lies with its voting members, usually all or a specified segment of its policyholders.
  - In the combination of such mutual insurers, the policyholders of each of the entities should be treated and accounted for on an equitable basis. This is often required by the laws of the applicable jurisdictions.

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- There is usually no difference in the extent of control or participation between the policyholders of the entities or, in some cases, between their management.
- Since a business combination of mutual insurance entities may mean an enlargement of the insurance risk pool, measuring and presenting a portion as if acquired (purchased) may not faithfully describe the business reality of the transaction.

In summary, the essential problem of the proper determination of a purchase price in mutual entity mergers of equals has not been fully addressed in the ED. The lack of current guidance in this area and in the measurement of appropriate fair values, as well as the other points listed above, lead us to our recommendation of deferral of treatment of such mutual entities until these issues can be satisfactorily concluded. In addition, there does not appear to be a rush to adopt such an ED as applied to mutual insurers.

### **Specific ED Questions**

Our responses to the specific questions raised in the ED are the following:

**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 interest.
- (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 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 approach would you recommend as an interim solution to the accounting for such transactions, and why?

***IAA response: Although there are not many examples of business combinations involving mutual insurance companies, the types of combinations involving mutual insurances companies vary in their nature.***

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***The IAA recommends that the IASB reconsider the nature of business combination involving two or more mutual entities in phase II of the Business Combinations (or phase II of the Insurance Contracts) project.***

***Even if a standard is needed for such a transaction, we do not agree that the proposed interim solution represents a preferable requirement. While the IASB more fully investigates the nature of such transactions, to avoid non-comparable and possibly misleading results and inappropriate presentation of financial results, it should permit both the pooling method and purchase methods.***

**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)-(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?

***IAA response: Although we believe that this amendment is not needed at the current time, if adopted, we are persuaded by the arguments raised in paragraph B13 that it may not be feasible or practical to apply such a requirement on a retrospective basis in the time permitted. In addition, further changes may be needed in IFRS 3 concerning the replacement of IAS 22 and relating interpretations. If the entities write insurance contracts, they might have to revalue these contracts once acceptable measurement rules are decided in phase II of the Insurance Contracts project.***

Along with other responders to this Invitation to Comment, the IAA appreciates the opportunity to express our views on this Exposure Draft and hope our comments add value to the deliberations.

**Members of the IAA's Insurance Accounting Committee**

Sam Gutterman	(Chair)
W. Paul McCrossan	(Vice-chair)
Francis Ruygt	(Vice-chair)
Clive Aaron	Institute of Actuaries of Australia
William Abbott	Institute of Actuaries
Yutaka Amino	Institute of Actuaries of Japan
Félix Arias Bergadà	Col.legi d'Actuaris de Catalunya
Daniel Barron	Israel Association of Actuaries
Ralph Blanchard	Casualty Actuarial Society
Guy Castagnoli	Association Suisse des Actuaire
Paolo De Angelis	Istituto Italiano degli Attuari
Mark J. Freedman	Society of Actuaries
Mariano Gongora Roman	Instituto de Actuarios Españoles
Stephen Handler	Actuarial Society of South Africa
William C. Hines	American Academy of Actuaries
Antony John Jeffery	Society of Actuaries in Ireland
Ad A.M. Kok	Het Actuarieel Genootschap
Kurt Lambrechts	Association Royale des Actuaire Belges
Jean-Pierre Lassus	Institut des Actuaire
Kristine Lomanosvka	Latvijas Aktuaru Asociacija
W. Paul McCrossan	Canadian Institute of Actuaries/Institut Canadien des Actuaire
Richard O'Sullivan	Society of Actuaries in Ireland
Markku Paakkanen	Suomen Aktuaariyhdistys
Venkatarama Rajagopalan	Actuarial Society of India
Nithiarani Rajasingham	Singapore Actuarial Society
Jaanus Sibul	Eesti Aktuaaride Liit
Dieter Silbernagel	Deutsche Aktuarvereinigung e. V. (DAV)
David Stevenson	Faculty of Actuaries
Bjarni Thordarson	Félag Íslenskra Tryggingastærðfræðinga
Wilma Torres	Instituto Brasileiro de Atuária (IBA)
Tuomo Virolainen	Svenska Aktuarieföreningen
Robert E. Wilcox	Conference of Consulting Actuaries
Kevin Yah	Actuarial Society of the Republic of China
Jesús Zúñiga	Colegio Nacional de Actuarios A. C.

**Full Member Associations of the IAA**

Consejo Profesional de Ciencias Económicas de la Ciudad Autónoma de Buenos Aires (Argentina)  
Institute of Actuaries of Australia (Australia)  
Aktuarvereinigung Österreichs (AVÖ) (Austria)  
Association Royale des Actuaire Belges (Belgique)  
Instituto Brasileiro de Atuária (IBA) (Brazil)  
Canadian Institute of Actuaries/Institut Canadien des Actuaire (Canada)  
Cyprus Association of Actuaries (Cyprus)  
Česká Společnost Aktuárů (Czech Republic)  
Den Danske Aktuarforening (Denmark)  
Egyptian Society of Actuaries (Egypt)  
Eesti Aktuaaride Liit (Estonia)  
Suomen Aktuaariyhdistys (Finland)  
Institut des Actuaire (France)  
Deutsche Aktuarvereinigung e. V. (DAV) (Germany)  
Hellenic Actuarial Society (Greece)  
Actuarial Society of Hong Kong (Hong Kong)  
Magyar Aktuárius Társaság (Hungary)  
Félag Íslenskra Tryggingastærðfræðinga (Iceland)  
Actuarial Society of India (India)  
Society of Actuaries in Ireland (Ireland)  
Israel Association of Actuaries (Israel)  
Istituto Italiano degli Attuari (Italy)  
Institute of Actuaries of Japan (Japan)  
Japanese Society of Certified Pension Actuaries (Japan)  
Latvijas Aktuaru Asociācija (Latvia)  
Lebanese Association of Actuaries (Lebanon)  
Persatuan Aktuari Malaysia (Malaysia)  
Colegio Nacional de Actuarios A. C. (Mexico)  
Het Actuarieel Genootschap (Netherlands)  
New Zealand Society of Actuaries (New Zealand)  
Den Norske Aktuarforening (Norway)  
Actuarial Society of the Philippines (Philippines)  
Polskie Stowarzyszenie Aktuariuszy (Poland)  
Instituto dos Actuários Portugueses (Portugal)  
Academia de Actuarios de Puerto Rico (Puerto Rico)  
Singapore Actuarial Society (Singapore)  
Slovensko Aktuarsko Drustvo (Slovenia)  
Actuarial Society of South Africa (South Africa)  
Col.legi d'Actuaris de Catalunya (Spain)  
Instituto de Actuarios Españoles (Spain)  
Svenska Aktuarieföreningen (Sweden)  
Association Suisse des Actuaire (Switzerland)  
Actuarial Institute of the Republic of China (Taiwan R.O.C.)  
Faculty of Actuaries (United Kingdom)  
Institute of Actuaries (United Kingdom)  
American Academy of Actuaries (United States)  
American Society of Pension Actuaries (United States)  
Casualty Actuarial Society (United States)  
Conference of Consulting Actuaries (United States)  
Society of Actuaries (United States)