NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

EXECUTIVE HEADQUARTERS
2301 McGee Street
Suite 800
Kansas City MO
64108-2662
Voice 816-842-3600
Fax 816-783-8175

FEDERAL AND INTERNATIONAL RELATIONS
Hall of the States
444 North Capitol St NW
Suite 701
Washington DC
20001-1509
Voice 202-624-7790
Fax 202-624-8579

SECURITIES VALUATION OFFICE
1411 Broadway
9th Floor
New York NY
10018-3402
Voice 212-398-9000
Fax 212-382-4207

WORLD WIDE WEB
www.naic.org

July 15, 2004

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London EC4M 6XH United Kingdom

Dear Sir David and Members of the Board:

Thank you for the opportunity to comment on the proposed Amendments to IFRS 3: Business Combinations. On behalf of the International Accounting Standards Working Group (IASWG) of the National Association of Insurance Commissioners (NAIC), I am pleased to provide you comments in response to your Invitation to Comment.

Invitation to Comment

Our comments have been organized in a manner consistent with the questions outlined in the IASB's Invitation to Comment. Additionally, we have provided general comments on the proposed amendments.

General Comments

The IASWG submitted a comment letter to the IASB on March 19, 2003 in response to the initial exposure of the Business Combinations draft. In this initial draft, we encouraged the IASB to exclude mutual entities from the proposed scope and were very pleased to see this request reflected in the adopted standard. As the IASWG actively monitors the IASB and all released standards and exposure drafts, we have concerns with the recent trend of the IASB to reevaluate international standards immediately after adoption and release. In accordance with this trend (illustrated by the recent exposure drafts of IAS 39, IFRS 3, and IAS 19), we are concerned that this continued process may generate an inappropriate perception regarding the Board's deliberative process. Furthermore, these immediate releases might imply that the Board has been swayed by political considerations.

The IASWG currently attributes these accounting 'corrections' as the result of the rushed completion of released standards. Now that the March 31, 2004 deadline has passed and the IASB has committed to fully consider all aspects of a standard before public release, we would anticipate the need to issue immediate amendments addressing unresolved issues or 'altered' decisions to be mitigated.

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 recognized 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?

Response:

With regard to the accounting proposal for mutual entities, the IASWG does not believe the interim solution is appropriate. The proposed IASB method does not reflect the true intention of mutual entity mergers. As stated in our comment letter dated March 19, 2003, in response to the initial Business Combinations exposure draft, we agree that a purchase method should be used for all business combinations which create a parent-subsidiary relationship; however, business combinations fostered by an exchange of equity resulting in a new entity should not be forced to follow 'purchase' accounting since that precept is not reflective of the actual transaction.

Within the initial Business Combinations exposure draft, the IASB stated an intention to further evaluate, and possibly develop, criteria to account for 'true mergers' using a method other than the purchase method. Although we felt that this should have been explored prior to issuing an initial exposure draft, we understood the need for additional time in considering the particulars of the transactions and to develop an appropriate accounting method. However, if this amendment is implemented we are concerned that the Board will remove this initiative off the agenda. We feel that this will be detrimental as it appears that both the IASB, as indicated by the exposure draft comments, and

IASWG are in agreement that the purchase method is not the appropriate method to account for these transactions.

Although the IASWG realizes that the number of mutual insurance entities has decreased, we feel that it would be irresponsible to require future mergers to be accounted for under the requirements of IFRS 3 as the economic reality of the merger would not be properly conveyed. Within the original IASWG March 19, 2003 Business Combinations comment letter, we identified a merger of two mutual insurers that occurred January 1, 2002. This merger, between Aid Association for Lutherans (AAL) and Lutheran Brotherhood (LB), the two largest fraternal societies in the US, was a true 'marriage of equals' and was not intended to be one party acquiring the other. If one party had been required to be identified as an 'acquirer' it is unlikely they would have combined. As this merger represented a continuation of existing business practices (i.e., risks and benefits) of each participant, the combined 'carrying values' (i.e., pooling of interest method) provided a more representative view than use of the 'purchase method'.

Per our interpretations of the amendments, if this merger had occurred with an exchange of equity, the new mutual insurer would have reported the assets and liabilities of one entity at carrying value, assets and liabilities of the other entity at fair value and the equity received from the 'fair valued entity' also at fair value. If no acquiree and acquirer were easily identifiable, by following the proposed amendments, the combined company would have the ability to present the more-favored financial results by selecting the entity to assume the classification of 'acquirer' and 'acquiree'.

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?

Response:

The IASWG disagrees with the IASB proposal to not amend the transition provisions and effective date if this amendment is adopted. As this method has been proposed after March 31, 2004, and will not be adopted until later this year, it does not seem feasible for the Board to require application of this standard to combinations that occur prior to the adopted/effective date of the revised IFRS. This argument seems consistent with the rationale provided by the IASB in paragraph BC13:

> The Board observed that requiring the IFRS to be applied retrospectively to all business combinations for which the agreement date is before the date was issued might improve the comparability of financial information. However, such an approach would be problematic for the following reasons:
>
> - It is likely to be impossible for many business combinations because the information needed may not exist or may no longer be obtainable.
> - It requires the determination of estimates that would have been made at a prior date, and therefore raises problems in relation to the role of hindsight – in particular, whether the benefit of hindsight should be included or excluded from those estimates and, if excluded, how the effect of hindsight can be separated from the other factors existing at the date for which the estimates are required.
>
> The Board concluded that the problems associated with applying the IFRS retrospectively, on balance, outweigh the benefit of improved comparability of financial information.

Although the time frame will be relatively short, the IASB has already permitted the use of different measurement bases for combinations that occur within the 2004 calendar year. (IFRS 3 does not need to be retroactively applied to combinations that occurred between January 1, 2004 and the effective date of March 31, 2004.) As such, we do not see the need for business combinations impacted by this amendment to retroactively apply IFRS 3 to the original effective date of March 31, 2004. To eliminate the potential issues identified within BC13, the adoption date of the revised standard should be used as the effective date for business combinations impacted by this amendment.

We appreciate the opportunity to comment on the Business Combinations Amendments exposure draft. Should you have any questions, please contact me at (501) 371-2667, or Julie Gann (NAIC Staff) at (816) 783-8125.

Sincerely,

Mel Anderson
Chair, NAIC International Accounting Standards Working Group

<u>Background and NAIC Process</u>

Formed in 1871, the NAIC is a voluntary organization of the chief insurance regulatory officials of the 50 states of the United States of America, the District of Columbia, American Samoa, Guam, Puerto Rico and the Virgin Islands. The mission of the NAIC is to assist state insurance regulators, individually and collectively, in serving the public interest in a responsive, efficient and cost-effective manner, consistent with the objectives of its members.

In fulfilling this mission, the NAIC has developed significant experience and expertise in the development of meaningful accounting principles for use in the financial statements of insurance enterprises. The NAIC has the responsibility to establish and interpret statutory accounting p rinciples. The codification of statutory accounting principles by the NAIC produced a comprehensive guide for use by insurance departments, insurers, and auditors.

The fundamental concepts upon which these principles were promulgated are conservatism, consistency and recognition. While these principles are not identical to the framework used by the IASB, which govern general-purpose financial statements, the NAIC has developed expertise with general-purpose financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP). The NAIC reviews all U.S. GAAP pronouncements to determine their relevance for statutory accounting purposes.

These comments have been prepared by the IASWG of the NAIC. As part of the NAIC's due process procedures, these comments have also been shared with interested parties to the IASWG, all of whom were given an opportunity to contribute to the IASWG's deliberations of these issues. However, the IASWG does not wish to imply that these comments are shared by all of the IASWG interested parties.