October 5, 2005

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

Technical Director – File Reference 1204-001
Financial Accounting Standards Board of the Financial Accounting Foundation
401 Merritt
Norwalk, CT 06856-5116

Dear Members of the IASB and FASB:

Thank you for the opportunity to comment on the June 2005 proposed Amendments to IFRS 3: Business Combinations and FASB Statement 141: 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 within the Invitation to Comment. Additionally, we have provided general comments on the proposed amendments.

General Comments

The NAIC is pleased to see the convergence efforts of the IASB and the FASB materialize through joint exposure of IFRS 3: Business Combinations and FASB Statement 141: Business Combinations. We are extremely supportive of the efforts to converge financial accounting standards.

Regardless of our support towards convergence, the NAIC has concerns with some key elements of the exposed standard. These concerns primarily relate to the effect IFRS 3 and FAS 141 would have to mutual insurance mergers as well as other insurance entity combinations.

The IASWG has previously submitted comment letters to the IASB in response to prior exposure drafts (2003 and 2004) proposing revisions to IFRS 3: Business Combinations. Our previous comments have generally addressed the Board’s intention to subject mutual insurance entity mergers to an accounting method designed for parent-subsidiary relationships and the fair value measurement requirements that would apply to insurance entities if deemed to be an acquiree of a business combination. These concerns continue to exist for the current exposure draft and further detail has been provided within this comment letter to communicate our position.
Question 1 – Objective, definition and scope

Are the objective and definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

Response:

As noted within previous comments letters of the IASWG to the IASB, we agree that the acquisition method would be the most appropriate method to use when accounting for business combinations that have a clear acquirer and acquiree. However, after reviewing the Boards’ conclusions regarding the inclusion of mutual entity mergers, it is still our opinion that true mergers (often involving mutual entities) resulting in a new entity should not be required to follow the ‘acquisition’ method as it is not reflective of the actual transaction. We are aware that there are instances in which mutual entities combine in a manner not characteristic of true mergers, therefore we would agree that a blanket scope exclusion for mutual entity combinations may not be representationally faithful.

We are supportive of the commitment to evaluate a ‘fresh-start’ method to account for combinations that occur when one entity does not assume control of the other entity. However, we are concerned that this project will not materialize if all such business combinations are initially subject to IFRS 3 and FAS 141 as proposed within the exposure drafts. Our concern on this regard is further heightened as the IASB has previously committed (in 2003 and 2004) to evaluate a ‘fresh-start’ method of accounting for business combinations. However, as there is no evidence of this project being added to the IASB agenda or researched by IASB staff, we must strongly oppose a revision that would eliminate the remaining scope exclusion for entities more likely to engage in these types of combinations. We would encourage the IASB to follow through on the commitment to evaluate the use of a ‘fresh start’ accounting model before revisions to the scope of IFRS 3 or FAS 141 are proposed.

In addition to our concerns on the application of the standard to combinations of true mergers, we have additional concerns on the overall effect of IFRS 3 and FAS 141 on insurance entity mergers/acquisitions. If IFRS 3 and FAS 141 were applied for insurance combinations, the standard would require extensive subjectivity in assessing the fair value of the noted acquiree (as consideration would not be exchanged in mergers) and in determining the fair value of the insurance liabilities. Phase II of the IASB Insurance Contracts Project includes developing a measurement model for insurance contract liabilities. Although the IASB is pursuing a fair value approach, through the discussions of the IASB Insurance Working Group and educational presentations provided to the IASB, it has clearly been conveyed that a fair value assessment of insurance contract liabilities (let alone the entire insurance entity) is not easily obtainable or verifiable. Given the status of the phase II developments (Discussion Paper not expected until late 2006), it does not seem reasonable to subject insurance entities, especially true insurance entity mergers without a clear acquirer, to undergo a fair value assessment and communicate within their financial statements the fair value of the acquired entity and its assets and liabilities without the support of an IASB established measurement model.

Until the IASB is able to conclude on the use of a ‘fresh-start’ accounting model and/or establish a measurement model to calculate the fair value of insurance contract liabilities, we would propose for the IASB and FASB to include an additional exclusion within the Scope section of the exposure drafts (paragraph 2) as follows:
Scope

2. An entity shall apply this [draft] IFRS when accounting for business combinations. However, this [draft] IFRS does not apply to:
(a) formations of joint ventures
(b) combinations involving only entities or businesses under common controls
(c) combinations accomplished by one entity issuing equity in exchange for the equity of another entity and immediately canceling the equity of that entity in which prospectively only one entity exists or through the exchange of membership interest (true mergers).

We have included as an Appendix reference to a actual merger among the two largest fraternal societies in the US and some of the key concerns that would have been raised if this merger would have been subject to the acquisition method and other guidelines within the proposed standards.

Question 4—Measuring the fair value of an acquiree

Do paragraphs A8-A26 in conjunction with Appendix E provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

Response:
In accordance with most true mergers (such as between mutual insurance entities) the business combination is a joining of common interests most often to expand member benefits and improve overall market share. Although the IASB and FASB have provided special consideration guidance for mutual entities, the provided information is solely based on theory. The application of this guidance resulting in numerical figures that can be reliably calculated and communicated is one that needs to be field tested to prove feasibility, especially for insurance entities.

Paragraph A24 – When two mutual entities combine, the fair value of the acquiree may be more reliably measurable than the fair value of member interests transferred by the acquirer. In a business combination involving only mutual entities in which the only consideration is an exchange of the acquirer’s member interests for the acquiree’s member interests, the fair value of the acquiree and the fair value of the member interests exchanged are presumed to be equal.

Paragraph A26 – A fair value measurement of a mutual entity should include the assumptions that the marketplace participants would make about future member benefits as well as any other relevant assumptions marketplace participants would make about the mutual entity. For example, in determining the fair value of a mutual entity, an estimated cash flow model may be used. In that case, the cash flows should be based on the expected cash flows of the mutual entity, which are likely to include adjustments for member benefits, such as the cost of reduced fees charged for goods and services.

We would agree that the fair value of member interests transferred by the acquirer in a mutual entity merger would be difficult (if not impossible) to calculate. However, the guidance provided within paragraph A26 advising utilization of expected cash flows does not provide sufficient guidance for insurance entities involved in a merger. In April 2005, the IASB Insurance Working Group began discussing the elements of various insurance contracts to recommend guidance on which (if any) future premiums and related claims should be included within the measurement of assets and liabilities. As the IASB itself has not yet concluded on this component, or the measurement model for determining the fair value for insurance liabilities, it is unclear how a
mutual insurance entity involved in a merger would determine which cash flows would be appropriately included for an overall fair value assessment if selected as the acquiree.

Question 8/9—Measuring and recognizing the assets acquired and the liabilities assumed

Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

Response:
As previously mentioned, a fair value measurement model for insurance contract liabilities has yet to be established for inclusion within IFRS 4: Insurance Contracts. Without an established measurement model within IFRS 4, the IASB is permitting insurance entities to follow their local GAAP guidelines for the measurement of insurance liabilities. However, in accordance with IFRS 3: Business Combinations, the IASB will require those insurance enterprises engaging in business combinations to arbitrarily determine fair value assessments of insurance contract liabilities prematurely of an established measurement model.

In order to address this concern we suggest for an exception to be added permitting insurance contract liabilities not to be recognized at fair value (similar to other exceptions provided in paragraphs 42-51) until the IASB has established a measurement model for insurance contracts. In accordance with phase I of IFRS 4, entities can utilize their local GAAP until the phase II of the insurance contract standard is finalized. A temporary exception could be included within this standard to mirror the provisions already provided within IFRS 4.

Question 15—Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?

Response:
The design of IFRS 3 and FAS 141 is suitable for business combinations that form a parent-subsidiary relationship, however, it is not well suited for true mergers of insurance entities. As the combinations of true mergers are completed upon approval of the members, requiring the designation of an acquiree or the reasons for the business combination may invoke resistance among the ‘acquiree’s’ membership. Additionally, our concerns noted in response to questions 8 and 9 pertaining to measuring insurance liabilities at fair value impacts the proposed disclosure requirements within the exposure draft. The temporary exception we proposed in our response to these questions would address our related disclosure concerns.

Question 18—Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

Response:
Until the establishment of a fair value measurement model for insurance contract liabilities, it is unclear on how the split presentation (required by the FASB, permitted by the IASB) will enhance the readability or transparency of the financial statements. Until there is a fair value measurement basis, these type of disclosures will not promote comparability. To promote
uniformity and comparability, the IASB and FASB disclosure provisions related to fair value should be suspended until phase II of IFRS 4 is complete.

We appreciate the opportunity to comment on the joint exposure of IFRS 3: Business Combinations and FAS 141: Business Combinations. 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

Background and NAIC Process

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, Virgin Islands, and the Mariana 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 principles. 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 NAIC International Accounting Standards Working Group. As part of the NAIC’s due process procedures, these comments have also been shared with interested parties, all of whom were given an opportunity to contribute to the deliberations of these issues. However, the NAIC does not wish to imply that all interested parties share these comments.
Appendix: Merger of Aid Association for Lutherans and Lutheran Brotherhood

This Appendix provides some preliminary financial information regarding the recent merger of the two largest fraternal societies in the US and some of the concerns that would have been raised if this merger would have been accounted for under the IASB and FASB exposed guidance. Additional information regarding this merger can be provided upon request.

Effective January 1, 2002, Aid Association for Lutherans (AAL) and Lutheran Brotherhood (LB) merged forming Thrivent for Lutherans (TL). Both organizationally and politically this was a marriage of equals and was not intended to be one party acquiring the other. If accounting rules would have forced one to be the acquirer, it may have motivated the ‘acquirer’s’ membership decision not to vote in favor of the merger.

As both of these companies were major insurance companies prior to the merger, the statutory financial information for year-end 2001 and year-end 2002 is as follows:

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<tbody>
<tr>
<td>Assets</td>
<td>$22.4 Billion</td>
<td>$16.8 Billion</td>
<td>$41.2 Billion</td>
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<tr>
<td>Surplus</td>
<td>$1.87 Billion</td>
<td>$1.12 Billion</td>
<td>$2.64 Billion</td>
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<tr>
<td>Premiums</td>
<td>$1.64 Billion</td>
<td>$1.43 Billion</td>
<td>$3.36 Billion</td>
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Since this merger was able to follow the pooling of interests method, the 2002 financial position of Thrivent for Lutherans is representative of the combined assets and obligations from each of the respective companies without changes to the measurement basis. If the acquisition method of accounting and other guidelines from the joint Business Combinations exposures had been required, the following issues would have caused confusion in developing and understanding the financial statements:

Identifying the Acquirer: As the example illustrates, since both companies were well-capitalized, comparable companies and no consideration was exchanged both entities could have made a viable argument that they were in fact the acquirer. Given the exposure draft requirement to designate a company as the acquirer, and the ability to subjectively make this assessment, it would be logical to assume that mutual organizations involved in these transactions would realize the advantages of selecting which organization could be determined the acquiree. Although the fair value measurement model for insurance contract liabilities has yet to be determined, based on preliminary assessments it has been noted that existing local GAAP and statutory measurement bases for insurance contract liabilities result in a more conservative representation of liabilities than the proposed fair value measurement models. As such, mutual insurance entities could structure their business combinations in a manner that allows the newly formed entity the greatest financial representation.

Measuring the Fair Value of the Acquiree as a Whole: As previously noted, the IASB has yet to establish a fair value measurement model pertaining to insurance contract liabilities for inclusion in the phase II Insurance Contracts Standard. However, the IASB has attempted to provide assistance regarding the valuation method required in the exposure draft by conveying that a mutual entity would utilize an expected cash-flow model that would include adjustments for member benefits. Although this example may benefit some mutual organizations, it does not seem sufficient for mutual insurance mergers, as the consideration of cash flows (cash inflows - renewal premiums and cash outflows - claim liabilities) are key aspects of the phase II insurance contract measurement model being debated by the IASB and its Insurance Working Group. With
limited guidance on how cash flows should be considered, the determination of an insurance acquiree’s fair value would be difficult to determine under the proposed standards.

Measuring and Recognizing the Liabilities Assumed: The financial statements of all insurance entities (at least in most countries) are calculated on a mixed measurement model to reflect the most appropriate value of the various assets or liabilities. As the IASB and most local GAAPs have not yet developed a fair value measurement model for insurance contract liabilities, compliance with paragraphs 28-32 of the exposure draft (assessing the identifiable assets acquired and liabilities assumed at fair value) would not be practical for most insurance entities and the calculated financials would not likely be comparable with other entities either within or outside their country of jurisdiction. Without a measurement model, it is probable that the resulting financial statements will not appropriately convey the true status of the combined business.

Determination of Goodwill: The exposure draft does not have any limitations on the assessment of goodwill for true mergers. In fact, under the exposure draft, it seems that goodwill would be a necessary component for the designated acquirer to recognize even if the business combination is a true merger. This issue causes concerns, as unlike parent-subsidiary acquisitions in which the parent has acquired an ownership right, in a true merger situation the assets and liabilities of the combining entities prior to the combination simply become the rights and obligations of the new entity formed. In a merger, any goodwill generated by arbitrarily designating one entity as the acquirer and revaluing assets and liabilities to match the measurement method required under the exposure drafts must be considered attributable to both entities, and thus should be prohibited in these types of combinations.