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Mr. Robert Herz, Chairman
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Sent by email

Copies to: Ms. Stephanie Tamulis, Project Director, FASB
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**Proposed Amendments to FASB Statement No. 141 and
International Financial Reporting Standard No. 3, *Business
Combinations* (FAS 141 and IFRS 3) and subsequent discussions at
the Boards**

Dear Chairmen Herz and Tweedie:

The Group of North American Insurance Enterprises ("GNAIE") reviewed the "Information for Observers" prepared for the 27 April 2006, IASB-FASB Joint Meeting where the Boards plan to discuss a number of issues related to the Business Combinations Exposure Draft ("BusCom ED"). Our review noted the absence of a critical re-deliberation topic related to the measurement of insurance contracts in business combinations and as such we would like to formally reiterate this issue to the Boards. More specifically, the BusCom ED requires assets acquired and liabilities assumed in a business combination to be recognized at fair value on the effective date of the combination but does not address situations where it may not be possible to consistently and/or reliably estimate the fair value of insurance liabilities (hereinafter "insurance contracts") at the effective date of the combination.

We believe if the Boards were to survey insurance companies that have acquired insurance enterprises and accounted for the acquisitions pursuant to SFAS No. 141, *Business Combinations* ("SFAS 141") or IFRS No. 3, *Business Combinations* ("IFRS 3"), they would find that in the absence of specifically negotiated values for underlying portfolios of insurance contracts, which in practice are very rare, the methods used to allocate a portion of "enterprise fair value" to insurance contracts vary widely by company and acquisition. Accordingly, given the nature and scope of the BusCom

To influence the development of international accounting standards to ensure that they result in robust, high quality standards for insurance enterprises

ED, we believe it should be a high priority for the Boards to address, and hopefully mitigate, this area of diverse industry practice. By way of this memorandum, we offer our insights and assistance on this and any other issues that arise in connection with the BusCom ED.

▪ **Measurement Basis for Insurance Contracts**

In past discussions with the Boards concerning their respective BusCom ED’s, we have pointed out that the requirement to “fair value” all insurance contracts in a business combination may not always produce consistent, comparable, and reliable results because (a) in the absence of specific negotiated values, there is no reference (or “principal”) market from which fair value estimates can be derived, (b) there is no guidance (in terms of standard methods and inputs) that currently exists (or that is proposed) concerning how to mechanically measure the fair value of insurance contracts (both life and non-life) in the absence of exchange-based transactions, and (c) there is a Modified Joint Project currently underway between the IASB and FASB, *Insurance Contracts Phase II* (hereinafter “MJP”) wherein the Boards are attempting to identify valuation and measurement guidance for insurance contracts (i.e. those contracts with significant insurance, mortality or morbidity risk) but to date no final guidance has been identified.

GNAIE believes that until accounting models for both life and non-life insurance contracts are identified in the MJP, and a decision rendered on the issue of whether fair value is the most appropriate measurement basis for both life and non-life insurance contracts, and if fair value, how fair value should be determined in the absence of reference or principal markets, the Boards should provide sufficient interim guidance (with the objective of minimizing consistency, comparability, and reliability issues) concerning the valuation and measurement of insurance contracts in connection with a business combination.

▪ **Misconceptions Regarding the Value of Insurance Contracts**

In connection with the preceding, we believe it is useful to address two common misconceptions in the ongoing debate about insurance contracts and whether they can be consistently and reliably fair valued. The first is the frequently expressed notion that evidence supporting the belief that insurance contracts can be reliably fair valued comes from the fact that existing accounting standards require all assets acquired and liabilities assumed (including insurance contracts) in business combinations to be recognized at fair value and thus “it is already being done in practice”. The second misconception concerns whether reinsurance markets represent a “reference” or “principal” market whose transaction values can be used as a basis to derive the “fair value” of insurance contracts.

❖ **Business Combinations**

In the case of business combinations, while we concur that there may be certain combinations where the fair value of specific portfolios of insurance contracts are separately negotiated in an arm’s-length manner as part of an exchange transaction, those situations are very rare, as negotiations typically take place at an “enterprise level” and do not involve separate price negotiations on specific underlying portfolios of insurance contracts. For example, in transactions involving public companies the acquirer generally only has access to information about an acquiree’s portfolio(s) of insurance contracts that is publicly available, which is generally insufficient to use as a basis to negotiate the fair value of specific insurance contracts or portfolios. That said, in those rare situations where arm’s-length negotiated values for insurance contracts do exist, we believe they should serve as the basis for insurance liabilities when allocating the purchase price in a

business combination. At the same time, we believe it would be inappropriate to account for the aforementioned insurance contracts on Day 2 or thereafter at “fair value” in the absence of a new reference transaction or market from which to calibrate future periodic market value changes.

In the more typical situations where the value of underlying portfolios of insurance contracts associated with business combinations are not separately negotiated, to comply with purchase price allocation requirements of SFAS 141 and IFRS 3, acquirers generally employ a wide variety of methods to allocate a portion of the “enterprise fair value” to individual pools of insurance contracts. The range of methods may, but do not necessarily involve the engagement of and/or discussions with third-party valuation experts, public accountants, and possibly regulatory authorities, in determining “a value” to assign to insurance contracts that serves as a proxy for “fair value”. We believe the absence of standard valuation methods and practices that have undergone independent testing and validation, together with the inherent uniqueness of most insurance contracts (both amongst and within reporting entities), results in a significant degree of variation in the resulting “fair value estimates” that emerge as they relate to common classes of insurance contracts across the industry. Accordingly, we do not support the general notion that the allocation of purchase price in past and present business combinations involving insurance contracts provides sufficient substantiation that insurance contracts can be reliably fair valued as there is insufficient evidence that the wide variety of estimation and allocation methodologies employed are sufficiently consistent, comparable, or reliable.

❖ **Reinsurance**

In the case of reinsurance, while we believe that assumption reinsurance arrangements that relate to specific portfolios of insurance contracts can provide an indication of the “fair value” of the subject insurance contracts, we do not believe the reinsurance market can be relied upon as a “principal market” as that term is used in the FASB’s Fair Value Measurement Exposure Draft. More specifically, it must be understood that the objective of all reinsurance contracts is to “transfer risk” from a ceding to an assuming company. Accordingly, in the absence of an assumption agreement (which is clearly the exception and not the rule) wherein “all risks” are transferred from a ceding to assuming company, reinsurance agreements may not, and generally do not, cover all elements of the underlying contract(s) and as such cannot be used as a reliable indicator of “fair value”. Additional challenges to using reinsurance contracts as an indicator of fair value involve their general lack of (a) standardization; which makes it difficult not only to compare transactions but also to apply indicators of value from one transaction to another, (b) transparency; because most transactions are private, the terms are not generally available to be relied upon as “market inputs” and (c) activity; there is generally not a sufficient amount of activity to provide “market value” indications on an on-going basis for any specific type of contract.

▪ **Recommendation**

As a result of the preceding, we believe the Boards must specifically address the valuation/measurement of insurance contracts (both life and non-life) in connection with the allocation of purchase price in the absence of specifically negotiated values for underlying portfolios of insurance contracts. Moreover, we believe it would be preferable if the specific guidance provided in the BusCom ED were consistent with the guidance and rationale ultimately set forth in the final MJP as well as the FVM Standard, as applicable.



We readily acknowledge that no “easy” or “obvious” solutions exist to address this transitional measurement issue (we use the term “transitional” to suggest the final MJP will identify a measurement basis for both life and non-life insurance contracts that will provide a basis for resolving this issue). That said, we offer our assistance to both Boards as it relates to the identification of standard interim methods to be used to allocate purchase price to insurance contracts (both life and non-life) in the absence of specific negotiated values and in advance of the finalization of the MJP, to ensure that insurance contracts are valued and measured in a manner that is consistent, comparable, and reliable.

We hope these comments will be of assistance to the Boards in their upcoming discussions. Moreover, in the event you gentlemen, or any Board Members would like clarification of our views we would be happy to explain our positions in more detail.

The Group of North American Insurance Enterprises (GNAIE) consists of the Chief Financial Officers of the leading US insurance companies including life insurers, property and casualty insurers, and reinsurers. GNAIE members include companies who are the largest global providers of insurance and substantial multi-national corporations. All are major participants in the US markets.

The goals of GNAIE are to influence international accounting standards to ensure that they result in high quality accounting standards for insurance companies and, to that end, to increase communication between insurers doing business in North America and the International Accounting Standards Board and the US Financial Accounting Standards Board.

GNAIE works to meet its goals through modeling of proposed accounting standards, analysis, comment, and coordination with various end users of financial reports.

We appreciate the opportunity to provide comments on the proposed Exposure Drafts and would be willing to make ourselves available to discuss our comments and recommendations in more detail.

Respectfully submitted,

The Group of North American Insurance Enterprises

A handwritten signature in black ink that reads "Douglas Wm. Barnert". The signature is written in a cursive, flowing style.

Douglas Wm. Barnert
Executive Director

DWB:KS:mtf