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File Reference No: 2011-200  
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3 January 2012

Dear Sirs

I am writing on behalf of CDC Group plc ("CDC") in response to the proposed Accounting Standards Update of Topic 946.

### **Introduction to CDC**

Founded in 1948, CDC is the UK's bilateral Development Finance Institution (DFI) wholly owned by the UK Government's Department for International Development. The nearest US equivalent to CDC is the IFC, which is part of the World Bank. CDC's mission is to be a pioneering investor, stimulating the private sector and demonstrating the power of enterprise and private capital to reduce poverty in the poorest places of the world. From 2004 – 2011 CDC operated primarily as a fund-of-funds, successfully investing during this time to increase its net value from £1bn to £2.8bn. In 2011 CDC announced a revised strategy with a geographic remit focused on low income and lower-middle income countries in sub-Saharan Africa and South Asia. As well as acting as a fund-of-funds investor, CDC will now also provide debt and direct investment to businesses in these regions. CDC's investments: provide much-needed capital for growing businesses; attract other investors by demonstrating success; improve environmental, social and governance; and drive economic growth, which is the only long-term route out of poverty. CDC currently has capital at work in over 1,000 companies in 70 countries through 74 different fund managers. A number of those fund managers account under US GAAP.

### **General**

CDC welcomes the initiative to conform both International Accounting Standards and US GAAP to fair value accounting for investments by investment companies. CDC's experience in the investment industry is that fair value accounting of investments is what fellow investors want, whereas consolidation of financial statement line items is of no practical use or interest. Also the cost and practicalities of line by line consolidation involves a considerable burden which CDC as investor ends up funding pro rata for no useful outcome. Holding investments at fair value to eventually achieve a realised gain from exit is also consistent with the way CDC and the private equity funds in which CDC invests manage investments. A new standard recognising investment entities accounting at fair value is helpful to CDC as an investor that prepares its financial statements in accordance with International Financial Reporting Standards and its interpretations adopted by the International Accounting Standards Board as adopted by the European Union.

CDC considers that the whole investment community should be able to use fair value accounting, including fund of funds, infrastructure funds, sovereign wealth funds and organisations owning private equity funds. If users of financial statements are analysing similar organisations with similar business models there needs to be similar accounting practice for comparability. It is felt that the currently

proposed criteria to be treated as an investment entity will not fully achieve this, particularly if it is the way the entity is structured that leads to the different answer rather than the underlying business model. CDC understands the FASB's aim to exclude the ability to structure operating businesses to meet the definition of an investment company and thereby avoid consolidation in an inappropriate way. However, CDC believes that the FASB's aim would be better achieved by changing one mandatory requirement to a rebuttable indicator and inserting a new mandatory requirement. See the answer to question one below.

## **Questions asked by the Board**

### **Scope**

#### **Question 1**

The proposed amendments would require an entity to meet all six of the criteria in paragraph 946-10-15-2 to qualify as an investment company. Should an entity be required to meet all six criteria, and do the criteria appropriately identify those entities that should be within the scope of Topic 946 for investment companies? If not, what changes or additional criteria would you propose and why?

#### **Answer**

CDC considers the business purpose of the entity to be essential to the definition. It is therefore suggested that criteria "c" relating to pooling of investors is made a rebuttable indicator as it relates to the nature of the investors in the entity rather than the nature of the entity under consideration. This obviously has an effect on CDC as CDC has only one investor, HM Government, but CDC acts in all other respects as an investment company and that is definitely how HM Government view us.

However, it is also suggested that a new mandatory requirement is as follows. The entity or its affiliates and investees have not entered into any transaction or gained rights that are on terms other than those that are at arms length at a price that would be paid or received in an orderly transaction between market participants at the measurement date. This acts as an excellent control over corporate conglomerates that aim to exclude operating businesses from consolidation by structuring them to meet the definition of an investment company.

With regard to criteria "cc." CDC also believes that it is essential that an investment entity should be able to have investments which are not fair valued such as corporate debt while equity investments continue to be fair valued.

#### **Question 2**

The definition of an investment company in the proposed amendments includes entities that are regulated under the SEC's Investment Company Act of 1940. Are you aware of any entities that are investment companies under U.S. regulatory requirements that would not meet all of the proposed criteria in paragraph 946-10-15-2? If so, please identify those types of entities and which of the criteria they would not meet.

#### **Answer**

No comment.

#### **Question 3**

The proposed amendments would remove the scope exception in Topic 946 for real estate investment trusts. Instead, a real estate investment trust that meets the criteria to be an investment property entity under the proposed Update on investment property entities would be excluded from the scope of Topic 946. Do you agree that the scope exception in Topic 946 for real estate investment

trusts should be removed? In addition, do the amendments in the proposed Updates on investment companies and investment property entities appropriately identify the population of real estate entities that should be investment companies and investment property entities?

**Answer**

No comment.

**Question 4**

The proposed amendments would require an entity to reassess whether it is as an investment company if there is a change in the purpose and design of the entity. Is this proposed requirement appropriate and operational? If not, why?

**Answer**

CDC consider this to be appropriate although unlikely for most investment organizations because of the agreements with investors existing throughout the life of the entity.

**Nature of the Investment Activities**

**Question 5**

An entity may be an investment company when it performs activities that support its investing activities. As a result, a real estate fund or real estate investment trust (that is not an investment property entity) could be an investment company if the entity (directly or indirectly through an agent) manages only its own properties. However, the entity would be precluded from being an investment company if the other activities were considered more than supporting the entity's investment activities (for example, construction). Is this requirement operational, and could it be consistently applied?

**Answer**

No comment.

**Question 6**

The proposed implementation guidance includes examples of relationships or activities that would indicate that an entity obtains or has the objective of obtaining returns from its investments that are not capital appreciation or investment income. Do you agree with these examples? If not, how would you modify the examples while still addressing the Board's concerns identified in paragraphs BC15 and BC16?

**Answer**

CDC considers that investees having business relationships, joint ventures, or trading with each other on an arm's length basis is consistent with investing for capital appreciation or investment income. CDC considers criteria c, e, and f as being inconsistent with being an investment company but would not necessarily conclude that a, b, and d are if they are negotiated between the entities on an arm's length basis. See the answer to question one above.

**Unit Ownership and Pooling of Funds**

**Question 7**

To be an investment company, the proposed amendments would require an entity to have investors that are not related to the entity's parent (if there is a parent) and those investors, in aggregate, must hold a significant ownership interest in the entity. Is this criterion appropriate? If not, why?

**Answer**

An entity with no more than one investor should be able to qualify as an investment entity. CDC considers the business purpose of the entity to be essential to the definition. It is therefore suggested

that criteria “c” relating to pooling of investors is made a rebuttable indicator as it relates to the nature of the investors in the entity rather than the nature of the entity under consideration. This obviously has an effect on sovereign wealth funds which only have one investor, their government, but they act in all other respects as an investment company and that is usually how the government views them. Other examples are where the entity has been set up as a co-investment vehicle or a parallel vehicle alongside the main fund because of tax considerations or special investment restrictions from the investor. Both are common occurrences for sovereign wealth funds.

CDC proposes that the concerns expressed in BC16, i.e. that an investment entity could be inserted into a larger corporate structure to achieve off balance sheet accounting, are already addressed by the answer to question one.

**Question 8**

The proposed unit-ownership criterion would require an entity to have ownership interests in the form of equity or partnership interests to be an investment company. The entity would consider only those interests in determining whether it meets the proposed pooling-of-funds criterion. Therefore, a securitization vehicle, such as a collateralized debt obligation, may not qualify as an investment company under the proposed amendments because it may not meet the unit-ownership or the pooling-of-funds criterion. The entity would not consider interests held by its debt holders when evaluating these criteria to be an investment company. For entities that do not have substantive equity interests (for example, those considered variable interest entities under Subtopic 810-10), should the unit-ownership and pooling-of-funds criteria to be an investment company consider interests held by debt holders? Please explain.

**Answer**

CDC agrees.

**Question 9**

Certain entities may meet all of the other criteria to be an investment company but have only a single investor (for example, a pension plan). The amendments in FASB’s proposed Update on investment property entities provides that if the parent of an entity is required to measure its investments at fair value under U.S. GAAP or the parent entity is a not-for-profit entity under Topic 958 that measures its investments at fair value, the entity would not need to meet the unit-ownership and pooling-of-funds criteria to be an investment property entity. Considering the Board’s concerns identified in paragraph BC24, should the criteria in this proposed Update be amended to address situations in which the entity has a single investor?

**Answer**

No comment.

**Question 10**

The unit-ownership and pooling-of-funds criteria in the proposed amendments do not consider the nature of the entity’s investors for evaluating if an entity is an investment company. That is, the criteria do not differentiate between passive investors and other types of investors. Do you agree that the nature of the investors should not be considered in evaluating the unit-ownership and pooling-of-funds criteria?

**Answer**

CDC agrees. It is the nature of the entity under consideration that matters.

**Fair Value Measurement**

### **Question 11**

The proposed amendments would require that substantially all of an investment company's investments are managed, and their performance evaluated, on a fair value basis. Do you agree with this proposal? If not, why? Is this proposed amendment operational and could it be consistently applied? If not, why?

#### **Answer**

In principle CDC agree but are concerned that the word 'substantially' might preclude investors who invest in both equity and debt, where the debt tends to be held to maturity but the investment is still made to obtain income. CDC consider that a requirement to fair value all investments or to consolidate all investments in these circumstances would be wrong.

## **Interests in Other Entities**

### **Question 12**

The proposed amendments would retain the requirement that an investment company should not consolidate or apply the equity method for an interest in an operating company unless the operating entity provides services to the investment company. However, the proposed amendments would require an investment company to consolidate controlling financial interests in another investment company in a fund-of-funds structure. An investment company would not consolidate controlling financial interests in a master-feeder structure. Do you agree with this proposed requirement for fund-of-funds structures? If not, what method of accounting should be applied and why? Should a feeder fund also consolidate a controlling financial interest in a master fund? Please explain.

#### **Answer**

CDC do not consider there to be any difference between indirect and direct ownership of investments if the key criteria are met with respect to those investments.

### **Question 13**

The proposed amendments would require an investment company to consolidate a controlling financial interest in an investment property entity. Should an investment company be subject to the consolidation requirements for controlling financial interests in an investment property entity? If not, what method of accounting should be applied and why?

#### **Answer**

As above for question 12.

### **Question 14**

The proposed amendments would prohibit an investment company from applying the equity method of accounting in Topic 323 to interests in other investment companies and investment property entities. Rather, such interests would be measured at fair value. Do you agree with this proposal? If not, why?

#### **Answer**

CDC agrees. CDC would like there to be consistent treatment for controlled investments and minority investments if the key criteria are met.

## **Presentation and Disclosure**

### **Question 15**

An investment company with a controlling financial interest in a less-than-wholly-owned investment company subsidiary or an investment property entity subsidiary would exclude in its financial highlights amounts attributable to the non-controlling interest. Do you agree that the amounts attributable to the non-controlling interest should be excluded from the calculation of the financial highlights? If not, why?

**Answer**

CDC agrees.

**Question 16**

If an investment company consolidates an investment property entity, the proposed amendments require the investment company to disclose an additional expense ratio that excludes the effects of consolidating its investment property entity subsidiaries from the calculation. Do you agree? If not, why?

**Answer**

No comment.

**Question 17**

Do you agree with the additional proposed disclosures for an investment company? If not, which disclosures do you disagree with, and why? Would you require any additional disclosures, and why?

**Answer**

CDC agrees.

**Retention of Specialized Accounting**

**Question 18**

The proposed amendments would retain the current requirement in U.S. GAAP that a noninvestment company parent should retain the specialized accounting of an investment company subsidiary in consolidation. Do you agree that this requirement should be retained? If not, why?

**Answer**

CDC agrees. CDC consider that the accounting at fair value should be retained as it is right in principle that the nature of an investment entity does not change as you move up the group. Investors in a non investment company get a greater understanding of the performance of its investment business if fair values are used and to mix consolidation with fair value accounting is preferable to full consolidation which could be misleading and unhelpful to investors.

## **Effective Date and Transition**

### **Question 19**

An entity that no longer meets the criteria to be an investment company would apply the proposed amendments as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption by calculating the carrying amounts of its investees as though it had always accounted for its investments in conformity with other applicable U.S. GAAP, unless it is not practicable. If not practicable, the entity would apply the proposed amendments as of the beginning of the period of adoption. Do you agree with this proposal? If not, why?

#### **Answer**

CDC agrees.

### **Question 20**

How much time would be necessary to implement the proposed amendments?

#### **Answer**

Most investment companies will already be providing their investors with fair value information so the effort of implementation into financial statements should be relatively minor. However, any change requiring consolidation, where not currently applied, would be significant and would take a considerable time and cost to implement.

### **Question 21**

The proposed amendments would prohibit early adoption. Should early adoption be permitted? If yes, why?

#### **Answer**

CDC considers the update to be an improvement over the current practice, so therefore early adoption should be encouraged.

## **Non-public Entities**

### **Question 22**

The proposed amendments would apply to both public and non-public entities. Should the proposed amendments apply to non-public entities? If not, how should the proposed amendments differ for non-public entities and why?

#### **Answer**

CDC considers consistency of approach across all entities of a similar nature to be important.

*Godfrey Davies*

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