

February 15, 2012

Leslie Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
Via email: director@fasb.org

RE: File Reference No. 2011-200 *Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*

Dear Chairman Seidman:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Exposure Draft: *Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements (ED)*. ABA brings together banks of all sizes and charters into one association. ABA represents banks of all sizes and charters and is the voice for our nation's \$13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than \$165 million in assets. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities.

Among other things, the ED defines six criteria to determine whether an entity is an investment company and, thus, must apply applicable investment company accounting. Those entities that are regulated by the Investment Company Act of 1940 are exempt from the six criteria and automatically assumed to be investment companies. Briefly, those criteria are:

1. The entity's only substantive activities are investing in multiple investments for returns from capital appreciation, investment income, or both.
2. The express business purpose of the entity is to provide the aforementioned returns.
3. Ownership in the entity is represented by units of investment, to which a portion of the net assets are attributed.
4. The funds are pooled to avail the investors of professional investment management and investors who are not related to the parent hold significant ownership in the entity.
5. Substantially all of the entity's investments are managed on a fair value basis.
6. The entity provides results about its investment activities to its investors.

If approved as proposed, the ED will require a change in practice related to certain banking activities that does not appear to be improve the usefulness of the financial statement information provided and may discourage participation in specific governmental programs designed by Federal law to encourage investment in small and private businesses.

Specifically, banks in the United States often participate in private equity investment activities, as sanctioned under two Federal programs:

1. Small Business Investment Companies, licensed by the Small Business Administration.
2. Merchant banking activity.

Investment funds under neither program are regulated by the Investment Company Act of 1940.

Small Business Investment Companies (SBICs)

In accordance with the Small Business Investment Act of 1958, the SBIC program was put into law to promote small business equity funding and these investments are often made through banking institutions, though bank holding companies sometimes will invest in SBICs. Generally, a bank's total of investments in SBICs is limited to 5% of capital and investments may only be made in businesses with tangible net worth of less than \$18 million and an average of \$6 million in net income over the previous two years at the time of investment. Further, 25% of SBIC investments must also be made in "Smaller Businesses"—businesses with tangible net worth of less than \$6 million and an average of \$2 million in net income over the previous two years at the time of investment. As part of the program, the SBIC may issue debentures up to 300% of the private equity contributed. The SBA then guarantees these debentures.

It should also be noted that SBICs are specifically excluded from the "Volcker Rule" limitations on investment company holdings within the Dodd-Frank Wall Street Reform and Consumer Protection Act. The SBIC program is thus a vital program to promote economic growth nationally and one that is important at the local, community level.

SBICs are currently considered investment companies by the Small Business Administration and, as such, are accounted for at fair value. Banks of all sizes sponsor SBICs. However, it is common that the ownership of the shares of the SBIC resides in the hands of the bank and persons who would be considered related parties to the bank (for example, a director). So, while we believe that SBICs generally satisfy the other five criteria, many would not qualify as investment companies under the ED, due to criteria number four above.

Since SBIC investments in companies are often at levels that would indicate significant or majority control of the enterprise, banks would be required to consolidate the assets of these investees onto their financial statements or to use equity method accounting. As a result, in the case of consolidation, banks would reflect on their balance sheets items like fixed assets of the investee, which are assets and liabilities that have no relevance to the bank's operations¹. Further, the level of control of the operations of the investee under the program is largely limited. With this in mind, we question a requirement to account for these funds other than as investment companies.

¹ A change in accounting would also have regulatory impact. In addition to impact on bank leverage ratios (by adding assets), a change in treatment would complicate the unique treatment afforded to SBICs within current regulatory Tier 1 capital calculations.

Merchant Banking Operations

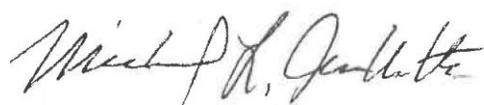
The Bank Holding Company Act of 1956 allows bank holding companies (BHCs) to make private equity investments in nonfinancial companies either directly or indirectly, subject to specific limitations. For example, until 1999, BHCs could hold up to 5% of the total voting securities of any nonbanking company, so long as those holdings do not exceed 25% of any class of voting securities. The Gramm-Leach Bliley Act of 1999 expanded the capabilities of financial institutions, including BHCs, to conduct merchant banking operations so that there is effectively no limit in control of nonfinancial companies that a bank holding company may hold, either directly or indirectly. These investments, however, cannot be operated by the BHCs and can be held only for a limited period, which is generally up to ten years. Within merchant banking operations, BHCs may also make private equity investments in qualifying private equity funds, which have different limitations on control and holding periods (which are generally up to fifteen years).

Private equity funds managed by bank holding companies under the merchant banking regulations are often held similarly to SBICs, with little or no significant “outside” investors. If not considered an investment company, the assets and liabilities of many fund investees would be consolidated with the bank financial statements or equity method accounting would be required, which may not necessarily be the most meaningful representation of the activities of the entity. As with SBICs, a change in the accounting for such holdings would naturally require the related entities to reevaluate their positions and participation in these government-sanctioned programs. In addition to the impact on the financial statement presentation, entities must analyze the cost of capital, as well as compliance with the new (or additional) basis of accounting.

We generally agree that the six factors noted in the ED provide important indications as to how such holdings should be reflected in an entity’s financial statements. Given the situations related to both SBICs and merchant banking operations, however, we recommend that the final Accounting Standards Update not include these factors as strict criteria to determine that an entity qualifies as an investment company. Instead, qualification as an investment company should be principle-based, using the preponderance of evidence, including the six indicators, as well as the parent company’s business model and expressed purpose in operating the investment fund. We believe this best responds to the needs of financial statement users without conflicting with the intent of the administrators of the related governmental programs.

Thank you for your attention to these matters. Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss this.

Sincerely,



Michael L. Gullette