

April 1, 2009

Via Email – director@fasb.org



LETTER OF COMMENT NO.

344

Mr. Russell G. Golden
Technical Director
FASB
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: FSP FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*

Date Released: March 17, 2009
Comment Deadline: April 1, 2009

Dear Mr. Golden:

Apollo Investment Corporation (“AIC”) appreciates the opportunity to comment on FSP FAS 157-e (the “Proposal”). Our comments reflect the perspective of a Business Development Company (“BDC”) regulated under the Investment Company Act of 1940 (the “1940 Act”).

Background

As you may be aware, BDCs occupy a very unique regulatory space. Similar to banks and other commercial lenders, BDCs originate, structure, and make direct loans to small and mid-size companies with the intention of holding these loans to maturity. However, BDCs are much less levered entities than banks with a maximum debt-to-equity ratio of a mere 1:1, with assets measured at fair value. BDCs also file their financial statements within Forms 10-Q and 10-K, similar to operating companies.

Congress created BDCs in 1980 under amendments to the Investment Company Act of 1940 in direct response to the economic crisis that threatened small and mid-sized businesses during the late 1970’s. Since then and whether in economic crisis, expansion or otherwise, BDCs have successfully provided significant and much needed capital to Main Street for almost 30 years. Ironically, and similar to the late 1970’s, small and mid-size businesses have again been orphaned by lenders during today’s economic challenges. And for the very first time in their history, many BDCs find themselves unable to fulfill their mandate from Congress (i.e., to provide private, illiquid, long-term capital to businesses on Main Street).

Select Questions Raised in the Proposal

1. *Is the proposed effective date of interim and annual periods ending after March 15, 2009, operational? YES*
2. *Will this proposed FSP meet the project's objective to improve financial reporting by addressing fair value measurement application issues identified by constituents related to determining whether a market is not active and a transaction is not distressed? Do you believe the amendments to Statement 157 in this proposed FSP are necessary, or do you believe the current requirements in Statement 157 should be retained?*

We do believe amendments to SFAS 157 are necessary and believe the proposed FSP contains some helpful documented criteria that can be useful when determining whether a market is inactive. However, we do not necessarily agree that all observable inputs should automatically be presumed associated with a distressed transaction simply because they were observed within an inactive market. Accordingly, we believe the concepts of inactive markets and distressed transactions should not be tied together, rather, they should be addressed separately. Therefore and similar to establishing helpful documented criteria for determining whether a market is inactive, we believe the Proposal should include a similar list of criteria that can be useful in determining whether an observable input is associated with a distressed transaction. Furthermore, the Proposal needs to include specific guidance with regard to what audit evidence would be considered practical and reasonable for management's judgments in these areas.

Accordingly, we believe further guidance is essential with regard to distressed transactions and what criteria should be considered by the reporting entity in determining whether an observable input was associated with a distressed transaction. Furthermore, we believe the Proposal must illustrate any such included considerations through a set of realistic examples across a broader group of financial assets that include public and private, liquid and illiquid debt and equity investments. Guidance should also include application practicality and examples of reasonable audit evidence generally available to reporting entities, irrespective of whether assets are valued daily, quarterly, semi-annually or annually.

3. *Do you believe the proposed two-step model for determining whether a market is not active and a transaction is not distressed is understandable and operational? If not, please suggest alternative ways of identifying inactive markets and distressed transactions.*

As described above, we believe the two step model should be separated into two distinct concepts, one, determining whether a market is inactive and two, determining whether observable inputs are associated with distressed transactions.

4. *Are the factors listed in paragraph 11 of the FSP that indicate that a market is not active appropriate? Please provide any other factors that indicate that a market is not active.*

Yes, we believe the factors listed in paragraph 11 of the FSP are reasonable criteria for reporting entities to consider in determining whether a market is not active. The Proposal should make clear that such listed criteria is not all inclusive and furthermore, should reference that such criteria may or may not be determinative depending on the reporting entity's principal market.

Additional Requests and Comments Not Specifically Raised in the Proposal

1. *Consider reopening the election to adopt SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities*

Given that reporting entities, including most BDCs, had to consider the election of SFAS 159 in advance of current interpretive guidance on SFAS 157, we request the FSP include reopening such election to afford reporting entities the symmetry of marking-to-market both sides of their balance sheets under the same principles and latest guidance. Given the selective adoption of SFAS 159 by companies to date and prior to the latest interpretive guidance on SFAS 157, reviewers of financial statements and operating results must carefully scrutinize and effectively perform pro-forma analyses when analyzing comparable companies.

That said, we are supporters of fair value measurement and seek your thoughtful consideration of the current circumstances specifically affecting the BDC industry. In addition, we believe the current application of SFAS 157's interpretive guidance has had certain unintended consequences such as generating confusion among BDC investors with regard to technical versus fundamental performance. Having lost the transparency of an investment portfolio's fundamental performance (e.g., the creditworthiness of the loans that BDCs hold), investors in BDCs have been left to speculate about a BDC's financial stability. This uncertainty has led to dramatically lower prices for their common stock. Therefore, the unintended loss of transparency has generated substantial losses for common stockholders of BDCs.

2. *Consider providing additional clarity, guidance and examples regarding the application of fair value measurements for identical or similar assets*

among significantly different reporting entities based on their differing principal markets (e.g., an open-end mutual fund with daily valuation requirements for their deemed liquid securities versus a closed-end BDC which is mandated to invest in and lend to small and mid-size companies with a quarterly valuation requirement publicly communicated 40-75 days after quarter end and considering such investment was knowingly originated and underwritten with no liquidity, irrespective of an active or inactive market).

Current guidance apparently requires reporting entities to assume a “one size fits all” hypothetical buyer for a BDC’s uniquely underwritten illiquid assets in a hypothetical market. To date, the application of current interpretive guidance of such a hypothetical buyer in a hypothetical market has not only reduced transparency for reviewers of our financial statements, but also the current guidance has possibly undervalued performing assets of BDCs, many of which have investments being reported at fair value levels substantially below managements’ estimated net present values of future cash flows. This apparently large, temporary reduction in the value of performing assets has increased reported leverage and therefore led us to significantly curtail or cease lending activities, even though we have access to many hundreds of millions of dollars of capital to lend. Unfortunately for small businesses, the importance of BDCs maintaining compliance with all regulatory and matching credit facility related covenants takes precedence.

Similar to the thoughts echoed by other commercial lenders, why would BDCs spend weeks or months working with and doing diligence on a potential small or mid-size borrower only to extend a truly illiquid loan to (as Congress intended) when immediately thereafter, macro events away from the creditworthiness of the new borrower dictate such loan should be valued assuming what a hypothetical buyer would pay for an illiquid loan to a small company in a hypothetical market?

3. *Clarify the responsibility of reporting entities in determining the appropriate discount rates and liquidity risk premiums to apply to discounted cash flow models and offer guidance as appropriate.*

The Proposal needs to clarify the responsibility of the reporting entity in determining the appropriate discount rates and liquidity risk premiums given its principal market and should consider normalized or usual and customary average rates/premiums across significant periods of time such as 5 or 10 years, as appropriate. The Proposal should also support reasonable judgment by the reporting entity given its principal market and allow for the exclusion of observable inputs of distressed transactions. Lastly, guidance on what evidence would be considered practical and reasonable will be necessary to satisfy audit standards.

4. *Consider the case where no practical market exists for select financial assets and whether fair value measurements should consider a return to what wasn't broken, that is a valuation model for private, illiquid investments that primarily utilize an enterprise value and waterfall approach but where the enterprise value utilizes the current or prospective guidance of SFAS 157 and the waterfall simply follows for debt investments.*

Given the dramatic differences among reporting entities who hold varying financial assets (e.g., mutual funds who must use daily judgment in estimating fair values for their traded securities and who must stand ready to redeem daily... versus BDCs who do not have redemptions and whose mandate is to make private illiquid hold-to-maturity loans to small businesses), the Proposal needs to better emphasize that reporting entities must render reasonable judgment in the determination of fair values for their financial assets considering the assets in which they invest, their respective business models and their principal marketplace. For BDCs, history offers compelling evidence on the accuracy of their fair value determinations as well as the principal market in which they have exited investments. Lastly, we believe the Proposal should attempt to describe other appropriate considerations of reporting entities in their determinations of fair values such as guidance on how best to incorporate an investment's significant structural enhancements such as call protection and information rights, among others.

In closing, we believe that SFAS 157 remains a principles based standard which we support and whose interpretative guidance for financial assets should continue to allow all reporting entities, whether a mutual fund, a bank, a BDC or otherwise, to fully exert management judgment in the determination of fair values for their assets. Such judgment should be consistently applied by each reporting entity, formally described, fully disclosed and back-tested. That said, the Proposal may want to specifically reference the consideration of back-testing results as powerful evidence of management's historical judgment on fair values. In addition, other suggestions of appropriate and practical audit evidence in this regard would be appreciated.

We appreciate the opportunity to comment on the Proposal as well as offer our additional thoughts and comments on related issues. Please don't hesitate to contact me with any questions or requests you may have.

Sincerely,

/s/ Richard I. Peteka
CFO & Treasurer
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