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Financial Accounting Standards Board 401 Merritt 7
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SVB Financial Group (SVB) appreciates the opportunity to comment on the proposed Accounting Standards Update (ASU), *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments* (hereafter, the "proposed ASU").

## Overview of SVB

SVB is a diversified financial services company headquartered in Santa Clara, California (Silicon Valley) and offers a variety of banking and financial products and services. We offer commercial banking products and services through our principal subsidiary, Silicon Valley Bank. We operate through 26 offices in the United States, as well as offices in China, India, Israel, and the United Kingdom. As of June 30, 2010, SVB had total assets of \$14.9 billion, total loans, net of unearned interest of \$4.5 billion, total investment securities of \$6.0 billion, and total deposits of \$12.1 billion.

SVB is a unique company focused on the "innovation markets" of technology, life sciences and venture capital. We work exclusively with clients in a select group of industries worldwide: technology (including clean tech), life sciences, venture capital & private equity, and, finally, premium wine. Our clients range from venture-backed start-ups to established private and public companies. Our focus has allowed us to develop unmatched expertise in dealing with our clients' challenges, as well as providing products and services tailored to their needs.

We have a market position of 50 percent among U.S. venture-backed companies. We also bank about half of the venture capital firms in the world. Our business model produces significant deposits and investment balances. This is because technology companies, particularly venture-funded start ups and venture capital firms, are typically cash rich. On average, as a group, they deposit 4 to 6 times as much as they borrow. Our focus has led us, over the years, to create complementary products and business lines designed to strengthen our relationships by helping our clients succeed, while generating fee-based income for us. Our ongoing relationships with the serial entrepreneurs and career venture capitalists that constitute the bulk of our clients are critical to our business success. One key aspect of supporting these relationships is our practice

of holding loans to maturity in order to maintain the flexibility to work with clients through business cycles that may impact their loan structures.

## Summary of SVB's Comments on the Proposed ASU

We do not support fair value as the primary measurement attribute for all financial instruments because fair value does not result in decision-useful information that would be helpful in evaluating our business. This is both in our view as well as the view of our investors that we have surveyed. Our business model is to originate and hold loans to specialized industry and customer segments for the purpose of collecting the contractual cash flows. Our investors primarily use our financial reporting information to estimate the earnings and cash flows that our business model will generate and to evaluate management's performance against credit quality, core loan growth, revenue generation, and operating efficiency, all within the context of an appropriate governance and risk management framework.

We are successful in lending to our customer base because we have more than 25 years of expertise and a deep knowledge of our target markets. Fair value measurement does not accurately reflect the cash flows that these loans will ultimately generate, and an investor, whether familiar or unfamiliar with our business model, would not be able to easily evaluate prospective cash flows and earnings potential using fair value. Under the proposed ASU, most of our loans would be measured using Level 3 inputs, resulting in a fair value that would be significantly less reliable than amortized cost and would have very limited relevance in helping our investors to predict future performance related to collection of contractual payments and earnings.

Measurement of our loan portfolio at fair value will introduce volatility into our financial results and will have negative business implications for the markets we serve and impact the predictive value for our investors. If volatility is introduced as an operating metric for our loan portfolio it will require increased levels of capital and will therefore need to be considered in the pricing of our lending arrangements. Furthermore, increased levels of capital could over time result in fewer funds being available for lending and negatively impact the small business and entrepreneurial markets that look to SVB for support. This real business impact could work against a growing economy and would be an unnecessary expense for the markets we serve.

Additionally, as we surveyed investors, they indicated without exception that fair value measurements would introduce significant volatility into our reporting that would not be reflective of the true nature of our business. Furthermore, our investors believe it would be challenging to effectively model this volatility, and therefore, impede their ability to evaluate the company's performance against its business model.

In a business model where loans are held for investment, we do not believe that the unfunded commitments for those loans should be recorded at fair value. We provide loan commitments with the intention of funding and holding a loan for investment and receiving a return over a long period of time as the contractual cash flows are collected. Our objective is not to extract value from these unfunded loan commitments based on secondary market price fluctuations. Historically between 30% and 40% of our unfunded commitments will become funded in any given period. Our investors' interest in evaluating our loan commitments is to understand the funding momentum within our target markets and whether the credit quality and

risk management related to those commitments is consistent over time. Further, our current practice is to evaluate all unfunded commitments for credit impairment captures any inherent loss and therefore provides a complete portfolio assessment for our shareholders.

We do not support FASB's proposed model to periodically re-measure all core-deposit liabilities that reflect the lower cost of deposit funding as compared to alternative funding. Our investors tell us that the most relevant measurement attribute for our liabilities is the amount that we could be required to settle them at period end. Furthermore our investors' fundamental focus is on deposit stability, sufficiency of deposits to support loan growth and overall cost (interest expense) of the deposit funding. The FASB's proposed model would present our coredeposit liabilities at an amount that is less than our current obligation and add confusion for investors. Further, we believe that this proposed model lacks clarity due to its arbitrary exclusion of certain drivers of deposit value, customer relationships. In addition, its benefits do not justify the operational cost of implementation and ongoing reporting.

We support the FASB's efforts to align the impairment model across all financial instruments but observe that this has not been achieved as different models would continue to exist based on how one might acquire the same asset. The proposed ASU provides for the recognition of expected loss today on an originated loan but would defer expected loss through an adjustment to yield on the same loan if it were purchased. We support the position that recording a credit loss should not be avoided due to arbitrary concepts such as probability assessments or other than temporary thresholds.

We believe that credit risk is comprised of both an expected loss and an actual loss, when it materializes. Actual losses should be recognized immediately. However, we believe expected credit loss, which we have priced into our loans, should be recognized as a reduction to income over the instrument's life. Expectations of credit loss should be based on our historical experience and should reflect both current economic and portfolio conditions as well as our reasonable expectation of events over the foreseeable future.

We believe there are significant operational ramifications of the proposed transition provisions and we estimate it will take a minimum of 2-4 years to implement the proposed ASU. The proposed ASU will require cross-functional commitment to a redesign of systems, processes, controls, and various policies—including risk management, credit, and accounting. Further, we believe that the current absence of IT systems/solutions that can capture the greater levels of disaggregated financial data required by the proposed ASU has a significant impact in terms of both the timing and the cost of implementation. We believe that this would far exceed the benefits of the additional information presented.

While primarily a domestic financial institution, SVB operates banking and representative offices around the globe and continues to expand internationally in the markets we serve. It is from this perspective that we view the importance of convergence between US GAAP and IFRS and we support the development of a single set of high-quality, globally accepted accounting standards to facilitate cross-border investment and efficient global operations. In light of this, we are concerned that the proposed ASU is not converged with IASB guidance on the topic of financial instruments, and as a result we would be required to maintain processes, systems and controls for two financial instruments frameworks with a considerable cost burden to our shareholders.

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We appreciate the opportunity to comment on select issues in the FASB's proposed ASU that particularly resonate with SVB. In the appendix that follows, we have provided a more detailed response to the FASB's questions related to these issues. If you have questions regarding this information, please contact me at (408) 654-7248.

Sincerely,

Kamran Husain

**Chief Accounting Officer** 

Kamen.

## **Appendix**

Question 13: The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholders' equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?

We do not support fair value as the default measurement attribute for all financial instruments. We believe that for certain types of financial instruments held by certain entities, fair value is not the measurement attribute that best achieves the objectives of financial reporting for those instruments and entities. Due to the nature of our customers and the loan terms we offer them, our lending is very specialized, and there is not an active market for our loans. Certain of our loans are made to emerging, early-stage and mid-stage companies with modest or negative cash flows and no established record of operations. Our loans typically have a three- to five-year maturity and contractual cash flows which are the periodic payments of principal and interest. Our success is based on our ability to profitably underwrite and collect the contractual cash flows on these loans. We do not sell loans in the ordinary course of our operations; rather, we underwrite, originate, and service loans which we nearly always hold until maturity.

We do not believe that the same measurement attribute should be used to measure the financial assets of all entities, irrespective of whether their business model is to actively trade financial assets in the market, or to originate and hold financial assets to collect or pay contractual cash In our view, the use of fair value for all entities' financial instruments reduces comparability between those entities, because in order to compare the performance of dissimilar entities, each entity's success should be evaluated against its business model. For example, when our investors use our financial information to evaluate our success in executing against our business model, they focus on credit quality, core loan growth, revenue generation, and operating efficiency, all within the context of an appropriate governance and risk management framework. They do not focus on secondary market liquidity risk for our loans, trading gains or losses, or exit prices of our loans, as they might if we had a practice of selling our loans. In further support of our view, we have surveyed our investors, who have confirmed that they would not find fair value information for our loans to be relevant or decision-useful. Ouite the opposite, they have told us that the use of fair value for our loans would obscure their assessment of losses by introducing secondary market liquidity risk which they view as irrelevant, and create volatility that would be problematic in modeling their expectation of future financial performance.

Fair value information for our loans is also less reliable than amortized cost. As a result of the specialized nature of our lending and the infrequency with which we sell these loans, there is little liquidity or available market data that we could use to measure our loans at fair value.

Therefore, a requirement to value our loans at fair value would result in primarily Level 3 fair value measurements.

Although we understand the FASB's mission is not to favor certain transactions, industries or entities through accounting standards, accounting information should nonetheless preserve its neutrality and represent economic reality. We have a viable business model based on our ability to underwrite loans to relatively-illiquid segments of the market. We are successful in lending to our customer base due to our unique expertise and a deep knowledge of our target markets. Fair value measurement does not accurately reflect the cash flows that these loans will ultimately generate, and an investor, whether familiar or unfamiliar with our business model would not be able to easily evaluate prospective cash flows and earnings potential using fair value.

We note that neutrality does not necessarily mean that all entities are treated the same, but rather that there is no bias in the selection of what is reported. We believe that the probable economic impact of the proposed accounting standard should be considered in the re-deliberations, because an accounting standard that discourages certain types of lending (even though they are supported by profits and positive cash flow over decades of experience) would indicate, in our view, that the proposed standard does not accurately convey the economic reality in all contexts.

Also in a business model where loans are held for investment, we do not believe that the unfunded commitments for those loans should be recorded at fair value. We provide loan commitments with the intention of funding a loan and receiving a return over a long period of time as the contractual cash flows are collected. Historically between 30% and 40% of our unfunded commitments will be funded in any given period. Our investor' interest in evaluating our loan commitments is to understand the funding momentum within our target markets and whether the credit quality and interest rate risk management related to those commitments is consistent over time.

We appreciate the FASB's view that many loan commitments are similar to written options that could be accounted for as derivatives under ASC 815, and that guidance should be developed for loan commitments in the proposed ASU. However, our objective is not to extract value from these loan commitments based on selling these contracts, or the funded loans, into the secondary market to take advantage of price fluctuations. Further, our current practice of evaluating all commitments for credit impairment captures any inherent loss to our shareholders. Therefore, in re-deliberations, we urge the FASB to consider the relevance of fair value information for loan commitments in a business model such as ours together with the cost-benefit considerations of developing new systems, processes and controls to report this information.

**Question 17:** The proposed guidance would require an entity to measure its core deposit liabilities at the present value of the average core deposit amount discounted at the difference between the alternative funds rate and the all-in-cost- to-service rate over the implied maturity of the deposits. Do you believe that this remeasurement approach is appropriate? If not, why? Do you believe that the remeasurement amount should be disclosed in the notes to the financial statements rather than presented on the face of the financial statements? Why or why not?

While we appreciate the theoretical argument that the measurement basis for the funding source, core-deposit liabilities, should closely resemble the measurement basis for the assets they are funding (loans), we do not support the FASB's proposed measurement guidance for core-deposit liabilities. As previously discussed, we do not support a fair value measurement basis for loans held for investment and further do not support a fair value measurement basis, or that which could be misunderstood to represent fair value, for deposits.

In surveying our investors, we understand their focus is on deposit stability, sufficiency of deposits to support loan growth and overall cost (interest expense) of the deposit funding. Furthermore, our investors' primary concern with respect to our core-deposit liability is its settlement value at a point in time as those balances that would meet the proposed definition of core-deposit liabilities can be redeemed by our customers on demand. Using the remeasurement amount in the proposed FASB model would present these core-deposit liabilities at something less than the current obligation we have with our customers and therefore would not be representationally faithful to the users of our financial statements at period end.

Finally, we find this proposed model lacks clarity due to its arbitrary exclusion of certain drivers of deposit value, customer relationships. In addition, the application of the requirements would be very complex and operationally challenging to implement and report on an on-going basis. We urge the FASB to consider the cost-benefit considerations of this proposal, given the concerns we note related to its representational faithfulness and decision usefulness.

Question 38: The proposed guidance would require an entity to recognize a credit impairment immediately in net income when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s). The IASB Exposure Draft, Financial Instruments: Amortised Cost and Impairment (Exposure Draft on impairment), would require an entity to forecast credit losses upon acquisition and allocate a portion of the initially expected credit losses to each reporting period as a reduction in interest income by using the effective interest rate method. Thus, initially expected credit losses would be recorded over the life of the financial asset as a reduction in interest income. If an entity revises its estimate of cash flows, the entity would adjust the carrying amount (amortized cost) of the financial asset and immediately recognize the amount of the adjustment in net income as an impairment gain or loss. Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure *Draft on impairment?* 

We are supportive of the FASB's objective to add clarity to impairment guidance for all financial instruments by aligning the impairment models. However, we observe that the FASB has not achieved their objective with the proposed exposure draft as there remain different models for originated and purchase financial assets. This differentiation is unnecessary and lacks transparency as the nature of a financial instrument is not altered by the method in which it is acquired.

We believe that credit risk is comprised of both an expected loss and an actual loss, when it materializes. Actual credit impairment should be recognized immediately. We believe expected credit loss, which we have priced into our loans, should be recognized as a reduction to income over the instrument's life.

Our underwriting standards are based on more than 25 years of specific, industry experience from servicing and collecting the investments we make with our customers. It is based on this experience that we develop our expectation of our ability to collect all contractual amounts due as well as any inherent credit risk. An overly-conservative impairment model that recognizes all expected loss before it occurs misrepresents economic reality and, more importantly, will reduce our perceived ability to derive value for our shareholders. This would discourage investor support for lending to certain of our customer segments, such as early-stage or entrepreneurial companies, where an untrained expectation of loss on origination could be higher than our experience tells us will occur.

Expectations of credit loss should be based on our historical experience and should reflect both current economic and portfolio conditions as well as our reasonable expectation of events over the foreseeable future. An expectation of credit loss that does not reflect a reasonable expectation of future events lacks the context necessary to provide decision useful information to users of our financial statements at points in time of a credit cycle. An impairment model that does not allow us to consider the impact of changes in a credit cycle would hinder our ability to be representationally faithful to our investors of the expected credit loss.