

Congress of the United States

Washington, DC 20510

May 16, 2000

The Honorable Alan Greenspan
Chairman
Federal Reserve Board
Washington, D.C. 20551

Dear Mr. Chairman:

We are writing to express our concern over the Federal Reserve and Department of Treasury proposed rule governing capital treatment for merchant banking activities under the Gramm-Leach-Bliley Act, which we believe will significantly reduce the participation of financial holding companies in the Small Business Investment Company (SBIC) program.

We are deeply concerned about the effects of the rule which would force financial holding companies that either own or invest in an SBIC to deduct 50 percent of the total value of their investment from Tier I regulatory capital. Currently, there is no standard industry practice for how much financial institutions charge against merchant banking investments, but they generally allocate what amounts to more than 8 percent of regulatory capital. The increased deductions are likely to impact adversely the success of the SBIC program and the availability of equity capital for small business.

Small business investment companies are a critical source of equity capital for small businesses. They are privately owned and managed investment firms that provide venture capital and start-up financing to small businesses and are regulated by the Small Business Administration (SBA). The SBIC program has long operated with a proven and rigorous system for screening applicants for capital and investment expertise before licensing. Additionally, SBICs are subject to annual financial reporting and onsite compliance examinations by SBA.

SBICs have filled the gap in small business finance by using private funds and funds borrowed at favorable rates with an SBA guaranty to make venture capital investments to either start-up or fast-growth small businesses. SBIC investments have been critical to the development of such notable companies as Intel Corporation, Apple Computer, Federal Express, America Online and Staples.

Most recently, in fiscal year 1999, SBICs invested a total of \$4.2 billion in more than 3,000 small business investments. This represents about 55 percent of all institutional venture capital investments and 24 percent of overall value. In contrast to the private venture capital industry, SBIC investments are far more diversified in terms of their size, location and industry, and they include companies with more modest projected growth rates.

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The SBIC program has proven to be one of America's most successful public-private partnerships. Over the life of the program, SBICs have generated \$26.6 billion in 12,000 financings of small businesses. From fiscal year 1994 through fiscal year 2000, the SBIC program has received \$210 million in federal funding. In return, the U.S. Treasury has received more than \$200 million in profits from participating SBICs. Further, only one of the 243 SBICs licensed over the last ten years has failed.

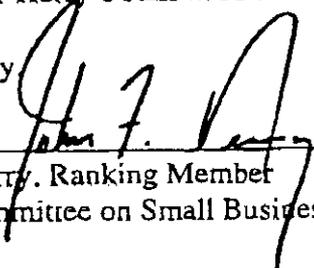
We recognize the importance of meaningful capital requirements for financial holding companies that are, for the first time, being given merchant banking opportunities. However, we believe imposing an identical standard on financial institutions that either establish or invest in SBICs is unnecessary and would severely limit the amount of equity capital available for the nation's small businesses. Congress specifically addressed safety and soundness of the SBIC program in at least five Senate and House hearings in the early '90s. Those hearings led to a series of bills, starting with enactment of the Small Business Credit and Business Opportunity Enhancement Act of 1992 (PL 102-366). The Congress built on that legislation by enacting the Small Business Investment Company Improvement Act of 1996 as part of the Defense Department FY97 Appropriations bill (PL 104-208). Implementation of that legislation has been so successful, that since 1994, when the regulations for the 1992 law actually went into effect, the program has returned to the Treasury almost more money in profits than it has cost the government to run the program. Therefore, we request that any investments by financial holding companies in small business investment companies be excluded from any final rule imposing a 50 percent capital deduction for merchant banking activities by financial holding companies.

Thank you in advance for your consideration of this request. If your staff has any questions, or need any further information, please contact John Phillips of Senator Kerry's staff at 224



Christopher S. Bond, Chairman
Senate Committee on Small Business

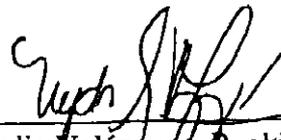
Sincerely



John F. Kerry, Ranking Member
Senate Committee on Small Business



James M. Talent, Chairman
House Committee on Small Business



Nydia Velázquez, Ranking Member
House Committee on Small Business

cc: The Hon. Lawrence Summers, Secretary of the Treasury