From: <a href="mailto:phallquist@mchsi.com">phallquist@mchsi.com</a>
To: <a href="mailto:pirector-FASB">Director-FASB</a>

Subject: File Reference: No. 1810-100, "Accounting for Financial Instruments and Revisions to the Accounting for

Derivative Instruments and Hedging Activities"

**Date:** Thursday, September 16, 2010 11:53:09 AM

Paul Hallquist 591 Park Avenue Hamburg, MN 55339-4509

September 16, 2010

Russell Golden Technical Director Financial Accounting Standards Board 401 Merritt 7, PO Box 5116 Norwalk, CT 06856-5116

Dear Mr. Golden:

Thank you for the opportunity to comment on the exposure draft, "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities."

As [President of State Bank of Hamburg, a banking institution in Hamburg, MN with \$20 Million in total assets, I am writing to express my opinions on specific provisions of the exposure draft.

I am strongly opposed to the portion of the proposal that requires all financial instruments - including loans - to be reported at fair value (market value) on the balance sheet.

Our bank does not sell our commercial loans. Basing our balance sheet on fair values leads readers of our financial statements to assume that we will sell the loans, which is not the case.

If there are issues with a borrower's ability to repay a loan, we work through the collection process with the borrower rather than sell the loan. When it appears we will not be paid all of our contractual agreements we pro-actively write down the balance, thus decreasing its value, furthermore, we have loan loss reserves to address expected and unexpected credit issues.

There is no active market for many of our loans, and estimating a market value makes no real sense.

Even if we could easily obtain a market price, since the loan is just one part of the financial relationship that we have with the customer (multiple loans, investment and trust services, etc.), there is no financial incentive to sell.

Marking all loans to market would cause our bank's capital to sway with fluctuations in the markets - even if the entire loan portfolio is performing. Instead of providing better information about our bank's health or its ability to pay dividends, the proposal would mask it. Also, given our size, swings in values could substantially erode our capital

base. Swings could put us in violation of required or industry standard leverage and capital standards. Raising capital quickly or accumulating excessive amounts of capital can be expensive and time consuming. Furthermore, raising capital for expansion or to weather downturns will be difficult if investors don't have a clear understanding of the financial performance of the bank. Mark to market accounting will cloud that picture.

The costs and resources that we will need to comply with this new requirement would be significant. This will require us to pay consultants and auditors to estimate market value. At acceptable returns on assets and equity, our raw dollar profits are around \$200,000. To pay auditors and consultants to perform mark to market work would seriously affect our profitability and in turn our ability to accumulate capital, pay dividends, and essentially stay in business. To small main street, community banks this action is seen as a way to crowd out or drive out our size of bank.

It is very important that any new processes are agreed upon and well understood by regulators, auditors, and bankers prior to finalizing the rules.

I do not support the proposal for recording interest income. Interest income should continue to be calculated based on contractual terms and not on an after-impairment basis.

Changing the way interest income is recorded to the proposed method makes the accounting more confusing and subjects otherwise firm data to the volatility that comes naturally from the provisioning process. I recommend maintaining the current method.

## III. COMMENTS ON HEDGE ACCOUNTING

I support the change of the requirement that a hedge is "reasonably effective" (as opposed to being "highly effective"). This should make it easier for banks like mine to implement hedge accounting.

It is very important that the term "reasonably effective" be better defined.

The "shortcut" and the "critical terms match" methods should be maintained. This greatly helps medium and smaller banks like mine to reduce the cost of compliance with the hedge accounting rules.

In summary, changes to fair value accounting will significally affect not only the financial picture of the bank, clouding performance, but the expense to comply will drive a number of banks our size out of the industry. Banks our size are just a critical to the economy as large banks are. We build our business on relationships, expectations and straight forward financial interpretation. To change that will affect us dramatically in many ways.

Thank you for considering my comments.

Sincerely,

State Bank of hamburg

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