merchants
BANK

September 30, 2010

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: File Reference # 1810-100

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." I am the CFO of Merchants Bank, a $1.4 billion bank located in Vermont with 34 branches throughout the state.

According to a June 30 webcast sponsored by the FASB, the objective of the proposal is "to provide a more timely and representative depiction of an entity's involvement in financial instruments, while reducing the complexity in accounting for those instruments," and; "to provide information about (1) how an entity operates its business (business model) and (2) the risks inherent in the financial instruments the entity uses in operating its business." In my opinion the proposed standard accomplishes neither of these goals, conversely it adds an enormous amount of complexity to accounting for financial instruments, and completely obfuscates the banking business model. Additionally, the standard will introduce unnecessary volatility into Bank capital levels. My comments are summarized below.

I. Comments on Fair Value:

Our basic business model is simple. We accept deposits and make loans. The estimated fair value of our assets and liabilities has nothing to do with how we run our business, nor does it provide a reliable measure of the true value of our institution. Our investors own our stock because they understand our business model, agree with how we manage our institution and think that ours is a good investment for the long term, not because of the perceived fair value or liquidation value of our loans or deposits. Fair value accounting obscures economic reality and financial performance – it does not promote greater transparency.

We manage our entire balance sheet as a whole, not just one loan or deposit at a time. Interest rates fluctuate constantly and we model our balance sheet under a variety of interest rate scenarios and make adjustments accordingly. Our strategies for managing our interest rate risk can include extending or shortening our assets or liabilities, simple hedging instruments, or leveraging or de-leveraging our balance sheet, among other strategies. The fair value of any of these individual financial instruments is irrelevant to this analysis.

We are a relationship based institution. The majority of our customers are both borrowers and depositors. We do not typically sell a loan on the secondary market. If a borrower is experiencing difficulties we will work with them toward resolution, which may include sale of the loan. There is no reliable market for our financial assets and liabilities, attempting to place a fair value on them is at best a subjective exercise, and at worst misleading. The value of our institution is in our relationships with our customers; those relationships cannot be quantitatively valued.

The proposed accounting is extremely subjective and time-consuming, and will be inconsistently applied across institutions. A high degree of management judgment is required throughout the process – from determining whether the mark on a loan goes through net income or other comprehensive income to determining what exactly constitutes a core deposit liability.

II. Comments on Asset Impairment:

The importance of ensuring that banks recognize credit impairment in their loan and investment portfolios in a timely and appropriate manner cannot be understated. Our bank has always been extremely proactive in recognizing and recording credit impairment in both our loan and investment portfolios. Our underwriting standards have always been, and continue to be, comprehensive and conservative and, as a result, our loan losses throughout the economic downturn have been extremely low.

The proposed accounting for interest income and the potential for a "first-period" credit loss on an originated loan are particularly concerning. The proposed accounting is extremely confusing and complex and will require (at least) two sets of books for our loan portfolio, while at the same time making it very difficult for the users of financial statements to understand how interest income is computed or what our actual returns are. The effects of the proposed accounting would be far-reaching and would no doubt produce many unintended consequences.

In closing, it is unclear who will benefit from this dramatic change in accounting for financial institutions and what the benefit might be. Users of financial statements can currently obtain information on the estimated fair value of financial institutions' assets and liabilities in the footnotes to the financial statements. The investing and regulatory communities have made their opposition to the proposed standard clear. In addition this proposal will force consolidation in the industry as the cost for smaller banks to comply will be unmanageable.

The true cost of compliance with this standard is unknowable. New processes, reports and systems will be required to gather and segregate the appropriate data, then assumptions will need to be created, reviewed, updated and applied; conclusions drawn, and finally, analysis completed. All of these judgments, assumptions and conclusions will need to be documented and auditable, and performed and reviewed on a quarterly basis. The standard will require that financial institutions spend significant amounts of money on hiring additional staff, re-training existing staff, hiring consultants and purchasing modeling software, and auditing fees will increase materially. The cost-benefit equation of this proposal is completely out of balance.

Sincerely,

Janet P. Spitler
CFO