September 25, 2012

Leslie Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116
Via email: director@fasb.org

Re: File Reference No. 2012-200: Disclosures about Liquidity Risk and Interest Rate Risk

Dear Chairman Seidman:

Thank you for giving us the opportunity to comment on the Exposure Draft: Disclosures about Liquidity Risk and Interest Rate Risk (ED). I am the Chief Financial Officer of Valley Financial Corporation (Valley), an $800 million bank holding company located in Roanoke, Virginia. Valley Financial Corporation is an SEC registrant, traded on the NASDAQ Capital Market. I am writing to express our opinions on specific provisions of the ED referenced above.

Bankers generally agree liquidity risk and interest rate risk are the key business risks, outside of credit risk, faced by banking institutions like Valley. As I’m sure you are aware, significant resources are normally deployed by both bankers and banking regulators in addressing, analyzing and evaluating these risks. In addition to separate procedures performed by bank examiners to assess the bank’s risk management processes related to liquidity risk and interest rate risk, certain related disclosures are required to be included in bank Call Reports. Further, for publicly-held institutions like Valley, significant disclosures are already required within the Management’s Discussion and Analysis (MD&A) section of our public filings. We recognize the need for investors to understand liquidity and interest rate risks; however we are concerned that the required information proposed in the ED will not achieve an improvement in financial reporting, and actually could be misinterpreted, misleading, and indeed harmful to the shareholders.

We are concerned that the ED attempts to codify existing regulatory disclosures into GAAP in inappropriately standardized formats. We understand that the Board believes the proposed requirements provide incremental, complementary information to what is already disclosed in public filings. However, the proposed liquidity gap analysis and the repricing analysis are standardized tables that are required to be prepared on a basis that differs from how banks monitor and manage the respective risks, and thus how banks inform users about these risks within the MD&A. Because the proposed disclosures are based upon information management does not use, this will likely result in confusion among investors as to what management actually does use. For the limited amount of information required in the ED that is utilized by management, more sophisticated and instructive information, is nevertheless, provided through MD&A and Guide 3 disclosures. Therefore, we do not believe
the required tables will be relevant and in fact, could potentially confuse and/or mislead financial statement users.

For example, much of the information in the proposed liquidity gap analysis does not reflect how banks manage liquidity and would, thus, feed erroneous conclusions. We generally manage liquidity risk to ensure we have the liquidity available to satisfy our existing customer base (including paying off maturing deposits, funding withdrawals, and satisfying loan commitments) and to enable us to grow our core businesses. Methods used to manage liquidity risk are subject to bank policies that are reviewed and approved by our board of directors. Diversifying funding sources, testing short and medium term adequacy under stress scenarios, and holding sufficient cash and readily marketable assets are methods we use to address liquidity risk. The various liquidity models we perform are dynamic and take into consideration run-off and origination of assets (including renewal and maturing loans) and liabilities, using various assumptions related to how quickly we can sell or pledge certain assets to provide liquidity.

The ED notes that the purpose of liquidity risk disclosures is to assist users in assessing the risk that a bank will encounter difficulty in meeting cash obligations. However, the proposed tables portray a scenario that does not reflect how management analyzes liquidity risk. As noted above, banks like Valley, manage their liquidity risk through a range of activities, tested under various stress scenarios. The available-for-sale securities portfolio is typically maintained to provide liquidity if and when (however unlikely) it is needed. These securities are not necessarily used for sale, but are (along with held-to-maturity securities) often posted as collateral for short-term borrowings banks use to meet their obligations. So, presentation of expected maturities of many financial assets that are available-for-sale ignores the reality that such assets are held precisely to provide liquidity. Therefore, the proposed table not only is irrelevant to a bank’s liquidity risk – it also presents a picture that essentially distorts how a bank manages this risk. Basing an analysis on such a presentation can lead to erroneous conclusions — both favorable and unfavorable — related to a bank’s management of liquidity risk.

Furthermore, maturity expectations (as defined in the ED), for the purpose of liquidity risk analysis, is not a concept that we believe faithfully represents management’s expectations related to satisfying liquidity needs, since expectations under the various stressed conditions bankers use in their analyses will vary widely. For example, withdrawal of core deposits under any stressed condition will have no relation to maturity expectations under normal conditions (which we assume is what is required in the ED).

Liquidity stress testing performed by banks covers a wide range of scenarios that are unique to the individual institution and a standardized schedule would not faithfully represent the risks about a bank’s ability to satisfy its cash obligations. The proposed table provides no incremental value over a discussion about how the company manages overall liquidity, supplemented by commonly-used liquidity ratios. The proposed analysis, in substance, does not address the objective of the ED.

There are similar issues with the interest rate tables proposed in the ED. For example, the proposed repricing analysis table requires that assets and liabilities be presented based on contractual repricing dates and does not take into consideration prepayments or embedded options. Therefore such an analysis would give limited insight into interest rate risk and could actually distort interest rate risk over the long run. In addition, expected yield by time period and duration would be presented. While we believe the net duration can be a relevant measure of portfolio risk, we are very concerned about the operationality of such a requirement from the preparers’ and auditors’ perspectives. While duration is often a relevant factor in determining the recorded value of some items in the financial statements, it is not for instruments that are accounted for at amortized cost (for example, loans, held-to-maturity debt securities, and deposits). Determining duration would have no
purpose other than for this specific disclosure. Therefore, calculating duration, especially for consumer deposits, will be a new and operationally burdensome process that has never been subject to audit or to the related establishment of internal controls over the process for financial reporting purposes. The assumptions that banks will need to make in order to provide duration will have no “anchor” in the financial statements, and because of the nature of the assumptions, are not likely to be auditable or relevant to the financial statements. We are concerned that the incremental value of this report will not exceed the significant additional costs.

As mentioned earlier, banks routinely provide qualitative and quantitative disclosures related to liquidity and interest rate risks in Call Reports, which contain certain repricing and maturity data for loans, securities, and deposits. Additionally, public institutions provide various schedules addressing these risks in their 10K and 10Q filings, including average yields earned on assets and rates paid on deposit liabilities and short-term borrowings as well as loan balances presented by period of contractual maturity. Guide 3 also requires disclosure of average and maximum amounts outstanding for short-term borrowings. Further, MD&A disclosures are intended to provide investors with guidance relevant to how these risks are managed and, as it relates to interest rate risk, the extent of exposure to various interest rate changes, using scenarios that management believes are reasonable. The MD&A requirements do not prescribe how management must communicate this information, which is important, as it allows management to utilize and present information it actually uses to monitor and manage these risks. Finally, given that the management of liquidity risks and interest rate risks involves forward-looking estimates not necessarily linked to financial statement line items (for example, the future decay of deposit liabilities or the future conversion of cash of liquid assets), the new internal control monitoring processes and/or audit procedures needed to comply with the requirements would be significant.

We are not aware of any problems with the inclusion of the information presented in the MD&A and, thus, question why such information must be part of GAAP. We see no significant improvement in financial reporting being achieved through the requirements of the ED, especially given the costs that will be required to develop and monitor financial reporting controls for the related assumptions and to audit the related assumptions. Therefore, we recommend that the FASB engage the SEC in clarifying what is appropriate for inclusion in Guide 3 and MD&A, and if the concern is primarily around comparability, the SEC could consider providing further instruction to achieve this goal. Similar discussions should be held with banking regulators, who perform separate detailed reviews of liquidity and interest rate risk management as part of their supervisory responsibilities.

Thank you for your consideration of our comments on the Exposure Draft. We hope you find the feedback to be useful and illustrative of the concerns that community banks like Valley have with the proposal.

Sincerely,

Kimberly B. Snyder, CPA
Executive Vice President &
Chief Financial Officer