

June 10, 2010

Director
Financial Accounting Standards Board
401 Merrit 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities, issued May 26, 2010

To the Director and Board Members:

We are a financially healthy, 100 year old, publicly traded community bank located in Virginia, with over \$800 million in assets, 18 branches, and over 200 employees. We believe that the purpose of external financial reporting is to provide the public and investors an accurate, timely and understandable report on the actual financial position and operations and cash flows of our business enterprise, in conformity with all relevant GAAP and regulatory requirements, from which well informed investment decision may be made.

We commend the Board on its desire "to provide financial statement users a more timely and representative depiction of an entity's involvement in financial instruments, while reducing the complexity in accounting for these instruments."

However, we respectfully wish to register strong disagreement with much of the recent exposure draft on *Accounting for Financial Instruments*, issued May 26, 2010.

We believe that the measurement basis for financial instruments should be determined by, first, the operative strategy of the business entity and, second, by the presence or absence of

robust and viable market for the financial instruments. This is basically consistent with the current FAS 115 guidance applied to held –to-maturity, available-for-sale, and trading bond portfolios.

The proposed default measurement basis for loans is fair value and is fundamentally inconsistent with the basic business model for most banks, which is to originate and hold loans until payoff, renewal or charge off. There is no material benefit that we can see to fair value accounting for what is, in effect, our finished inventory, loans held for investment. A bank "manufactures" and sell loans to its customers, not unlike any other manufacturer. We recognize the fact that our "manufacturing" creates a financial instrument, but the most likely, albeit unintended, consequence of implementation of fair value accounting for loans is that banks will become more restrictive in their lending and offer fewer options to their customers, in order to minimize the fair value volatility of their loan portfolios. That volatility will be directly impacting net income or comprehensive net income under these new requirements.

For most plain vanilla loans, there is not a viable marketplace from which to derive benchmark prices for generic categories of loans. We cannot price our loans as quickly, efficiently or as reliably as we do our bonds. Consequently, loan fair value amounts will be at best ambiguous and at worst misleading. The auditors will probably want to term this Level 3- pricing.

If we as a bank provide basic GAAP financial statements, which purport to represent financial position and results of operations, with such ambiguous data as a starting point, not only will investors be misled (those few that remain in our sector), but bank management will likely be making decisions and taking actions based on poor quality, subjective data. *Our strategic concern is that the proverbial tail (the accounting system) will wag the dog (the bank)*.

Amortized cost is not perfect, but it does provide an objectively verifiable and, importantly, understandable basis from which to account for loans. The exposure draft acknowledges, indirectly, exactly that in paragraph 34 in the discussion on *Investments That Can Be Redeemed Only for a Specific Amount*. That section is discussing FHLB and Federal Reserve stock, but the key points are – there is no readily determinable market value and they are not held for capital appreciation. **Those two factors are the same for plain vanilla loans as for investments without readily determinable market value.**

A good argument can be made that bank core deposits have a value, a core deposit intangible, beyond the nominal dollars reflected in our customers' accounts. However, this discussion is more relevant in the context of accounting for intangible assets than fair value of financial instruments. Further, the exposure draft creates a present value formula for this intangible based on a new concept, an "all-in-cost-to-service rate", which netted against an alternative

funding rate, and combined with an estimated implied maturity for non-maturity core deposits determines the amount. This approach contributes mightily to further obfuscation, subjectivity and complexity of our financial reporting.

We object to interest income being computed based on historical cost less allowance for credit losses. This will make it very difficult for us to evaluate yields on different generic categories of loans.

Having any dollar excess of the contractual interest on loans over the GAAP based interest become, effectively, part of the loan loss allowance is imaginative, but further adds to the complexity of our financial reporting.

The proposed requirements for the Allowance for Credit Losses, accounting by class and by pool versus individually assessed loans, represent a quantum increase in complexity with little to no discernible benefit. This level of granularity will be extremely difficult for most community banks to provide and will require significant resources to accomplish.

Banking is already a very transparent industry. Our financial information is readily available from the SEC and FDIC and from our own web sites. To the extent we can keep subjectivity to a minimum in our financial reporting, investors and the industry will be well served.

The operational complexities inherent in these proposals are implicitly recognized in the four year deferral for "small" non-public companies. However, much of the deferral "benefit" from being "small" is rendered moot by the "non-public" modifier. In truth, this exposure draft, if approved, will require massive changes in bank core information operational systems throughout the country. The tremendous resources needed to accomplish this will dwarf the nominal, and arguable, value of the new information derived, thereby flunking the cost / benefit criteria of most sound decision making and failing one of the Exposure Draft's primary goals: reducing the complexity of accounting for financial instruments.

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Chief Financial Officer

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