



Letter of Comment No: 3
File Reference: FSPSOP946A

November 11, 2005

Mr. Lawrence W. Smith
Director, TA&I – FSP
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Proposed FASB Staff Position No. SOP 94-6-a, “Nontraditional Loan Products”

Dear Mr. Smith:

Deloitte & Touche LLP is pleased to comment on the proposed FASB Staff Position No. SOP 94-6-a, “Nontraditional Loan Products” (“proposed FSP”).

We recognize the importance of robust disclosures for entities that may be exposed to greater risks through the use of loan products whose terms may delay the recognition or discovery of loan defaults, credit impairments, or both. However, we do not believe the proposed FSP, in its current form, should be issued as a final standard because it does not provide clear delineation as to its scope to ensure that it will be consistently and appropriately applied. In addition, we believe that the proposed FSP is narrowing interpretations of GAAP, by its interpretation of the phrase *concentration of credit risk* and by defining nontraditional loans as a *major category* and, as such, should provide for transition. If the Board proceeds with the issuance of the proposed FSP, additional suggestions intended to improve the clarity of the guidance are provided in the Appendix.

Scope

The proposed FSP broadly defines nontraditional loan products as those with “higher risk than *traditional products*” (emphasis added). It is clear that the Board intends that preparers and auditors will exercise substantial judgment in determining whether a particular lending product meets this definition. However, operational issues may arise when applying this broad definition. The definition of nontraditional loan products is relative; there is no common understanding of the term *traditional loan product*. This relative definition may result in the following outcomes:

- Inconsistent application — because various preparers will have different views of where the boundary of traditional risk ends. For example, some lenders will no doubt conclude that loans with high loan-to-value ratios are traditional, based on changing underwriting standards. Other lenders may argue that their underwriting standards are such that their nontraditional products bear no unusual risk.
- Difficulties in regulating and auditing — because the definition is idiosyncratic.
- Difficulties in defending against second-guessing — because regulators may conclude that an entity’s dividing line between traditional and non-traditional risk is inappropriate.

Further, although the proposed FSP uses the term *loan product*, most of the examples provided are mortgage-related. If, as suggested in paragraph 6, the scope of the FSP is meant to be broader, then examples specific to other loan products, such as credit card loans, would be beneficial.

Transition Guidance

The proposed FSP states that no transition guidance is required because it only references existing effective literature. We understand the proposed FSP's rationale for asserting that nontraditional loan products may trigger certain disclosure requirements that exist within current GAAP; however, we believe this guidance, in fact, represents new interpretations of those existing disclosure requirements and may cause confusion in practice.

For example, the proposed FSP indicates that nontraditional loan products likely would be considered a *major category* of loans for some entities, as that term is defined in AICPA Statement of Position 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*. We do not believe that it is clear that this type of categorization was contemplated by AcSEC when it established that requirement, or by the Board when it cleared the SOP. This guidance also appears inconsistent with the major loan categories specified by Regulation S-X, Article 9, "Bank Holding Companies," and the SEC Industry Guide, "Statistical Disclosure by Bank Holding Companies" (Guide 3).

The proposed FSP also indicates that nontraditional loan products may represent a *concentration of credit risk*, as that term is used in FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*. Using loan payment terms (e.g., interest only loans, or loans with teaser rates) as a means of identifying a credit risk concentration also appears to be a new interpretation of Statement 107 that was not previously contemplated in practice. (The relevant factors that are used by many institutions to define concentrations are borrower, industry, geography, collateral, and loan type (i.e., major category).)

We fully support the Board's efforts to require companies to provide meaningful disclosure about risk exposures to users of financial statements; however, we believe the proposed FSP's assertion that existing GAAP has always required preparers to provide such disclosures is not consistent with longstanding interpretations of the aforementioned standards that previously have been accepted by all financial statement users, preparers, and their regulators. Thus, the Board should provide transition provisions for implementing the proposed FSP.

Objective and Form

If the Board disagrees with our view that the proposed FSP establishes new interpretations (or that it at least eliminates previously acceptable alternative interpretations) and continues to maintain that the proposed FSP simply reminds constituents of current requirements, then we encourage the Board to reconsider whether an FSP is the best vehicle for accomplishing this objective. Using an FSP to emphasize the correct application of lower level GAAP (e.g., an AICPA Statement of Position) may confuse constituents and cause them to question whether the FSP elevates the lower level GAAP to a higher level in the hierarchy. In addition, many constituents view FSPs as vehicles for creating new accounting requirements; therefore, using an FSP solely to emphasize existing GAAP may create additional confusion. The Board should consider whether the use of other established vehicles to deliver its message, such as a FASB

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Staff Implementation Guide or a FASB Staff Article, would be more effective and minimize constituents' confusion.

Deloitte & Touche LLP appreciates the opportunity to comment on the proposed FSP. If you have any questions concerning our comments, please contact Robert Uhl at (203) 761-3705.

Yours truly,

Deloitte & Touche LLP

cc: James A. Johnson

APPENDIX A
Deloitte & Touche LLP
Editorial Suggestions

Paragraph 2

The Board should consider revising the language in paragraph 2 to clarify that products with a feature listed in items (a)–(f) *may* [emphasis intentional] meet the definition of nontraditional loan products. We do not believe that nontraditional loan product features listed in paragraph 2 (for example, a teaser rate) necessarily translate to higher risk for every loan. For example, a loan that may be considered *nontraditional* because it was originated with a teaser rate, but for which the loan-to-value ratio is 50 percent, may present less credit risk to the lending institution than a *traditional* loan with a loan-to-value ratio of 80 percent. The inherent risks associated with a nontraditional lending product may be effectively mitigated by underwriting and monitoring controls put in place by the institution. A portfolio of nontraditional loans held by a lender with sophisticated, effective controls may create no greater concentration of credit risk than a portfolio of traditional loans held by an institution with weak controls.

Further, one feature of nontraditional loan products provided in the proposed FSP is a high loan-to-value ratio. Most would consider an 80 percent loan-to-value ratio to be high in absolute terms; however, such a ratio is also very common. The Board should consider adding some additional clarification about loan-to-value ratios in the proposed FSP.

Paragraph 4 (added text is underlined)

Negative amortization and the deferral of interest increase the loan amount, which can result in an increased loan-to-value ratio and thus reduce the borrower's relative equity absent any increases in the fair value of the underlying asset.

Paragraph 7 (deleted text is ~~struck out~~)

Certain nontraditional loan products expose a reporting entity to greater credit risk than traditional ~~mortgage~~ products.

Paragraph 8

An additional disclosure is discussed in this paragraph related to an entity's underwriting procedures. While we believe this is a relevant disclosure, it is not a *quantitative* disclosure and, therefore, should not reference paragraph 15C of Statement 107.