



Letter of Comment No: /
File Reference: FSPSOP946A

November 11, 2005

Mr. Lawrence Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Proposed FASB Staff Position No. SOP 94-6-a, *Nontraditional Loan Products*

Dear Mr. Smith:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the proposed FASB Staff Position (the "proposed FSP") identified above. We understand that the market for lending products with features that contain greater amounts of credit risk than traditional lending products is growing and that there may be confusion in practice in applying current disclosure requirements to such products. Therefore, we agree with the issuance of the proposed FSP to clarify that nontraditional loans may represent a concentration of credit risk under FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* (FAS 107) and should, in some circumstances, be considered separately from traditional loan products when making disclosures about origination, holding, guaranteeing, servicing, or investing activities. We have the following recommendations to clarify the proposed FSP:

Scope of the Proposed FSP

The proposed FSP could be interpreted as addressing only nontraditional mortgage products. However, we believe that other nontraditional products consisting of unsecured loans, such as credit card receivables, could be within the scope of the proposed FSP if they have teaser interest rates that step-up to high interest rates or minimum payment options that result in negative amortization. We recommend the Board clarify whether the scope of the proposed FSP was intended to include both secured and unsecured loans. This could be accomplished by expanding paragraph 6 of the proposed FSP to include the clarification.

Definition of Nontraditional Loan Products

In paragraph 2 of the proposed FSP, the FASB defined nontraditional loan products as "those that expose the originator, holder, investor, guarantor, or servicer to higher risk than traditional products." The paragraph notes that features of such products that create higher risk may include "interest and/or principal repayments that are less than fully amortizing mortgages. . ." We understand that the interest and/or principal repayments on many nontraditional loan products may be greater than a fully amortizing mortgage in certain periods. For example, a loan with a teaser rate effective for two years

would require interest and/or principal repayments less than a fully amortizing mortgage in years 1 and 2, but would require interest and/or principal repayments greater than a fully amortizing mortgage for subsequent years. Therefore, we recommend that the phrase "in certain periods" be added after the term "repayments" in the third sentence of paragraph 2.

Accounting for Nontraditional Loan Products

We understand that diversity may exist in the accounting for nontraditional loan products, specifically related to the calculation of the effective yield rate used in amortizing loan fees and costs under FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91), because of the uncertainty in timing and amount of payments for many of these products. Paragraph 17 of the proposed FSP reminds preparers that FAS 91 requires the use of the interest method for recognizing interest income and that "when recognizing interest income on loans with interest rates that increase during the term of the loan . . . an entity shall apply the guidance in Statement 91, paragraph 18(a)."

However, the answer to Question 44 in the FASB Staff Implementation Guide on FAS 91 states that estimates must be made by the lender to apply the interest method for construction loans for which the timing and amount of payments are not specified. We believe that the answer to Question 44 would also apply to many nontraditional loan products, and that judgment must be used in applying the interest method for these products. Therefore, we recommend that the FSP explicitly state that judgment should be used in applying the FAS 91 model to nontraditional loan products, and refer to the answer to Question 44.

Other Comments

- Paragraph 13 of the proposed FSP states that nontraditional loan products would likely be considered a major category of loans to be disclosed under AICPA Statement of Position 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*. This implies that all nontraditional loan products should be grouped together as a major category of loans. The paragraph also states that under SEC Regulation S-X, Rule 9-03, any material loan category that has unusual risk concentration should be disclosed separately. We believe the amount and timing of the credit risk associated with nontraditional loan products can be different depending on the nature of the product. For example, the amount and timing of credit risk would be different for Interest-Only loans, Option Adjustable Rate Mortgages, and High Loan-To-Value loans due to differing reset periods, payment shocks, and interest recasting provisions. Further, the grouping of these loans for disclosure purposes may be inappropriate in certain circumstances under the SEC guidance. Therefore, we recommend that the sentence "Nontraditional loans likely would be considered a major category for some entities" be removed from the paragraph or clarified to indicate that different types of nontraditional loans may be considered a major category.
- Paragraph 16 refers to the fact that lenders should consider the risk factors of the specific loan product when assessing the fair value of loans that are classified as "held for sale." We recommend that the final FSP state that these risk factors should also be considered when determining fair value for purposes of FAS 107 disclosures and if the loans were the subject of hedging relationships.



We appreciate the opportunity to express our views on the Proposed FSP. If you have any questions regarding our comments, please contact Deidre Schiela (973-236-7222) or John Lawton (973-236-7449).

Sincerely,

PricewaterhouseCoopers LLP