October 22, 2010

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

Re: File Reference No. 1820-100

Dear Mr. Stoklosa:

Citigroup appreciates the opportunity to comment on the Exposure Draft, *Revenue Recognition* (the Exposure Draft or the ED). We support the objective of convergence with International Financial Reporting Standards. However, we would like to comment on the provisions related to customer loyalty programs. Specifically, we believe the provisions of the ED neither can nor should apply to financial institutions' reward programs, particularly credit card reward programs. Furthermore, the issues noted below for credit card loyalty programs also exist for other loyalty programs related to financial instruments that are offered by financial institutions (e.g., debit card programs).

Set forth below is a discussion of credit card loyalty programs followed by our comments on the ED's proposed accounting for loyalty programs.

Credit Card Loyalty Programs - Overview

Credit card loyalty programs generally award points for:

- Simply opening an account, i.e., with no required transaction
- Making purchases using a credit card
- Switching from one internal loyalty program to another
- Transferring account balances from another institution.

Occasionally, points can be awarded for:

- Referring new customers
- Paying balances.

Loyalty programs are developed to attract customers and encourage transactions based on different customers' interests. There are award programs focused on the purchase of airline tickets or hotel accommodations, cash-back rewards, automobile purchases, charitable contributions, contributions to school alumni associations and others. Different reward programs have different redemption rates and different costs per point.

Our understanding is that the accounting for rewards programs under U.S. GAAP by credit card issuers is mixed. We believe that many large U.S. credit card issuers record a liability and a reduction of revenue at grant date for the expected cost of the points to be redeemed (taking into account estimates for the redemption rate and the cost per point). Subsequent fulfillment results in a reduction of the liability and of cash.

The credit card business model is a volume-driven model, i.e., many small transactions (billions of transactions annually for larger credit card issuers), with a small profit margin, managed through a systemic process. The credit card rewards programs are likewise orchestrated. Large financial institutions account for the overwhelming majority of the credit card industry. Institutions develop estimated redemption rates with varying degrees of sophistication. Large institutions employ systemically fed databases that track point redemption by vintage (point award date), by program, to develop baseline redemption rates that are then adjusted by management, if necessary, to reflect internal and external trends as well as changes in program terms and conditions.

Credit card loyalty programs are constructed to give management tools to encourage desirable customer behavior. They have certain required levels of points that must be accumulated in order for customers to redeem and obtain products. They are intended to provide an incentive to customers to make future purchases. The business has great discretion in determining and changing various program criteria, including for awarding and redeeming points, the mix and amount of goods and services that points can be redeemed for, maintaining/closing/combining programs and selecting vendors to fulfill redemptions. As a result, these are dynamic programs actively managed through actions that ultimately change redemption rates and costs per point to achieve specific business objectives.

There are two primary characteristics of a credit card loyalty program that distinguish it from customer loyalty programs discussed in the ED:

a. *Credit card loyalty programs do not require a revenue transaction with the customer.*

Points can be awarded to credit card customers for simply opening up a new account, and the majority of these loyalty programs require no fee. In addition, points are typically awarded to customers for sales activity on their card accounts. These transactions in and of themselves may not result in revenue from the customers. Customers can pay their balance in full by the due date and thus not generate any interest revenue for the card issuer. While sales transactions do generate interchange revenue, this revenue is related to settling the receivable with the merchant bank through the credit card association and does not constitute revenue from the contract with the customer. The ED focuses the discussion of customer loyalty programs on those that stem from a revenue transaction with the customer, which are common for businesses that sell goods and non-financial services to customers, but are not applicable to credit card loyalty programs.

b. *Credit card issuers are not in the business of providing the merchandise that customers obtain by redeeming their points.*

Credit card issuers typically contract with third parties to fulfill point redemptions for their customer loyalty programs. Many credit card loyalty programs entail "menu" style redemption offerings where customers may choose to redeem points for various items including merchandise, gift cards, airline flights and cash, among other items. The credit card issuer is typically not in the business of providing such goods to customers. In other words, the credit card issuer is simply providing an inducement to promote customer loyalty. In the case of these loyalty programs, the business intent and the substance of the transaction is not to sell and profit from the goods and services for which points can be redeemed.

As such, the fulfillment of customer redemptions for credit card loyalty programs is not thought to be the completion of a revenue transaction with that customer. This type of arrangement is in contrast to other types of loyalty programs in which the provider is in the business of providing the goods or services that the points can be redeemed for, such as an airline carrier that provides miles to customers that can be redeemed for future flights or, as in Example 26 to the ED, for a vendor of goods that provides discounts on future purchases of those goods.

We believe these two distinguishing characteristics of credit card loyalty programs warrant a different treatment for such programs than what is required by the ED.

Comments on the ED's Proposed Accounting for Loyalty Programs

No "transaction price" to allocate

Credit card award transactions do not have a "transaction price" to allocate. Paragraph 35 of the ED defines "transaction price" as "the probability-weighted amount of consideration that an entity expects to receive from the customer in exchange for transferring goods or services." As discussed in the Overview above, the award transaction is not a performance obligation resulting from the sale of a product or service to the customer that has a transaction price with accompanying revenue. Whether points are awarded for the opening of a credit card account or for purchase activity on one's credit card account, these transactions by themselves do not give rise to a revenue transaction between the customer and the credit card issuer. The main source of potential revenue from the contract with the customer is the interest charge on the credit card loan; however, receivables under Topic 310 and financial instruments under Topic 825 are scoped out by paragraph 6 of the ED. Also, the customer may choose to pay his loan balance in full, in which case no interest revenue is earned by the card issuer.

Although there is a revenue component associated with customer purchase activity, i.e., the interchange, the interchange is a fee derived from the merchant. It results from a transaction between the merchant and the merchant bank, wherein the merchant pays a fee to the merchant bank for effectively factoring its credit card receivables to the merchant bank. The merchant bank shares a portion of that interchange fee with the credit card issuing bank through the association (e.g., Visa, MasterCard) settlement process. Based on the guidance included in paragraph 13 of the ED, combining the merchant agreement with the customer agreement is not appropriate, because their prices are not interdependent. Likewise, we do not believe it is appropriate to defer interest revenue as at the time of the customer purchase; at the time that the loyalty points are awarded, that interest revenue is not yet earned and might never be earned if the customer pays his loan balance in full. Therefore, there is no customer revenue to defer at the point the customer is awarded the loyalty point. As such, we do not believe that credit card loyalty programs fit the fact pattern described in the ED for customer loyalty programs.

Furthermore, under the allocation methodology prescribed by the ED, the “fair value” of a reward is fixed at the grant date. For a credit card issuer, one could argue that the cost of the point to the issuer is in fact the fair value. Even if one believes that a profit margin should be attributed to a credit card issuer reward point, because of the dynamic nature of the points as previously described, the fair value of a point could significantly change from grant date to redemption date. Therefore, we do not believe that the recognition of revenue on the basis proposed in the ED is appropriate for credit card issuer loyalty programs.

Scope

Paragraph 6 of the ED scopes out financial instruments and receivables, and no example is provided for a credit card loyalty program or a program with similar features (as described above). The ED should clarify whether such programs are excluded. If credit card loyalty programs are to be included in the scope of the ED, more guidance is needed on the "transaction price" issue noted above, and an example should be provided.

Operational Issues for Credit Card Loyalty Programs

We would also like to comment on the cost/benefit of the proposed accounting as it relates to credit card loyalty programs. As mentioned above, credit card loyalty programs are very dynamic in nature. Both redemption rates and costs per point can be and are changed by management actions as well as by conditions outside the control of management. Even if the ED were to mandate a specific revenue to reference as the transaction price for a credit card loyalty program, it would be difficult operationally to determine the amount of revenue to be deferred and later recognized at the loan level.

Credit card issuers have multiple loyalty programs. Within each of these programs, points are tracked by vintage. Different vintages within the same loyalty program are of different sizes, produce different multiple points per sale and have different redemption rates and cost per point dynamics. Given the multiple loyalty programs, the changes occurring within each loyalty program over time, and the different dynamics within different vintages of the same program, the proposed accounting would require systems revisions and multiple estimates to defer revenue, to reverse deferred revenue on redemption and to adjust the rate of reversal based on changing redemption rates.

Conclusion

Because of the nature of loyalty programs offered by financial institutions as described above, we believe that credit card loyalty programs and similar programs (such as debit card programs) should be scoped out of the ED. Overall we feel that in the case of these loyalty programs, the proposed accounting is misleading to readers of the financial statements, by requiring the recognition of revenue on products that the business does not sell and does not manage as such.

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We thank the Board for its consideration and would welcome the opportunity to further discuss our comments with the Board members and FASB staff. Please do not hesitate to contact me at (212) 559-7721.

Very truly yours,

Robert Traficanti

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