March 12, 2012

Ms. Susan Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2011-230

Dear Ms. Cosper:

Capital One Financial Corporation ("Capital One") is a diversified financial services company with over $200 billion in assets that offers a broad spectrum of banking products and financial services to consumers, small businesses, and commercial clients. We appreciate the opportunity to provide our comments on the revised Proposed Accounting Standards Update - Revenue from Contracts with Customers (the "proposed update" or "proposed guidance"), recently issued by the Financial Accounting Standards Board (FASB).

Since financial instruments are outside the scope of the proposed update, many of our activities are not impacted. However, we are concerned the scope of the proposed update is unclear as it relates to arrangements involving revenues and obligations derived from the same transaction but under separate contracts with unrelated parties, for example, credit card loyalty programs.

Most large financial institutions, including Capital One, offer credit card loyalty programs to attract customers and encourage purchase volume. Loyalty programs vary in terms of the rewards offered (e.g. cash back, travel "points", merchandise, charitable contributions, etc.), the rate at which reward points are awarded and minimum redemption thresholds. The types of credit cards that offer loyalty programs similarly vary, including: general usage credit cards issued under a payment network brand (e.g. MasterCard or Visa), general usage co-branded cards (e.g. co-branded with a department store or airline) and private-label cards which can only be used at a particular store or group of stores.

General usage credit cards transactions typically involve five parties: the cardholder, the issuing bank (i.e. the cardholder’s bank), the network (MasterCard or Visa), the merchant and the acquiring bank (i.e. the merchant’s bank). In a typical transaction, a cardholder purchases goods or services from a merchant using their credit card as payment. As part of the clearing and settlement process, the issuer pays the acquiring bank an amount equal to the transaction amount less the interchange fee and posts the transaction, in full, to the cardholder's account. The acquiring bank then pays the merchant an amount equal to the transaction amount less the merchant discount. The merchant discount takes into consideration the amount of the interchange fee. Interchange rates are established by the payment networks.
Capital One, like many credit card issuers, generally recognizes the cost of loyalty rewards as an offset to interchange income when the rewards are earned by the customer and records a corresponding rewards liability. The rewards liability is computed based on points earned to date that are expected to be redeemed and the average cost per point. The rewards liability is reduced as points are redeemed. We provide transparency on this net treatment to our users via disclosure in the notes to our financial statements.

Our interpretation of the proposed guidance is that credit card loyalty programs are outside the scope, but this conclusion requires subjective judgment that could be avoided through enhanced scope clarity. Paragraph 17 of the proposed guidance indicates an entity shall combine contracts and account for them as a single contract if they are entered into at or near the same time with the same customer (or related parties) and, among other criteria, the amount of consideration to be paid in one contract depends on the price or performance of the other contract. While the number of points awarded to a cardholder typically depends upon the transaction price between the cardholder and the merchant, combining the contract between the issuing bank and payment network with the contract between the issuing bank and cardholder appears inappropriate since the acquiring bank and cardholder are unrelated parties. We have a similar concern with paragraph 57 of the proposed update which indicates when determining the transaction price, “if an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, the entity shall recognize as a refund liability the amount of consideration that the entity reasonably expects to refund to the customer.” This statement implies that the consideration must be paid by the same customer to whom it will be refunded, which is not the case for interchange revenue (paid directly by the acquiring bank and ultimately by the merchant) and credit card loyalty rewards (refund due to the cardholder).

Paragraph 65 of the proposed update indicates consideration payable to a customer or to other parties that purchase the entity’s goods or services from the customer (i.e. the customer’s customer) should be considered when determining the transaction price. While it could be argued the merchant is ultimately a customer of the issuing bank and the cardholder is the merchant’s customer, thus the cardholder is the customer’s customer, this argument requires an entity to look through multiple contracts with multiple unrelated parties to arrive at such a conclusion. It is unclear whether this is the intent of the proposed update.

Assuming credit card loyalty programs are within the scope of the proposal via the payments to a “customer’s customer” guidance in paragraph 65, we are concerned the application of the proposed update results in increased complexity with no discernable benefit to financial statement users. The consideration contemplated in paragraph 65 includes “cash, credit or other items that the customer can apply against amounts owed”. As noted above, the types of rewards offered under credit card loyalty programs may include both cash and non-cash items. Application of the proposed guidance to cash rewards will result in recognition of interchange revenue net of the related rewards cost since such amounts will be reflected in the transaction price. However, non-cash rewards may result in gross recognition of interchange revenue since it appears the cost of non-cash rewards should not be reflected in the transaction price. While both types of rewards are economically similar to the card issuer, they may be accounted for differently simply because of the form of the reward. Furthermore, credit card loyalty programs frequently allow the cardholder to choose how they would like to redeem their rewards points. Therefore, a card issuer will have to estimate how
many customers will redeem their rewards for cash versus non-cash items and potentially recognize revenue differently based on this estimation.

Due to the nature of credit card loyalty programs and the concerns noted above, we believe these arrangements are outside the scope of the proposed update. However, further scope clarification is needed to ensure consistency in accounting treatment across the financial services industry. Current industry practice of directly offsetting interchange revenue by the estimated cost of loyalty rewards programs best reflects the economics of such programs and should, therefore, continue.

Sincerely,

Scott Blackley
Senior Vice President
Controller and Principal Accounting Officer
Capital One Financial Corporation