

November 14, 2008



LETTER OF COMMENT NO. 4

Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

File Reference No. 1620-100

Dear Mr. Golden:

Discover Financial Services ("Discover") appreciates the opportunity to comment on the Exposure Draft dated September 15, 2008, of the proposed amendments to FASB Interpretation No. 46R, Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51 ("Interpretation 46R"). Discover is one of the six largest U.S. credit card issuers as measured by receivables outstanding as of December 31, 2007. As of August 31, 2008, Discover had approximately \$48 billion in total credit card receivables outstanding, including \$27 billion in securitized receivables that we had originated and continue to service. Discover conducts its credit card issuing business through its subsidiary, Discover Bank, a Delaware state-chartered bank.

Discover has been active in credit card securitization since 1990. Since 1993, when we began using a master trust structure, we have securitized approximately \$82 billion in credit card receivables through more than 100 separate transactions. Our structure was expanded to include a note issuance trust in 2007. Our securitizations involve transfers of all of our right, title and interest in specified credit card receivables to a credit card master trust, and the transfer of a collateral certificate representing an interest in that master trust to a note issuance trust. Today both trusts are recognized as qualifying special purpose entities ("QSPEs"). These trusts are variable interest entities ("VIEs") that would likely have to be consolidated by Discover Bank under the proposed amendments to Interpretation 46R and FASB Statement No. 140.

We appreciate the Board's ongoing efforts to reconsider the appropriate accounting for transfers of financial assets, which have led to certain of the proposed amendments to this standard. We support the Board's objective, as stated in the Exposure Draft, to "improve financial reporting by enterprises involved with variable interest entities." However, we believe some of the Board's proposals will produce results contrary to that objective.

Our specific comments on the Exposure Draft are outlined below.

Initial measurement of assets

Under Interpretation 46R, the assets of the VIE should be recorded in initial consolidation at their transition date fair values, except for assets transferred to a VIE by the primary beneficiary "at, after, or shortly before" the date that the transferor became the primary beneficiary. With the application of fair value measurement upon initial consolidation for currently securitized loan receivables, and measurement at par less a reserve for loan losses applied to unsecuritized receivables and to all future receivables generated, whether securitized or not, the proposed transition measurement approach introduces a mixed-attribute model which will distort financial performance and will result in significant comparability issues. Depending on the borrower payment rates experienced by an issuer, the adverse effects of measuring the securitized receivables at fair value will linger in the comparative financial statement presentations across multiple fiscal quarters and possibly multiple years. This would hinder both interperiod comparisons of a single enterprise as well as performance comparisons of different enterprises – effects that are contrary to the Board's objective of improving financial reporting.

For a revolving-period securitization, existing securitized receivables will be reported at their transition date fair value, resulting in the recognition of either a discount or premium to par, as appropriate. Assets subsequently originated, whether transferred into the securitization vehicle or not, will be reported at originated cost less an allowance for loan losses. Because the receivables that are marked at fair value have no associated loan loss reserve, charges to earnings will be needed to establish additional reserves as the fair-valued receivables are paid down and new receivables - which will require associated reserves - are generated. Growth of the loan loss reserve will continue until all of the fair-valued receivables are repaid. The growth in the size of the loan loss reserve relative to the total portfolio of receivables could incorrectly suggest deterioration in the credit quality of the assets, even if the credit quality of the loan portfolio is stable or improving over that time. The resulting financial presentation will be misleading to readers of the financial statements. Some credit card issuers have concluded that the fair value of the securitized receivables is in excess of their par value, as evidenced by the value of the associated interest-only strip receivable. In the event that a premium does need to be recorded on the receivables to reflect their fair value, amortization of this premium will create another charge against earnings as those receivables are paid off. We believe this will distort the financial performance of the loan portfolio.

The use of fair value measurement for the newly consolidated assets from a credit card master trust will diminish the quality of financial reporting rather than improve it. We believe a more appropriate transition approach for credit card master trusts and similar structures is to record the newly consolidated assets using the amounts at which they would have been measured had the transferor always been required to consolidate the trust (i.e. their carrying amounts). We use the term *carrying amounts* here and elsewhere in this letter as that term is used in the existing transition guidance contained in paragraph 37 of Interpretation 46R.

Initial measurement of liabilities

Requiring the securitized debt to be initially measured at fair value will, as a result of the current market disruptions and the widening in credit spreads which has occurred over the past year, result in this debt being measured at significantly less than par. Forcing issuers to now fair value

these liabilities will result in significant charges to earnings over their remaining terms as the discount on these securities is amortized. Those who would not otherwise elect to fair value such instruments would point out that fair-valuing the debt will also significantly understate the actual liability with respect to that debt – which is an obligation to pay the face amount of the debt, rather than its fair value – and will make the reporting enterprise appear to be less leveraged than it is. The overall effect will be to significantly understate liabilities. In addition, requiring the use of fair value for securitized debt will result in the same mixed-attribute model concerns for these liabilities as for the securitized assets since future debt issued through the securitization structure, as well as any other debt issued by the transferor, will be measured at amortized cost. Given that 5- and 7-year terms are common among outstanding credit card asset-backed securities, comparability issues could remain in financial statements for years to come. We do not believe that fair valuing the liability is consistent with the Board's transparency objective.

We believe that initially recognizing both the assets and liabilities of a credit card master trust on the transferor's balance sheet at their *carrying amounts* – as that term is currently applied in paragraph 37 of Interpretation 46R – is the best transition approach for bringing these securitizations on balance sheet. This approach minimizes comparability concerns by avoiding the use of a mixed-attribute model and is consistent with our understanding of the Board's view that the assets and liabilities of these entities should never have been excluded from the transferor's balance sheet.

Transition measurement of assets transferred but not derecognized

In the typical credit card master trust structure, a minimum retained interest in the pool of trust receivables (the "seller's interest") is required under the securitization agreement to be maintained by the transferor at all times. Credit card securitizers typically report the seller's interest on their balance sheet within loans receivable with an associated reserve for loan losses. We are concerned that the transition guidance under paragraph 21(a) would change the measurement of those assets to fair value. We believe assets that have been transferred to the VIE but not derecognized from the transferor's balance sheet – because neither a sale nor a secured borrowing has resulted from that transfer – should not be assigned a different value upon consolidation of the trust under Interpretation 46R. Such assets should be subject to the fair value exception in paragraph 21(a) for assets transferred "at, after, or shortly before the date the entity became the primary beneficiary." Accordingly, we request that the Board clarify the application of paragraph 21(a) in this context. However, this clarification will not be needed if the Board decides to apply transition guidance similar to that which it currently provides in paragraph 37 of Interpretation 46R to these types of structures, as we have suggested above.

Transition for revolving-period securitizations

Paragraph 21(a) of Interpretation 46R, as amended, requires the primary beneficiary to initially measure assets and liabilities that it has transferred to the VIE "at, after, or shortly before the date that the entity became the primary beneficiary at the same amounts at which the assets and liabilities would have been measured if they had not been transferred." The proposed standard is silent as to whether this transition provision should be applied to the continuous transfers of assets that occur in a revolving-period securitization.

During the revolving period of a credit card securitization, new receivables are transferred into the credit card master trust on an almost daily basis. While these transfers on their own are neither sales nor secured borrowings, ¹ they either replace receivables that were recognized as sold to the master trust and were subsequently collected, or they increase the seller's interest (which for many issuers is recorded as loans receivable with an associated loan loss reserve). Upon consolidation of the master trust, *all* trust receivables will presumably be recorded at their fair value under the general transition provisions of paragraph 21(a). Clarification is needed concerning whether the provision for transfers made "shortly before" the date that the entity becomes the primary beneficiary applies to recent transfers into revolving-period securitization structures, and if so, how the term "shortly before" should be defined in this context. This clarification will not be needed if the Board decides to apply transition guidance similar to that which it currently provides in paragraph 37 of Interpretation 46R to these types of structures.

Maximizing comparability and usefulness of financial information

In Statement No. 154, Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3, the Board identified retrospective application as the best transition method where a new principle does not otherwise require the use of a different method. In selecting that approach, the Board noted that applying a different accounting principle to prior accounting periods as if that principle had always been used results in greater consistency and thereby enhances interperiod comparability of financial information. The Board stated that "improved consistency enhances the usefulness of the financial statements, especially by facilitating analysis and understanding of comparative accounting data."²

Because historical cost will be the measurement attribute applied to assets transferred and debt issued in future credit card securitization transactions, application of a transition method that uses that same measurement attribute would maximize consistency across periods, a key objective cited by the Board in Statement 154. The Board further noted in that standard that "if it is impracticable for an entity to determine the period-specific effects of a change in accounting principle for all prior periods, the cumulative effect of the change to the new accounting principle should be applied to the carrying amounts of assets and liabilities as of the beginning of the earliest period to which the new principle is applied, and an offsetting adjustment should be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period. The Board believes that method maximizes consistency across accounting periods for which the necessary information is available, and it also provides better information than a cumulative-effect adjustment in the period of change." The recognition of an adjustment to beginning retained earnings in the period of adoption is consistent with what the Board has proposed in paragraph 6 of the amended Interpretation 46R; however, the introduction of fair value in that transition will undermine the Board's objective of promoting consistency across periods.

To maximize comparability among reporting periods and between enterprises, we recommend that transition for credit card securitizations involve transition-date measurement of the trust

¹ As discussed in the current version of Statement 140, paragraphs 79 and 195.

² Statement 154, paragraph B7.

³ Statement 154, paragraph B11.

assets and liabilities as if the QSPE had always been subject to consolidation by the transferor. This approach would recognize the *carrying amounts* of these assets and liabilities consistent with the existing transition method outlined in paragraph 37 of Interpretation 46R. The Board does not explain the rationale behind the proposed discontinuation of that transition method and we are aware of no compelling reason why that guidance should be abandoned.

If you would like to discuss any of the comments made in this letter, please contact Kevin Killips, Senior Vice President, Controller and Chief Accounting Officer of Discover Financial Services at 224-405-1101.

Sincerely,

Roy A. Guthrie Executive Vice President and Chief Financial Officer