



R. Scott Blackley, *Controller and  
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May 15, 2013

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

Re: File Reference No. 2013-220

Dear Ms. Cospier:

Capital One Financial Corporation ("Capital One") is a diversified financial services company with over \$300 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 Proposed Accounting Standards Update – *Recognition and Measurement of Financial Assets and Financial Liabilities* (the "Proposed Update" or the "Proposal"), recently issued by the Financial Accounting Standards Board ("FASB").

As a diversified financial services company, Capital One appreciates the FASB's goal of developing a consistent, comprehensive and less complex framework for classifying and measuring financial instruments. We agree that presenting and measuring financial assets based on the way in which the entity expects to benefit from the cash flows embedded therein provides financial statement users with useful information. However, based on the exceptionally restrictive nature of the proposed cash flow characteristics and business model assessment tests, we do not believe the FASB has achieved its objective, nor do we believe financial statement users will be presented with more decision useful information.

We are not aware of any inherent concerns, beyond complexity, with the existing classification and measurement guidance. Moreover, we believe the existing guidance is well understood by financial statement users and provides them with decision-useful information. Therefore, we urge the FASB to reconsider the Proposal as it does not improve financial reporting. We suggest that the FASB consider retaining the existing guidance.

#### *Cash Flow Characteristics Test*

Feedback provided in response to the 2010 Proposed Accounting Standard Update - *Accounting for Financial and Revisions to the Accounting for Derivative Instruments and Hedging Activities* ("2010 Proposal"), indicated most stakeholders supported retaining the use of amortized cost measurement for most loans.<sup>1</sup> We understand the FASB intended the Proposed Update to align with the 2010 Proposal feedback and achieve amortized cost

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<sup>1</sup> Proposal, Basis for Conclusions paragraph 19

measurement for most loans, unless the contractual cash flows characteristics were more than insignificantly variable in nature due to contractual terms that change the economic relationship between principal and interest (e.g. leverage, interest rate reset features, contingent payments, etc.) Based on our assessment of applying the cash flow characteristics test to simple, "plain vanilla" loans, many common loan arrangements will not be considered to give rise to solely payments of principal and interest resulting in measurement at fair value through net income. One example of a "plain vanilla" loan failing the cash flow characteristics test is a loan acquired at a significant premium or discount. Due to the definition of principal as "the amount transferred by the holder at initial recognition", all prepayable instruments (a very common contractual term for mortgage and auto loans) would fail the cash flow characteristics test because the prepayable amount (par) would not substantially represent unpaid amounts of principal and interest (par plus or minus the significant premium or discount).

An additional example of a "plain vanilla" loan that would fail the cash flow characteristics test can be found within credit card portfolios such as a loan with rewards to customers and/or those associated with a merchant partner. One interpretation of the Proposal is that if the cash flow characteristics test is performed at the contract level, reward programs that offer cash-back or other balance-reducing rewards (typically equivalent to 1-2% of purchase volume) fail the cash flow characteristics test since the repayment amount could be viewed to be 98-99% of the principal amount outstanding. If the cash flow characteristics test is performed at an economic level, including all parties between whom cash flows are contractually paid for a single transaction, the inclusion of merchant interchange or partnership revenue sharing would cause the repayment amount to be greater than the principal amount and, thus, not be considered solely payments of principal and interest.

Beyond simple types of loans that we believe will fail the cash flow characteristics test; we believe common fees based on the occurrence of future events (i.e. contingent cash flows) may similarly fail the cash flow characteristics test. For example, many loans impose a late fee if the borrower misses a contractually-required payment. Late fees for consumer loans are often set as fixed dollar amounts, not based on a percentage of the total principal balance due. While there is clearly an increase in credit risk when a borrower misses a contractual payment, it is unclear whether the fee imposed would be considered solely related to credit risk (i.e. a component of interest) since the fee is not ratably linked to the principal amount outstanding.

#### *Business Model Test*

We are equally concerned that the proposed business model test, particularly the limited situations in which sales from the amortized cost measurement category are permitted, will cause a significant number of loans to be classified and measured at something other than amortized cost. For example, banks routinely enter into partnership agreements with merchants for terms of 5 – 10 years to originate credit card loans to a mutual group of customers. When the agreement expires, the merchant often has the right to repurchase the related loans, arrange for the sale of the loans to a third party or renew the existing agreement. If one of the partners chooses not to renew the agreement and thus, the card issuing bank sells the loans, under the Proposal the sale taints the remaining loans classified and measured at amortized cost thereby calling into question the entity's assertion that it holds financial assets to collect contractual cash flows. We do not believe the reclassification

guidance sufficiently addresses these situations since they occur more than “very infrequently”.

Likewise, we are concerned with applying the business model test to syndicated commercial loans – large loans that a single creditor originates and funds with the intent to sell portions of the loan to other creditors shortly thereafter. Applying the business model test as currently proposed, the entire loan would be measured and classified in the fair value through other comprehensive income category, including the portion the originating lender intends to retain and hold for the collection of contractual cash flows, since reclassifications may only occur when there is a change in business model.

We appreciate the intent of the guidance regarding pools of similar financial assets whereby upon recognition, if an entity has not yet identified specific assets it will subsequently sell versus those it will hold and manage for the collection of contractual cash flows, the entity may classify a percentage of the pool into one of the three classification categories. However, we do not believe such a model is operational. Without specifically identifying which instruments the entity intends to sell, the percentages used will be estimates. If the entity does not complete the subsequent sale within an extremely short period of time or the initial allocation percentages are not precisely correct, subsequent measurement will require reclassifications from one category to another or result in sales out of the amortized cost category. Neither of these outcomes is consistent with the reclassification or amortized cost sales guidance provided in the Proposal.

#### *Presentation & Disclosure*

We disagree with several of the proposed changes to the presentation and disclosure of financial instruments. First, we do not believe parenthetically presenting the fair value of financial instruments measured at amortized cost (other than short term receivables or payables or demand deposit liabilities) on the face of the balance sheet provides financial statement users with better information than what is already presented in the notes to the financial statements. Rather, we anticipate that the parenthetical information will likely lead to confusion rather than clarity. Second, we disagree with disclosing quantitative unobservable input information used to determine amortized cost instruments’ fair value categorized within Level 3 of the fair value hierarchy. Providing such information for instruments that are regularly measured at fair value (as required today) is appropriate since those assumptions directly affect the reported results of the entity. Providing the same information for amortized cost instruments diminishes the relevance of the existing disclosures and is not consistent with the objective of the FASB’s on-going Disclosure Framework project to improve the effectiveness of disclosures by clearly communicating the information that is most important to users of each entity’s financial statements.

Our third concern pertains to the proposed disclosures of core deposit liabilities’ “implied weighted-average maturity” and “estimated all-in-cost-to-service rate”. Proprietary deposit models are developed for each of the product classes and customer types (e.g., demand deposits, money market deposits, negotiable order of withdrawal accounts, savings accounts; consumer, commercial, internet, and branch) These models are developed or calibrated based upon empirical data and are unique to the institution. Providing detailed product-level duration (i.e., implied weighted-average maturity) information would disclose information that is critical to our balance sheet management strategies. Likewise, we believe disclosing

information regarding our estimated deposit servicing rate would competitively disadvantage our entity.

We would also like to put forth that our analysis of the Proposed Update, while thorough enough to make the aforementioned observations, is not as comprehensive as it would have been had we had ample time to review all aspects of the Proposed Update. For example, a comprehensive review of the recently released black-lined version of the Accounting Standards Codification Topics impacted by the Proposed Update could yield additional significant concerns. Like many preparers, we have been busy with year-end and first quarter financial reporting requirements while also evaluating other significant proposals recently exposed by the FASB. Consequently, we may have additional comments at a later date.

For the reasons described above, we do not support the Proposed Update. We believe the proposal will require a significant amount of time and work to implement and, more importantly, will provide financial statement users with *less* decision-useful information. Again, we suggest that the FASB consider retaining the existing guidance.

Sincerely,

/s/ R. Scott Blackley

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