



Susan R. McFarland
Executive Vice President and
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April 1, 2011

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

Re: File Reference No. 2011-150

Dear Ms. Cosper:

Capital One Financial Corporation (“Capital One”) is a diversified financial services company with over \$197 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 comments on the Supplementary Document—*Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Impairment* (the “Supplementary Document”), recently issued by the Financial Accounting Standards Board (the “FASB”).

We believe that certain aspects of the credit impairment model contained in the Supplementary Document (the “joint model”) represent improvements over the credit impairment model (the “original model”) contained in the Proposed Accounting Standards Update, Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815), *Accounting for Financial Instruments and Revisions to Accounting for Derivative Instruments and Hedging Activities* (the “Proposed Update”), as well as current practice. However, we have also noted numerous concerns with the joint model in addition to the FASB’s approach to achieving the objective of the Proposed Update in the area of credit impairment.

We have structured this comment letter into four sections as follows: 1) **What We Support** provides our views on the aspects of the joint model as well as other activities related to the credit impairment subproject that, with proper development, have the potential to allow the FASB to achieve its objective of the Proposed Update; 2) **Our Concerns** discusses aspects of the joint model and the FASB’s approach to the credit impairment subproject that appear problematic to achieving the objective of the Proposed Update; 3) **Our Proposal** presents a proposed approach that attempts to leverage the aspects of the joint model that we support while ameliorating our concerns; and 4) **Responses to Questions for Respondents**.

What We Support

- **One impairment model for all loans** – We do not believe that the differences between originated assets and purchased assets are significant enough to justify two different accounting models. Based on our experience with accounting and reporting under ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (“ASC 310-30”), we believe that users of financial statements do not broadly understand ASC 310-30 and are frustrated with the challenges it creates in assessing loan performance.

- **Economic factors** – We believe that a credit impairment model should consider forward-looking economic factors when determining the amount of credit impairment. Such a view of credit will accomplish the FASB’s goal of providing an “early warning” or more rapid recognition of losses, while inhibiting pro-cyclicality.
- **Foreseeable future** – We believe that losses beyond a reasonable forecasted period under a “life of loan” concept will be difficult to estimate with any amount of certainty and will create earnings volatility attributable to measurement uncertainty rather than actual economic events. Current systems and processes can support a foreseeable future approach and we believe that users will find an allowance based on this approach as most decision-useful.
- **Expected loss model** – We believe that an entity should not need to identify a triggering event to record an allowance that represents what it can reliably forecast for the foreseeable future.
- **Balance sheet approach** – We believe that the allowance recorded on an entity’s balance sheet should always be sufficient to cover expected losses forecasted over the foreseeable future.
- **Transparency for users** – We are concerned that users will not understand what the time-proportional allocation method (the “TPA method”) attempts to present, the fact that credit metrics may be driven by different methods period-to-period, and the lack of consistency amongst entities in the same industry which may be using different methods during the same periods.
- **No discounting** – We believe that discounting projected losses creates complexity in making a credit impairment model operational and in communicating credit metrics to users.
- **Coordination between standard-setters and regulators (US and foreign)** – We encourage the FASB to consider the views of regulators of the various jurisdictions throughout the world to assess how the principles of the joint model will be enforced. If the regulators of certain jurisdictions enforce different and/or contradictory definitions of concepts like “foreseeable future,” diversity in practice will develop.
- **One high quality model for all entities** – We recognize the importance of convergence and the role that this factor played in the development of the joint model. However, we believe that creating a high quality standard is of greater importance than reaching convergence out of compromise.
- **Field visits and testing** – Given constraints on time and lack of clear understanding into the application of principles like “foreseeable future” and the “good book” versus “bad book” split, we believe that it will be beneficial that preparers, users, and regulators representing diverse constituencies participate in field visits and field testing.

Our Concerns

- **One impairment model for all financial assets** – We do not believe that there is a “one size fits all” approach to credit impairment as not all financial instruments are evaluated for impairment in the same fashion due to differences in the characteristics of these instruments.

We are not aware of pervasive criticism pertaining to the current other than temporary impairment (“OTTI”) models for debt and equity securities and question the necessity of replacing these models.

- **Income statement approach** – All income statement based approaches of which we are aware, including the TPA method contained within the joint model, do not provide for proper matching of revenues to when losses actually occur and are not consistent with an effective interest method of revenue recognition where the amount of income recognized is in proportion to the principal balance as opposed to being recognized on a straight-line basis.
- **Lack of clarity on proposed principles** – We struggle with the lack of a robust definition of the principles of “foreseeable future” and the “good book” versus “bad book” split and need additional guidance to fully understand the joint model.
- **Lack of attention to loans not in open pools and other aspects of loan accounting** – We question the value of exposing such narrowly defined elements of the credit impairment subproject (i.e., a scope that is only applicable to open pools). While we note that the FASB is seeking feedback on how the joint model would apply to closed pools, individual instruments, and other elements, it may have been beneficial to apply the FASB’s effective due process to these other elements prior to exposing just one. Having an understanding of the FASB’s views on the methods for measuring credit losses, interest income recognition, impairment for loans modified in troubled debt restructurings (“TDRs”), the concept of ‘non-accrual’ as it relates to interest income recognition, and presentation and disclosure would also have been helpful in our evaluation of the Supplementary Document.
- **Lack of time to test the proposal** – We, like many preparers subject to year-end public reporting requirements, effectively had one month to assess the joint model and much of this time was spent attempting to interpret the proposed principles. We encourage the FASB to both take additional time to fully develop the proposed principles it exposes and allow preparers enough time test these principles before voting on a final credit impairment model.
- **Operational complexity** – We are not aware of existing loan accounting and credit systems capable of supporting the joint model. Further, by requiring entities to assess credit impairment for the “good book” under both a foreseeable future approach and the TPA method, entities must perform two separate processes. Finally, the annuity approach and discounting concepts embedded in the TPA model appear overly complex. Consequently, we believe it is of utmost importance that the FASB complete a thorough cost-benefit analysis of the joint model as part of field testing.

Our Proposed Model

- **We support an impairment model that would always recognize expected credit losses for the foreseeable future period at the reporting date** – As noted above, we believe that losses beyond a reasonable forecasted period will be difficult to predict with any amount of certainty. Our understanding of feedback collected by the FASB from users who opposed recognition of a lifetime credit loss for all classes of financial assets is that these users were primarily concerned about the reliability of lifetime credit loss estimates. We believe that an approach that requires immediate recognition of credit losses expected in the foreseeable future sufficiently addresses the problems with the current impairment guidance and that the TPA method component of the model provides no incremental benefit. In fact, subjecting

these already subjective loss amounts to the TPA method will result in presenting less transparent information to users regarding the adequacy of the allowance. Rather, we believe that users would be better served by having preparers focus on deriving an accurate allowance representing all credit losses for the foreseeable future by product which we project to be between 2 to 3 years. We note the criticality of field testing this approach and aligning expectations of reasonable foreseeable future periods with regulators' plans to enforce these periods such that consistency is gained from the date of adoption.

- **Recognizing “foreseeable future” losses could eliminate the need for the “good book”/“bad book” framework** – We believe that if the foreseeable future period is long enough, then there is no need for “good book” vs. “bad book” as lifetime expected credit losses on what would effectively be the “bad book” would be captured in the foreseeable future period. The removal of the probable threshold that exists under the current incurred loss model will allow the “good book” to also be appropriately captured in the foreseeable future period. It should also be noted that this approach can be applied by banks and other organizations without significant systems and process changes and does not pose significant operational challenges in application for constituents.
- **Further enhanced transparency by not discounting** – We believe that the most transparent approach for users is to present the allowance in an undiscounted fashion. This approach is also the most operational for preparers.
- **Apply to all loans, but not investment securities** – As noted above, we believe that not all financial instruments are evaluated for impairment in the same fashion due to differences in the characteristics of these instruments and we are not aware of pervasive criticism pertaining to the current OTTI models for debt and equity securities. Thus, we advocate retaining these currently well-understood models. We believe that the FASB should focus its attention on improving upon the current incurred loss approach and eliminating the differences between accounting for acquired vs. originated loans.

Capital One proposes the following alternative accounting model for purchased loans, which we believe is superior to current practice and the method presented in the Supplementary Document. We support the basic principles that were previously followed under SFAS No. 141, *Business Combinations* (“SFAS 141”), and SEC Staff Accounting Bulletin Topic 2.A.5 (commonly referred to as “SAB 61”), *Adjustments to Allowances for Loan Losses in Connection with Business Combinations*, allowing an acquirer to carry over the acquiree’s allowance. This would allow all loans, whether originated or acquired, to be accounted for under a single, simple impairment and income recognition model. We believe that acquired loans should be initially recognized at fair value with credit loss considerations being reflected in the allowance. Presumably, the acquiree’s allowance would approximate the allowance determined to be necessary by the acquirer; however, we do support providing flexibility to the acquirer to adjust the acquiree’s existing allowance to reflect the acquirer’s assumptions and allowance methodologies. We realize that this issue was debated during the development of ASC 805, *Business Combinations*, and we acknowledge the theoretical merits against establishment of an allowance at acquisition as presented in paragraph BC197 of the Proposed Update. However, we believe that practical impacts to users must be given due consideration. In our experience, users find that consistently accounting for credit losses on loans through the use of the allowance provides more understandable and decision-useful information. To the extent that user feedback gathered by the FASB indicates utility in retaining aspects of current practice for certain situations (e.g., acquiring assets at a deep

discount due to credit), we would not object if preparers were allowed a choice between methods.

The existence of a single impairment model for all loans will eliminate the need for TDR accounting and disclosure requirements. We believe that users are primarily concerned with the overall adequacy of the allowance for credit losses and would prefer greater visibility into all modifications. Accordingly, we believe separate disclosure of a subset of loan modifications designated as TDRs is confusing and provides users with only marginally useful information to evaluate the adequacy of the impairment allowance. Thus, the development of a consistent disclosure principle for all modifications would appear to be a beneficial path for the FASB to follow.

We recognize that the proposal model described above does not contain the income statement approach embodied by the TPA method which was considered a key factor in allowing the FASB and IASB to reach agreement on the joint model. Being fully supportive of convergence, we would not object to a revised joint model in which entities are permitted to assess which method employed by the joint model (the foreseeable future method vs. the TPA method) will yield the larger allowance amount upon adoption of a new credit impairment standard. The assessment would be performed at the product level and would result in a policy election which would be disclosed by product type. Further, entities would not be required to calculate and disclose the amount of credit impairment under the method which yielded the lower allowance amount. Finally, entities would only be required to reassess the policy election if a triggering event occurred that would be probable of changing the original assessment.

Responses to Questions for Respondents

Question 1: Do you believe the proposed approach for recognition of impairment described in this supplementary document deals with this weakness (i.e. delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

While we believe that moving from an incurred loss model to an expected loss model addresses the current practice weakness of delayed recognition of expected credit losses, we believe that the joint model should be revised to remove the requirement to follow the TPA method for the reasons previously cited above.

Question 2: Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

The proposed approach would be at least as operational for closed loan portfolios and certain other instruments as it would be for open pools of loans, however we have concerns with the operational aspects of the TPA method. We have not fully assessed the ramifications of the proposed approach to debt instruments other than loans as we are not aware of consistent industry practice of evaluating these instruments for impairment on an open pool basis.

Question 3: Do you agree that for financial assets in the ‘good book’ it is appropriate to recognize the impairment allowance using the proposed approach described above? Why or why not?

No, we believe that if the foreseeable future is long enough then there is no need for “good book” vs. “bad book” as lifetime expected credit losses on what would effectively be the “bad book” would be captured in the foreseeable future period. The removal of the probable threshold that exists under the current incurred loss model will allow the “good book” to also be appropriately captured in the foreseeable future period.

Question 4: Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

No, preparers will need better refinement of the “good book” vs. “bad book” principles, the foreseeable future method will almost always produce the higher allowance (particularly in a steady state environment), existing systems cannot handle the TPA method, and there is the basic challenge of estimating lifetime losses.

Question 5: Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

No, lack of consistency would develop and the TPA method does not adequately match losses with income. We would modify the proposal as noted in the “Our Proposed Model” section above.

Question 6: Is the proposed requirement to differentiate between the two groups (i.e. ‘good book’ and ‘bad book’) for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

No, there is a lack of clarity within the principles in the Supplementary Document which will lead to diversity in practice. We believe that field testing with preparers, regulators, and users will be instrumental to developing the proposed requirement to differentiate. We also note that under a pure foreseeable future approach, such differentiation may not be necessary.

Question 7: Is the proposed requirement to differentiate between the two groups (i.e. ‘good book’ and ‘bad book’) for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

No, loan accounting systems may not be able to handle the proposed requirement to differentiate and a solely management approach is subject to too much second-guessing. We believe that field testing with preparers, regulators, and users will be instrumental to developing the proposed requirement to differentiate. We also note that under a pure foreseeable future approach, such differentiation may not be necessary.

Question 8: Do you agree with the proposed requirement to differentiate between the two groups (i.e. ‘good book’ and ‘bad book’) for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

No, we believe that if the foreseeable future is long enough then there is no need for “good book” vs. “bad book” as lifetime expected credit losses on what would effectively be the “bad book” would be captured in the foreseeable future period. The removal of the probable threshold that exists under the current incurred loss model will allow the “good book” to also be appropriately captured in the foreseeable future period.

Question 9: The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this proposed model. Specifically, on the following issues:

- a) Do you agree with the proposal to require a floor for the impairment allowance related to the ‘good book’? Why or why not?

No, it is our understanding of the responses to the Proposed Update and the FASB’s outreach activities that entities are able to make reliable estimates of macroeconomic events and expected conditions over a period greater than twelve months. The floor is only necessary if the TPA method is employed.

- b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the ‘good book’ only in circumstances in which there is evidence of an early loss pattern?

We believe that many product types exhibit early loss patterns and we believe that the foreseeable future method would accurately capture these losses.

- c) If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?

We believe that the foreseeable future method would accurately capture these losses.

- d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?

Yes, the length of the foreseeable future period would be driven by the reliability of forecasted data which is subject to changing economic conditions. Still, this period would almost always be expected to be in excess of twelve months and should be disclosed.

- e) Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.

Yes, we project that the foreseeable future period will typically be between 2 to 3 years. We are happy to participate in field testing to provide further details.

- f) If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a ‘ceiling’ should be established for determining the amount of credit impairment to be recognized under the ‘floor’ requirement

(for example, no more than three years after an entity's reporting date)? If so, please provide data and/or reasons to support your response.

No, the economic cycle should dictate the length of the foreseeable future period. We are happy to participate in field testing to provide further details.

Question 10: Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2(a)(i) [the time-proportional expected credit losses]? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.

We believe that the foreseeable future period will almost always exceed the time-proportional amount. We are happy to participate in field testing to provide further details.

Question 11: The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the proposed approach described in paragraph B8(a)? Why or why not?

Yes, we believe that an undiscounted estimate is more operational and easier to understand.

b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

While we do not support discounting, we believe that an approach utilizing discounting would have the strongest theoretical basis if it required the use of the current effective interest rate on the loan.

Question 12: Would you prefer the IASB's approach for open portfolios of financial assets measured at amortized cost to the common proposal in this document? Why or why not? If you would not prefer this specific approach, do you prefer the general concept of the IASB's approach (i.e. to recognize expected credit losses over the life of the assets)? Why or why not?

No, the IASB's approach appears to be an income statement approach that does not appropriately match expense with revenue, is too complex to understand, and is not operational.

Question 13: Would you prefer the FASB's approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific approach, do you prefer the general concept of the FASB's approach (i.e. to recognize currently credit losses expected to occur in the foreseeable future)? Why or why not?

Yes, we prefer the FASB's approach as noted in the "Our Proposed Model" section above.

If you have any questions about our comments, please contact Pam Koch at (804) 284-0152.

Sincerely,

A handwritten signature in black ink, appearing to read "Susan McFarland". The signature is written in a cursive, flowing style.

Susan McFarland
Executive Vice President and Principal Accounting Officer