



March 20, 2012

Ms. Leslie Seidman
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Financial Accounting Standards Board
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P.O. Box 5116
Norwalk, CT 06856-05116

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
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Re: FASB File Reference No. 2011-230, Proposed ASU (Revised), *Revenue Recognition* (Topic 605): *Revenue from Contracts with Customers*; IASB ED/2011/6, Exposure Draft, *Revenue from Contracts with Customers* (together, the “Proposal”)

Dear Ms. Seidman and Mr. Hoogervorst:

The Clearing House Association L.L.C. (“The Clearing House”), an association of major commercial banks,¹ appreciates the opportunity to comment on the Proposal.

Executive Summary

The Clearing House supports the efforts of the Financial Accounting Standards Board (the “FASB”) and the International Accounting Standards Board (the “IASB”, and together with the FASB, the “Boards”) to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. generally accepted accounting principles (“U.S. GAAP”) and International Financial Reporting Standards (“IFRS”) that would remove inconsistencies and

¹ Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world’s largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House’s web page at www.theclearinghouse.org.

improve the comparability of revenue recognition across entities, industries, jurisdictions and capital markets and also provide more useful information to users of financial statements.² Although financial instruments are excluded from the scope of this Proposal, our member banks have a number of revenue streams from other sources that may be impacted by the Proposal and therefore we have identified the issues herein that we believe are relevant to the commercial banking industry. Due to the lack of implementation guidance related to the financial services industry, we are concerned that there could be unintended consequences when the Proposal is applied in practice. For example, as further described below, The Clearing House is unable to appreciate how, or even whether, to apply the Proposal to credit card reward programs, which represent a significant business activity for many of our member banks. Accordingly, we encourage the Boards to perform further outreach and field-testing with our member banks and The Clearing House respectfully requests an opportunity to meet with the Boards before the Proposal is finalized.

Specifically, The Clearing House:

- *recommends* that the scope of the Proposal be clarified to explicitly exclude all financial instruments;
- *recommends* that the netting of underwriting revenues and expenses be continued, as this presentation is most relevant and useful to our industry;
- *requests* a meeting with the Boards to discuss the potential application of the Proposal to credit card reward programs, and to understand the relevance of contract assets to the commercial banking industry, as both issues are unclear to The Clearing House;
- *recommends* that onerous contracts be assessed at the customer level, as this better reflects the underlying economics of the arrangements, and because we believe the cost of analyzing profitability at a lower level outweighs the benefits;
 - If the Boards do not accept this recommendation, The Clearing House *recommends* that the obligation be evaluated at the contract level, consistent with other proposed guidance on combining performance obligations;³
- *recommends* that the onerous loss calculation be based on incremental direct costs to fulfill the obligation and that, if the revenues from a contract are excluded from the scope of the Proposal, then any performance obligation relating to that contract also be excluded;

² FASB Project updates on Revenue Recognition, Project Objective at http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=900000011146.

³ Proposal, paragraph 30.

- *supports* the inclusion of the residual approach for allocating the transaction price of a performance obligation, as such an approach is helpful in situations when estimating the selling prices of financial services that are highly variable or uncertain;
- *recommends* that the Boards adopt a more principles-based approach to disclosures, as many of the proposed disclosures are overly burdensome, would represent an excessive addition to interim financial statements and do not provide useful information to investors; and
- *supports* the application of the Proposal to transfers of nonfinancial assets that are outside an entity's ordinary activities, as this is consistent with the Boards' overall objective to reduce inconsistencies and improve comparability of revenue recognition practices, and as the control-based model on which the Proposal is based is consistent with the approaches used for other asset transfers, such as the transfer of financial assets and the transfer of businesses.

I. The scope of the Proposal should be clarified to exclude all financial instruments.

Currently, the Proposal specifies a number of ASC Topics that address the accounting for financial instruments that are excluded from its scope, such as Topic 320, Debt and Equity Securities; Topic 310, Receivables; Topic 815, Derivatives and Hedging; Topic 825, Financial Instruments; and Topic 860, Transfers and Servicing.^{4,5} It is unclear whether financial instruments that are addressed elsewhere in the Codification, such as letters of credit and loan commitments (Topic 440), would be included in the scope of the Proposal. We believe it was the Boards' intent to exclude all financial instruments from the scope of the Proposal, and we support such an approach, given the highly specialized nature of financial instruments. If this is the case, we recommend that paragraph 9 of the Proposal on scope be clarified to explicitly state that all financial instruments, as defined in Accounting Standards Codification 815-10-20, Derivatives and Hedging – Overall – Glossary, are excluded from the scope of the Proposal.

II. Netting of underwriting revenues and expenses should be continued.

The Clearing House notes that the current guidance on accounting for underwriting expenses will not be superseded by the Proposal. Specifically, under today's guidance, financial institutions defer the recognition of underwriting expenses until the associated underwriting revenues are recognized.⁶ This long-standing practice is codified in ASC 940-340-35, and is not marked as superseded in the proposed amendments to the Codification. We believe that it is appropriate to preserve this guidance, as we believe it is appropriate for underwriters to

⁴ Financial Accounting Standards Board Exposure Draft, Proposed Accounting Standards Update (Revised), *Revenue Recognition* (Topic 605): *Revenue from Contracts with Customers*, page 12.

⁵ While the comments and recommendations in this letter apply to both the FASB and IASB exposure drafts, our technical references herein are to the FASB Accounting Standards Codification (the "Codification") only.

⁶ In the event that the underwriting transaction is not completed and the securities are not issued, the entities participating in the costs associated with the underwriting write the costs off to expense.

recognize these expenses for accounting purposes at the same time as the related revenue is recognized.

However, we note that the guidance on the presentation of these expenses, which appears in ASC 940-605-05-1a,⁷ is superseded by the Proposal. We believe the current net presentation should be carried forward, as this is the most useful information for investors. It is our experience that investors in investment banks are interested in the net profitability of underwriting transactions rather than the specific individual expenses in the deals and therefore presenting these costs on a gross basis would not provide useful information to investors. Accordingly, we recommend that the following statement should be incorporated into ASC 940-340-35:

Expenses directly associated with underwriting revenues should be presented on a net basis with underwriting fee revenues.

III. Further outreach is needed to understand the application of the Proposal to credit card reward programs and the relevance of contract assets to the commercial banking industry.

It is unclear how, or whether, to apply the Proposal to the credit card reward programs offered by many financial institutions and, therefore, the Proposal could result in unintended consequences related to both the timing and presentation of revenue related to credit card activity. By way of background, credit card arrangements often involve multiple parties, including the user of the card (the “Cardholder”); the bank that issues the credit card (the “Issuing Bank”); in some cases, another company that brands the card with its own name; the Credit Card Association (VISA, MasterCard, etc.); a merchant who accepts credit cards as a form of payment; and an intermediary financial institution responsible for the settlement of the electronic payment transactions.

Most financial institutions have reward programs that offer cash, merchandise or a choice of either cash or merchandise rewards to the Cardholder. Rewards may be provided by the Issuing Bank itself (in the case of cash) or may be fulfilled by a third-party loyalty provider (in the case of merchandise). The loyalty provider may be paid a certain amount for each point earned by the Cardholder, in which case the Issuing Bank is relieved of any further obligation to the Cardholder, or the loyalty provider may be paid only when the Cardholder selects merchandise in exchange for a certain number of previously earned points.

⁷ ASC 940-605-05-1a. Underwriting. The management fee is the fee paid to the manager or co-managers of the underwriting for services rendered in organizing the syndicate of underwriters and maintaining the records for the distribution. The underwriting fee is paid to the underwriting participants as compensation for the risk assumed through their agreement to buy a specified portion of the issue. It is usually net of the expenses directly associated with the underwriting. The selling concession is the fee paid for selling the offering. A broker-dealer may underwrite a security offering by contracting to buy the issue either at a fixed price or a price based on selling the offering on a best-effort basis.

After analyzing the guidance in the Proposal, we have concluded that Example 24 – “Customer loyalty program”, is not relevant to credit card reward programs. In Example 24, the loyalty points are redeemable in the form of discounts on future purchases. Accordingly, the enterprise is required to defer a portion of revenue received and recognize it in future periods as the rewards are redeemed. However, in the case of the credit card reward programs, the points that are awarded to the Cardholder do not require any future purchases to be made by the Cardholder in order for the points to be redeemed. Accordingly, we believe this guidance is not applicable to these programs.

The Clearing House is uncertain on how the Proposal should, in fact, be applied to these programs, or whether they are even included in the scope of the Proposal. This is a result of (i) the complexity of these programs, (ii) the multiple parties involved, (iii) the variety of reward choices, (iv) the difficulty of determining which party constitutes the customer, (v) what is the appropriate revenue stream to consider and (vi) the complexity of determining whether a performance obligation exists for the delivery of the rewards upon redemption. Accordingly, we respectfully request that we have the opportunity to discuss this issue with the Boards prior to the finalization of the Proposal. It is critical that The Clearing House understands the effects of the Proposal on the accounting for these programs as they represent a significant business activity for many of our member banks.

In addition, the guidance regarding contract assets as illustrated in Example 18 – “Contract asset and receivable” is also unclear in terms of its potential application to revenues derived from the delivery of services. Based on our analysis to date, we have not identified any situations in the commercial banking industry to which this would be applicable. However, we are concerned that there may be certain unidentified and unintended outcomes in applying this guidance to service-type arrangements. Accordingly, we encourage the Boards to perform further outreach and field-testing with The Clearing House member banks on this aspect of the Proposal as well.

IV. Onerous contracts should be assessed at the overall customer level.

The Clearing House agrees that an entity should recognize a liability and a corresponding expense if an obligation is onerous. However, we believe that the basis for determining an onerous obligation should be at the customer relationship level, which is consistent with the economic analysis related to business decisions regarding customer relationships. For service businesses with multiple product offerings, it is not unusual to negotiate individual rates for specific services after active arm’s-length negotiations. As a result, a certain service in one customer’s contract may appear to have lower profitability than that same service in a contract negotiated with another customer. Bifurcation beyond the customer relationship level is not meaningful. The management, potential renegotiation and related profitability of a specific performance obligation may be impacted by other customer contracts; accordingly, when such contracts are evaluated as a group they would not result in loss recognition, whereas loss recognition might be required if one would only look at an individual performance obligation. In addition, many institutions have made sizeable investments in

systems to track profitability at the customer relationship level; the need to analyze profitability at a lower level would add a level of operational complexity and cost that is not justified based on the benefits derived.

If the Boards do not agree with this approach, the next preferable alternative would be to evaluate the performance obligation at the contract level. This would be consistent with paragraph 30 of the Proposal, which states that as a practical expedient within step 2 of the revenue recognition framework, an entity may account for two or more distinct goods or services promised in a contract as a single performance obligation if those goods or services have the same pattern of transfer to the customer. For a services contract deemed to be a continuous transfer, it is inconsistent to combine distinct services for identification of a performance obligation, but then to unbundle those items when assessing if that performance obligation is onerous, especially if the unit of account for onerous obligation review is at the performance obligation level, which is determined in step 2. The bundling allowed as a practical expedient under paragraph 30 should also carry over to the assessment of onerous performance obligations.

In addition, the onerous loss calculation should be based on incremental direct costs to fulfill the obligation. Certain costs cited in paragraph 92 of the Proposal (*e.g.*, depreciation, insurance) would exist regardless of an individual contract (other than new equipment purchases dedicated to that contract's performance) and are not incremental direct costs of fulfilling a contract. Paragraph 94 specifies the new requirements for capitalizing the costs of obtaining a contract and specifically states that those costs are incremental. This same logic should be consistently applied to the costs to fulfill a contract and to calculate whether a performance obligation is onerous.

Finally, we believe that if the revenues from a particular contract are excluded from the scope of the Proposal (such as in connection with a deposit or lending arrangement), any performance obligation relating to that contract should also be excluded. We recommend that the Boards clarify this in the final Proposal.

V. The Clearing House supports the inclusion of the residual approach for allocating the transaction price of a performance obligation.

In determining the standalone selling prices of the separate performance obligations, The Clearing House supports the inclusion of guidance in paragraph 73 of the Proposal that permits entities to estimate the selling price using the residual approach, whereby the price is estimated by reference to the total transaction price less the sum of the observable standalone selling prices of other services included in the contract. We believe this is particularly applicable to services that our member banks provide, and would be appropriate for estimating the selling prices of services that can be highly variable or uncertain, such as structuring fees for products that are very new or customized for a particular client, when bundled with other services for which the fair value may be more observable.

VI. Certain disclosures are either duplicative of existing disclosures or do not provide useful information for investors in the commercial banking industry.

In general, it is difficult to assess the adequacy of the disclosures required for any item in the financial statements when the disclosure requirements are specified in each standard rather than in accordance with an overall disclosure framework. Accordingly, we encourage the Boards to develop a comprehensive financial statement disclosure framework as soon as possible.

The Clearing House appreciates the need to provide additional disclosures to investors regarding the nature, timing, amount and uncertainty of revenue and cash flows arising from contracts with customers. In particular, we believe that a robust qualitative discussion that includes a description of the principal sources of revenue and the accounting policies applied to each significant revenue stream, and a description of the significant estimates and judgments (i) made in connection with the recognition and measurement of revenue and (ii) as to the extent to which revenue in the current period is affected by changes in those estimates, is essential. However, we believe that certain of the specific disclosures described in the Proposal are either duplicative to existing disclosures or do not provide particularly useful information for the commercial banking industry, but would impose a significant burden on financial statement preparers. We recommend that the Boards adopt a more principles-based approach to disclosures and refrain from an overly prescriptive approach.

In particular, the disclosures proposed in paragraphs 114 and 115 of the Proposal appear to duplicate information already required under existing standards. For example, the proposed requirement to disaggregate revenue seems to duplicate the entity-wide disclosures required by segment reporting standards; and concentration risks (including risks from concentrations in the volume of business transacted with a particular customer, concentrations in revenue from particular products and services and concentrations in the market or geographic area in which an entity conducts its operations) are already required by ASC Topic 275, *Risks and Uncertainties*. We believe the existing requirements on disaggregation and concentration of risks are sufficient, and additional quantitative disclosures are not necessary.

With respect to the reconciliation of contract balances for both annual and interim financial statements, we do not believe this information will be useful to investors, and the objective satisfied by this disclosure is not entirely clear. As noted above, we do not believe this information is particularly relevant to the commercial banking industry. At the same time, the requirement will likely require many enterprises to develop new systems to capture the necessary information. Accordingly, we do not believe the benefit of these disclosures will outweigh the cost of producing them and, therefore, we recommend either that this proposed disclosure requirement be eliminated, or that the Proposal recognize that such disclosures are not necessary where they are not material or meaningful to users of the financial statements.

In addition to our concern regarding the usefulness of the disclosures regarding contract balances, we believe that the proposed requirements for disclosures in interim financial statements are far too prescriptive and will result in an excessive amount of disclosure that will

overwhelm both users and preparers. This includes the Boards' proposal to require the following disclosures in interim financial statements:

1. The disaggregation of revenue (paragraphs 114–116);
2. A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117);
3. An analysis of the entity's remaining performance obligations (paragraphs 119–121);
4. Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123); and
5. A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

We recommend that the level of disclosure in interim financial statements be more principles-based and follow the general guidelines of ASC Topic 270, *Interim Reporting*. Interim financial statements should focus on the progress of the company and any material changes since the last annual financial statements were issued. A requirement to include these disclosures in interim financial statements will contribute to the ever-expanding size of the interim financial statements, which are now becoming so voluminous that it can be difficult for the average reader to distinguish what is truly important from what is merely being updated. Accordingly, we recommend that these disclosures not be specifically required for interim financial statements but instead be left to the discretion of the individual financial statement preparer.

VII. The proposed guidance should be applied to transfers of nonfinancial assets that are outside an entity's ordinary activities.

The Clearing House agrees that the proposed guidance should be applied to the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities. In the case of The Clearing House member banks, this would potentially apply to transactions such as the sale of real estate. We believe this is consistent with the overall objective of the Proposal, which is to remove inconsistencies in existing revenue requirements and to improve comparability of revenue recognition practices across entities, industries, and capital markets. In addition, we believe that the fundamental approach of the Proposal, that revenue should be recognized when an asset is transferred to a customer, and that an asset is transferred when the customer obtains control of the asset, is consistent with the control-based models used for other types of asset transfers, such as ASC 860, *Transfers and Servicing*, for transfers of financial assets and ASC 810-10-S99 for transfers of businesses. We believe that the proposed indicators of when control has been transferred, as described in paragraph 37 of the Proposal, including: (a) the customer is obliged to pay for the asset; (b) the customer has legal title to the asset; (c) the entity has transferred physical possession of the asset; (d) the customer has the significant risks and rewards of ownership of the asset; and (e) the customer has accepted the asset, will prove sufficiently robust to ensure that recognition and measurement of revenues for these types of transfers is appropriate.

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We thank you for considering the comments provided in this letter. If you have any questions or are in need of any further information, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org) or Gail Haas at (212) 612-9233 (email: gail.haas@theclearinghouse.org).

Sincerely yours,



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