

STAFF PAPER

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Project	FASB/IASB Joint Transition Resource Group for Revenue Recognition		
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Purpose

1. Some stakeholders informed the staff that there are questions about the guidance in Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), regarding the scope of the new revenue standard as it relates to credit card issuing banks and credit cardholders.
2. The questions discussed in this paper are applicable only under U.S. GAAP because they relate to the interaction of two U.S. GAAP topics. However, for reference, the staff has included some IFRS considerations in Appendix C.

Background

3. Credit card issuing banks enter into credit card arrangements that involve multiple parties and intermediaries, including the cardholder, the network, the merchant, and the merchant acquirer. Under the arrangements, the card issuer provides financing to the cardholder, who may directly pay little or no consideration to the card issuer for the financing if the balance due is paid off within each billing cycle. The card issuer may also provide rewards to the cardholder based on the level of purchase

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activity. The card issuer funds both the financing and rewards, in part, by interchange revenue paid to the card issuer by the networks.

4. There are various forms of credit card arrangements. An open loop transaction is where the payment network is not under common control with the card issuing bank or the merchant acquirer. A closed loop transaction is where the payment network, card issuing bank and merchant acquirer may be under common control. Refer to Appendix B for further background on the structure of credit card arrangements.

Accounting Guidance

5. Topic 606 includes the following guidance for the scope of Topic 606 and credit card arrangements:

606-10-15-2 [5]¹ An entity shall apply the guidance in this Topic [Standard] to all contracts with customers, except the following:

c. Financial instruments and other contractual rights or obligations within the scope of the following Topics: [financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial Instruments*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*]

1. Topic 310, Receivables ...

606-10-15-4 [7] A contract with a customer may be partially within the scope of this Topic [Standard] and partially within the scope of other Topics [Standards] listed in paragraph 606-10-15-2 [5].

¹ IFRS 15 references are included in “[XX]” throughout this paper.

a. If the other Topics [Standards] specify how to separate and/or initially measure one or more parts of the contract, then an entity shall first apply the separation and/or measurement guidance in those Topics [Standards]. An entity shall exclude from the transaction price the amount of the part (or parts) of the contract that are initially measured in accordance with other Topics and shall apply paragraphs 606-10-32-28 through 32-41 [73-86] to allocate the amount of the transaction price that remains (if any) to each performance obligation within the scope of this Topic and to any other parts of the contract identified by paragraph 606-10-15-4(b) [7(b)].

b. If the other Topics [Standards] do not specify how to separate and/or initially measure one or more parts of the contract, then the entity shall apply the guidance in this Topic [Standard] to separate and/or initially measure the part (or parts) of the contract.

Question 1: Are the rights and obligations of the card issuing bank's contract with the cardholder in the scope of Topic 606?

6. A card issuing bank can have various income streams from a cardholder. Those revenue streams related to interest income, credit card balance consolidation and balance transfer fees, late (delinquency) fees, returned check fees (on customer's credit card payment), cash advance fee, foreign currency fees, rush/expedited card fees, over-limit fee, and overdraft protection fees are all within the scope of Topic 310, Receivables, and, therefore, are not included in the scope of the new revenue standard (per the scope exception in paragraph 606-10-15-2). Those income streams have specific guidance in Topic 310; for example, interest income is addressed in paragraph 310-10-25-9 and delinquency fees (which includes late fees and returned check fees) are addressed in paragraph 310-10-25-13. Many of the

other fees are considered to be loan origination fees as addressed in Section 310-20-20.

7. However, questions have arisen as to whether other credit card fees (such as periodic or annual fees) are in the scope of Topic 310 or in the scope of Topic 606. Credit card fees are defined in the Master Glossary of the Accounting Standards Codification as follows:

The periodic uniform fees that entitle cardholders to use credit cards. The amount of such fees generally is not dependent upon the level of credit available or frequency of usage. Typically the use of credit cards facilitates the cardholder's payment for the purchase of goods and services on a periodic, as-billed basis (usually monthly), involves the extension of credit, and, if payment is not made when billed, involves imposition of interest or finance charges. Credit card fees include fees received in similar arrangements, such as charge card and cash card fees.

8. The question arises because some services might be provided in conjunction with the lending arrangement and the receipt of the credit card fee. For example, the card issuing bank may provide certain ancillary services, such as concierge services or airport lounge access. This had led some stakeholders to question whether those services should be included in the scope of Topic 606.
9. In order to answer this question, one must first assess whether or not the fees are in the scope of Topic 310. If the fees are in the scope of Topic 310, then the guidance in that Topic would apply. If the fees are not in the scope of Topic 310, then an entity would need to assess the contract under Topic 606. The staff is aware that some stakeholders are referring to paragraph 606-10-15-4 (refer to the Accounting Guidance section of this memo for the full paragraph) in trying to determine the answer to this question. However, the staff notes that the guidance in that paragraph would apply at the point an entity determines that a contract includes goods or services in the scope of both Topic 606 and another Topic. That is, once that determination is made, the guidance in paragraph 606-10-15-4 provides a hierarchy on how to apply separation and allocation guidance. Therefore, if a determination

is made that all goods or services in a contract are outside of the scope of Topic 606 then the guidance in that paragraph would not be applicable.

10. Subtopic 310-20, Nonrefundable Fees and Other Costs, includes guidance on the recognition and the balance sheet classification of nonrefundable fees and costs associated with lending activities. The following paragraphs provide guidance on accounting for credit card fees:

310-20-05-03 Available lines of credit under credit card and similar charge card arrangements are loan commitments, and fees collected in connection with such cards (credit card fees) are viewed in part as being loan commitment fees. Entities issue credit cards, debit cards, bank charge cards, and other similar cards (collectively, credit cards) with a variety of terms. An issuer may charge an origination fee in connection with the issuance of a credit card and periodic renewal fees for the continued extension of credit card privileges. As part of a promotion to attract new cardholders or retain existing cardholders, some of those issuers may waive the payment of credit card fees for the initial use period or in some cases for a longer period. Other entities issue credit cards that do not require the payment of any fees for the use of the credit card.

310-20-25-15 Credit card fees generally cover many services to cardholders. Accordingly, fees that are periodically charged to cardholders shall be deferred. This accounting shall also apply to other similar card arrangements that involve an extension of credit by the card issuer.

11. Additional discussion on this topic is included in the basis for conclusions to FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with*

Originating or Acquiring Loans and Initial Direct Costs of Leases (FAS 91) (excerpts included in Appendix A). The Basis describes that the Board concluded that a loan commitment might be either integral to lending or a separate customer service depending on the nature of the commitment. The Board concluded that to the extent a fee is to compensate the entity for a service provided during the commitment period, the separate components of a commitment fee cannot be identified and measured reliably enough to allow for separate accounting recognition for each component part. The staff notes that the basis for conclusions is non-authoritative; however, this description in the basis provides context around the language in paragraph 310-20-25-15 that “credit card fees generally cover many services to cardholders.”

12. The staff thinks that this question arises, in part, because the scope guidance in Topic 310 relates to a “fee” while the scope guidance in Topic 606 relates to “goods and services.” However, if the fee is in the scope of Topic 310, then the staff thinks that the services being performed in exchange for that fee also would be in the scope of Topic 310.
13. In the staff’s view, credit card fees are within the scope of Topic 310 based upon the guidance in Topic 310 and the Basis for Conclusions to FAS 91 explains what the Board considered to be “credit card fees.” Consequently, credit card fees are not within the scope of Topic 606.
14. As part of the staff’s research on this implementation question, the staff discussed the accounting for credit card fees under current U.S. GAAP with stakeholders. The staff’s outreach included many credit card issuing banks and some of the large accounting firms that have significant experience auditing those institutions. All of the stakeholders included in the staff’s outreach stated that ***all credit card fees*** are presently accounted for within the scope of Topic 310 (specifically Subtopic 310-20), rather than the guidance in Topic 605, Revenue Recognition. The staff notes that the ASU for the new revenue standard did not include consequential amendments to Topic 310 to change the scope of that topic related to credit card fees. Consequently, in the staff’s view, the conclusion under existing and new revenue recognition guidance should be the same.

15. The staff thinks it is important to note that a credit card issuing bank should not assume that all of its types of arrangements are excluded from the scope of Topic 606 solely because credit card fees are excluded from the scope of Topic 606. The entity should evaluate its other types of arrangements and reach a conclusion about the applicable U.S. GAAP for those other types of arrangements. For example, an entity that issues credit cards might also offer asset management services to clients for a fee. Those asset management services likely would be within the scope of Topic 606. Paragraph 606-10-15-1 states that the guidance in Topic 606 applies to *all entities*. That is, there are no entities or industries that are excluded from Topic 606. Rather, paragraph 606-10-15-2 provides a list of contracts/transactions that are in the scope of other Topics. Therefore, it would not be appropriate for an entity to conclude that it is excluded from the scope of Topic 606 solely because of its industry (such as, a financial institution or an insurance company).
16. The staff also thinks it is important to note that if any entity (bank or otherwise) enters into an arrangement that is labelled a credit card lending arrangement, but the overall nature of the arrangement is not a credit card lending arrangement, then the entity should not presume that the arrangement is entirely within the scope of Topic 310 and outside the scope of Topic 606. As an example to illustrate the staff's point, assume an entity enters into an arrangement that is labelled a credit card lending arrangement and that involves the entity providing a credit card to the customer and the entity also transferring control of an automobile to the customer. In exchange, the customer pays a fee to the entity. Although the arrangement includes a credit card lending component, the overall nature of the arrangement is not simply a credit card lending arrangement. The transfer of control of an automobile is a key element of the arrangement. Consequently, the entity cannot assume that the entire arrangement is within the scope of Topic 310.

Question 2: Are cardholder rewards programs subject to Topic 606?

17. The 2011 Exposure Draft included an example of a customer loyalty program that was in the scope of Topic 606 and provided a material right to the customer resulting in a separate performance obligation for the loyalty points (Example 22 in 2011 ED). In response to the 2011 ED, some preparers in the financial services industry requested clarification about the application of the proposal to credit card

rewards programs. Specifically, those respondents were uncertain whether the Boards intended the revenue model to be applied to credit card rewards models.

18. The Boards deliberated whether to provide explicit guidance on this issue (in situations in which the rewards program is deemed not to be in the scope of another topic, such as Topic 310). The Boards decided that entities should follow the guidance in the model to determine instances when customer loyalty rewards programs are or are not performance obligations and did not specify whether or not credit card rewards programs are in or out of the scope of Topic 606. Specifically, the Basis for Conclusions includes the following:

BC388. Some respondents asked the Boards to clarify whether specific options, such as customer loyalty points, should be accounted for as a performance obligation when the arrangement involves more than two parties. This often occurs in a credit card arrangement in which an entity provides the credit card holder with points based on the amount of purchases made at other entities (often referred to as “merchants”). The Boards determined that the assessment of whether any loyalty points represent a performance obligation requires an analysis of the facts and circumstances in each arrangement. The Boards decided not to provide any further guidance because the issue was specific to the credit card industry and the Boards observed that these arrangements are often complex and can vary significantly. Furthermore, the Boards noted that Topic 606 includes all the requirements to enable entities to account for the various arrangements.

19. It is important to note that Example 52 in Topic 606 does not address the scope question being asked in this paper. Rather, it addresses the accounting for a contract already deemed to be in the scope of Topic 606. The staff notes that there are differences between the credit card arrangements (as illustrated in Appendix B) and

the fact pattern included in Example 52. Additionally, the example is addressing a specific fact pattern rather than illustrating the general accounting for all reward programs.

20. The staff highlights that there are several items to consider in answering this question. Because the outcomes would be facts and circumstances specific, the intention of this paper is not to provide an answer as to whether or not credit card rewards programs broadly are included in or excluded from the scope of Topic 606. Rather, the staff has outlined parts of the new revenue standard that entities should consider when coming to a conclusion in their specific scenarios.

21. The scope section of the new revenue standard provides guidance on how to account for contracts when the contract includes both a financial instrument component and another component included in the scope of the new revenue standard. For example, if an entity concludes that the entire arrangement consideration is in the scope of Topic 310 (that is, because the recognition of the credit card fees related to the rewards program are in the scope of that topic) then the rewards program would not be in the scope of Topic 606. However, if the entity were to conclude the contract included a component in the scope of the new revenue standard, the following are some items an entity should consider when determining the appropriate accounting for the reward program.
 - (a) Step 1 of the revenue model requires an entity to identify the customer in the contract. Customer is defined as “a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.” The entity would need to determine who its customer(s) is (are) in the arrangement (for example, the entity’s customer may be the merchant paying interchange fees, rather than the cardholder, or both).

 - (b) Step 1 of the revenue model provides guidance about when to combine two or more contracts with the same customer and account for them as a single contract. If the contracts are not with the same customer (for example, where there is a contract with the cardholder and a separate

contract with the merchant, which are not related parties), the entity would not need to combine the contracts.

- (c) Step 2 of the revenue model provides guidance for identifying performance obligations (including material rights). If an entity concluded that a contract is in the scope of Topic 606 and that the cardholder is a customer, then the entity would assess whether goods and services provided under the rewards program are distinct goods or services. It is important to note that just because the cardholder is determined to be a customer, does not mean it is the card issuer's *only* customer (that is, the card issuer may conclude that its customers are the cardholders and the merchants).

Question for the TRG Members

1. Do the TRG members agree with the staff's views in this paper?

Appendix A

FASB Statement No. 91 *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases: Excerpts from the Basis for Conclusions*

BC45. The Board concluded that a loan commitment may be either integral to lending or a separate customer service depending on the nature of the commitment. Paragraph 8² of this Statement requires commitment fees to be deferred except in limited circumstances and, if the loan commitment is exercised, recognized by the interest method over the life of the loan as an adjustment of yield or recognized in income on expiration of the commitment if the loan commitment expires unexercised.

BC46. The Board considered two principal factors in reaching its conclusions about whether a commitment is principally a separate service or is integral to lending. The first was whether the commitment provides the customer with a benefit that is objectively distinguishable from a commitment that is expected to result in a lending transaction. The Board could find little substantive difference between the activities involved in loan origination and those involved in loan commitment when the enterprise reasonably expects the commitment to be exercised. Accordingly, the Board concluded that the accounting for fees for both activities should be the same unless the likelihood the commitment will be exercised is remote.

BC47. The second factor was whether the commitment provides the customer with a benefit that is not principally derived from the use of borrowed funds. Some respondents suggested that a fee received for granting a commitment constitutes a separate revenue-generating activity that should result in fee recognition over the commitment period. Those respondents indicated that the commitment fee compensates the enterprise for a variety of risks assumed during the commitment period. Those risks may include a liquidity risk, credit risk, or interest rate risk. Other

² Paragraph 8 of FAS 91 includes two criteria where commitment fees would not be deferred: (a) likelihood that commitment will be exercised is remote and (b) the amount of the commitment fee is determined retrospectively as a percentage of the line of credit available but unused.

respondents suggested that a commitment fee usually has both service and yield components and the accounting should reflect the substance of the fee. Some respondents, while noting that a commitment fee may have service and yield components, acknowledged that reliably measuring the separate components may be too difficult. As a result, they suggested that the commitment fee should be recognized over the combined commitment period and loan life. Recognition during the commitment period would be on a straight-line basis using a combined life approach; upon exercise, the remaining unamortized balance would be recognized under the interest method over the same period used for recognizing deferred origination fees and costs.

BC48. The Board rejected the suggestion of those respondents that the commitment fee be recognized over the commitment period or the combined commitment and loan period. The Board acknowledges that a fee received by an enterprise at the time a commitment is granted may be compensation to the enterprise for a variety of services provided and risks assumed. Those services and risks may include a guaranteed availability of funds and a guaranteed interest rate. However, to the extent that a commitment fee may compensate the enterprise for interest rate or credit risks assumed during the commitment period, the Board noted that the enterprise can suffer from those risks only if the loan is made. The related economic sacrifice is incurred by the lender over the term of the loan and not over the term of the commitment. Accordingly, the Board concluded that the lender should recognize the compensation related to those risks assumed over the period the enterprise incurs the economic sacrifice, that is, while the loan is outstanding. To the extent that a portion of the commitment fee represents a yield adjustment, recognition of the commitment fee over the combined commitment and loan period results in premature recognition of income. Further, even to the extent that a portion of the commitment fee is to compensate the enterprise for some service provided during the commitment period, the Board concluded that the separate components of a commitment fee cannot be identified and

measured reliably enough to allow separate accounting recognition for each component part.

BC49. The Board concluded that if, at the inception of the commitment period, the likelihood of the commitment resulting in a loan is remote, the commitment fee should be recognized as service fee income over the commitment period. The Board decided that otherwise the fee should be deferred and, if the loan commitment is exercised, recognized by the interest method over the life of the loan as an adjustment of yield or, if the loan commitment expires unexercised, recognized in income upon expiration of the commitment.

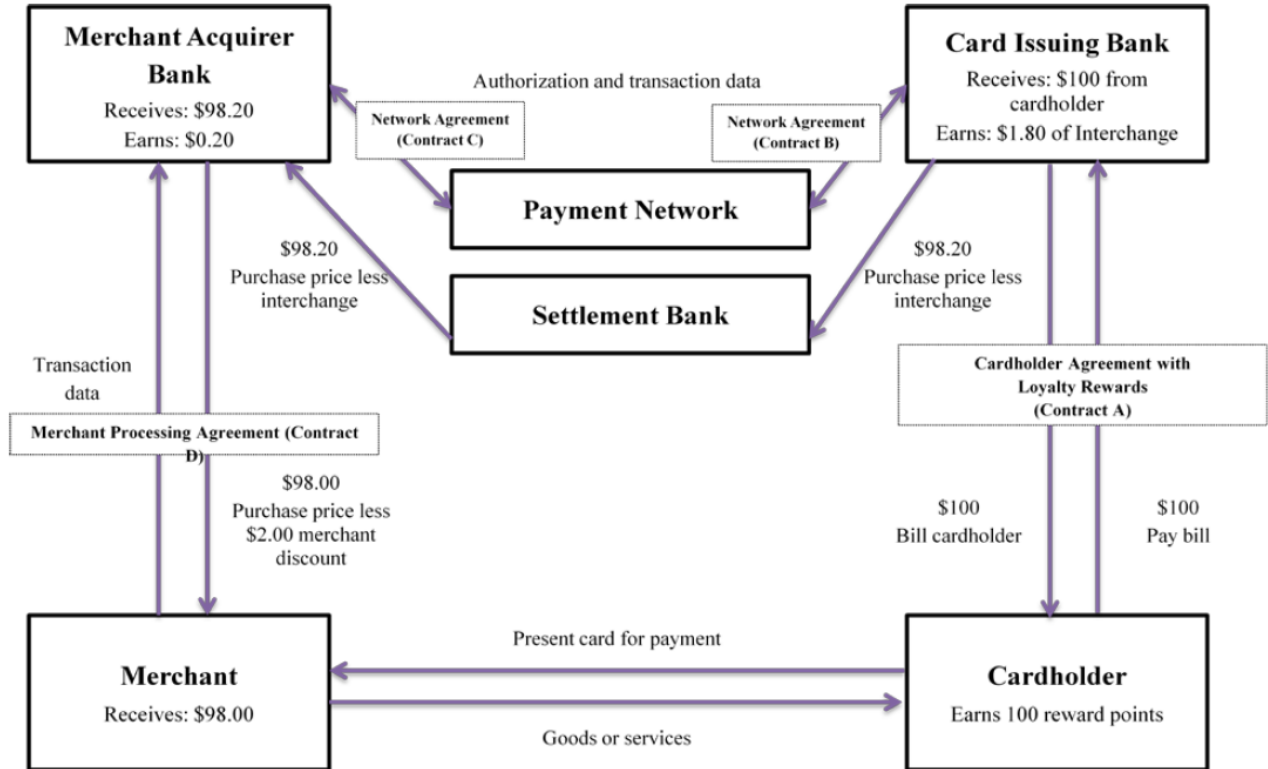
BC50. The fees for some loan commitments are structured in a manner that precludes any part of the fee from being considered integral to lending because the amount of the commitment fee is based on the portion of a loan commitment that is not exercised. For example, a lending institution may grant its customer a commitment for a revolving line of credit, the fee for which is determined as a percentage of the unused line of credit. Since the percentage is applied only to the portion of the commitment that was not funded as a loan, the fee relates to the service of maintaining the availability of funds and is not considered to be principally integral to lending. Further, the level of fee for such commitments has historically been nominal in relation to the stated interest rate on any related borrowing. The Board concluded that if the amount of the commitment fee is determined retrospectively as a percentage of the line of credit available but unused in a previous period, if that percentage is nominal in relation to the stated interest rate on any related borrowing, and if that borrowing will bear a market interest rate at the date the loan is made, the commitment fee should be recognized as service fee income as of the determination date.

BC51. The Board retained the provision in the Exposure Draft that called for recognition of credit card fees on a straight-line basis over the period the fee entitles the cardholder to use the credit card. Some respondents suggested that credit card fees are not related to the lending process and should be excluded from the scope of the Statement. The Board did not

accept that view. While the amount of fee collected from each individual borrower may not be of the magnitude of other commitment fees collected by the lender on other loan arrangements, the Board concluded that the substance is the same. A credit card fee represents a payment by the cardholder to obtain the ability to borrow from the lender under predefined conditions. Such borrowings take place at the option of the borrower. The Board noted that such arrangements provide opportunities to lend and concluded that the related fees represent commitment fees. The Board recognized that application of the interest method to the outstanding balances of a credit cardholder would be impracticable in most instances. Accordingly, this Statement requires the fee to be recognized on a straight-line basis over the period the fee entitles the cardholder to use the card. The Board agreed with those respondents who suggested that the conclusion regarding credit card fees be extended to fees collected in similar arrangements that involve an extension of credit by the card issuer, such as charge cards and cash cards. The Board views the substance of these transactions as similar and has included fees received from such arrangements in the definition of credit card fees for purposes of applying this Statement.

Appendix B

Open Loop Transaction Summary (Provided by Submitter)



As depicted above, a typical Open Loop Transaction involves multiple parties and various contractual arrangements. Key contracts in the Open Loop Transaction include:

- Contract A – Cardholder Agreement with Loyalty Rewards between Cardholder and Card Issuer
- Contract B – Network Agreement between Card Issuer and Payment Network
- Contract C – Network Agreement between Merchant Acquirer and Payment Network
- Contract D – Merchant Processing Agreement between Merchant and the Merchant Acquirer

While these contractual arrangements are separately negotiated and may be entered into at different points in time, they are inter-dependent and integrated components of the overall arrangement that are necessary for the occurrence of the credit card transaction between the Cardholder and Merchant. The Card Issuer, Merchant Acquirer and Payment Network

each bear risk related to their respective roles in the transaction, and each performs functions integral to the credit card arrangement.

- The Card Issuer’s primary role is to authorize the transaction and settle (nightly) the Cardholder’s purchase (with later collection from the Cardholder). The Card Issuer has a lending relationship with the Cardholder that may result in the Cardholder paying the entire balance on the payment due date (a “transactor”) or choosing to repay over time (a “revolver”). Regardless of the tenor of the lending, a Card Issuer is lending to the Cardholder each time a purchase is made.
- The Merchant Acquirer’s primary role is to transmit data from the Merchant to the Payment Network, pay the Merchant, and remit funds to the Payment Network for chargeback credits related to Cardholder return/credit transactions (Merchant Acquirer is responsible for collection from the Merchant).
- The Payment Network’s primary role is to oversee the payment platform, transmit the authorization from the Card Issuer and settle the payments between the Card Issuer and Merchant Acquirer (including risk exposure to the default of a counterparty in the overnight settlement process).

Appendix C

IFRS Considerations

1. Although this question has been raised in the context of U.S. GAAP and the staff has not received any questions on IFRS related to this issue, the staff thought it might be helpful for TRG members to understand the IFRS guidance on this topic. Prior to IFRS 15, guidance on financial services fees was included in paragraph 14 of the Illustrative Examples accompanying IAS 18 *Revenue*. As part of the IASB's consequential amendments arising from IFRS 15, that guidance was moved to IAS 39 *Financial Instruments: Recognition and Measurement*, and was ultimately moved into IFRS 9 *Financial Instruments* (IFRS 9, issued in July 2014, replaces IAS 39). Accordingly, IFRS 15 did not change the requirements in respect of determining whether fees related to financial instruments are in the scope of IAS 39/IFRS 9 or IFRS 15.
2. Paragraph 5 of IFRS 15 includes a scope exclusion for financial instruments in the scope of IFRS 9 (or IAS 39 if the entity has not adopted IFRS 9). Therefore, to answer this question under IFRS, a similar analysis to that of U.S. GAAP would need to be performed. That is, an entity would first determine whether or not the credit card fees are in the scope of IFRS 9 (IAS 39).
3. IFRS 9 provides the following guidance³:

B.5.4.1 In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate for a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised.

³ The guidance in IAS 39 is identical.

4. Paragraphs B5.4.2 through B5.4.3 of IFRS 9 provide examples of fees that are and fees that are not an integral part of the effective interest rate of a financial instrument. This guidance does not explicitly address credit card fees. However, any credit card fees that are not an integral part of the effective interest rate of the financial instrument are accounted for in accordance with IFRS 15.