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Via email: Smcosper@fasb.org and Jhillenmeyer@fasb.org

Ms. Susan M. Cospers, Task Force Chairman

Ms. Jennifer Hillenmeyer, EITF Coordinator

Financial Accounting Standards Board

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Delivery via email

Re: EITF Issue No. 15-B, "Recognition of Breakage for No-Cash Prepaid Cards"

Dear Ms. Cospers and Ms. Hillenmeyer:

We appreciate the Board's recent addition to the Financial Accounting Standards Board's ("FASB") Emerging Issues Task Force's ("EITF") agenda of Issue No. 15-B, "Recognition of Breakage for No-Cash Prepaid Cards" ("Issue No. 15-B") as we believe there are practice issues and diversity in practice associated with this issue and that further standard-setting is needed for this area. The purpose of this letter is to provide the EITF with additional facts and circumstances that relate to our industry and that we believe should be considered as part of the EITF's deliberations. We request that the EITF carefully examine and consider the facts and circumstances and the related analysis that we've included herein as the scope of Issue No. 15-B further develops into an issues summary and the issues are then deliberated. We are available to answer any questions that the EITF may have.

Introduction

Blackhawk Network Holdings, Inc., together with its subsidiaries (collectively, "BHN", "we", "our" or the "Company"), is a leading prepaid payment network utilizing proprietary technology to offer a broad range of prepaid gift, telecom and debit cards, in physical and digital forms, as well as related prepaid

products and payment services in the United States and 21 other countries. Our payment network supports our key constituents: consumers who purchase or receive the products and services we offer, Content Providers who offer branded gift cards and other prepaid products that are redeemable for goods and services, Distribution Partners who sell those products, and business partners that distribute our products as incentives and rewards.

Our product offerings include gift cards, prepaid telecom products and prepaid financial services products, including general purpose reloadable (“GPR”) cards and our reload network (collectively, prepaid products). We offer prepaid cards from leading consumer brands (known as closed loop) as well as branded gift and incentive cards from leading payment network card associations such as American Express, Discover, MasterCard and Visa (known as open loop) and prepaid telecom products offered by prepaid wireless telecom carriers. We also distribute GPR cards, including Green Dot and NetSpend branded cards, as well as PayPower, our proprietary bank-issued GPR card. We operate a proprietary reload network named Reloadit, which allows consumers to reload funds onto their previously purchased GPR cards.

We distribute products across multiple high-traffic channels such as grocery, convenience, specialty and online retailers (referred to as “Distribution Partners”) in the Americas, Europe, Africa, Australia and Asia.

We are a publicly traded company, whose equity securities are registered with the SEC. The accounting matters addressed in this letter are of growing significance to our Company and we expect them to become material to our consolidated financial statements in the future. We also believe the issues are of growing significance to companies in our industry.

Product Background

We provide services for the promotion, distribution, activation and settlement of prepaid stored-value gift cards on behalf of third-party “Content Providers” (described below). The gift cards are distributed to end consumers through various retail points of sale, for example grocery stores, that we refer to as “Distribution Partners” (described below). End consumers purchase the prepaid cards to provide as a gift to others or for personal use. The value, or amount “loaded” onto the prepaid card is referred to as the “load value” and is the amount that can later be redeemed to pay for in-store purchases.

We have established our competitive position in the industry primarily through our ability to attract and retain distribution rights for leading third party Content Provider card programs and our ability to provide an extensive distribution network of grocery, convenience and other retail store outlets. Content Providers include national retailers and restaurants such as Applebee’s, Best Buy, The Home Depot®, iTunes Music Store, Sears, Starbucks, Target and various telecom service providers which have entered into contractual arrangements with us for the promotion, distribution, activation and other services related to the issuance of their prepaid cards.

The Content Provider is directly responsible for the redemption of its prepaid cards and is the primary obligor for the monetary liability to the end consumer. These prepaid cards are referred to as third-party or “closed loop” cards because they can only be redeemed by the issuing Content Provider at its own retail locations, affiliate locations or online web site. In exchange for our services, the Content Providers contractually agree to pay a distribution commission that is negotiated between us and the Content Provider and is equal to a percentage of the load value of each prepaid card sold. This commission is funded through a net-settlement exchange of cash from the Distribution Partner who collects the initial load value of the purchased card from the end consumer. The Distribution Partner remits the load value of the purchased card net of its share of the distribution commission to us and we remit the remaining load value net of our share of the commission to the Content Provider.

We also have separate and distinct contractual arrangements with a network of retail grocery, convenience and other retail store outlets, our Distribution Partners, for the sale of these prepaid cards in their stores. Distribution Partners are companies such as Giant Eagle, Kroger, Safeway, Publix and Albertsons. In exchange, we share with the Distribution Partner a portion of the distribution commission funded by the Content Provider. The Distribution Partner earns commissions for displaying and supporting activation of Content Provider prepaid cards, collecting funds from the end consumers for the load value amount loaded onto the card, activating the card through a point of sale terminal and transmitting the funds to us. We then transmit the relevant portion of the funds to the Content Provider, retaining the commission that we earn. We have contractually agreed to provide certain Distribution Partners with allotments of advertising dollars, marketing materials, and display items which assist the Distribution Partners in selling all card types offered by us.

The Content Providers have contractual approval rights over our array of Distribution Partners through which their prepaid cards will be sold. We directly negotiate with the Content Provider the gross amount of the commission that will apply to sales of their respective prepaid cards. However, we and each Distribution Partner separately negotiate the allocation or “split” of these gross commissions between both parties, as reflected in the respective Distribution Partner contracts. Although the Content Provider is involved in the approval (or any later cancellation) of the Distribution Partners that can offer and sell their prepaid cards, the Distribution Partner also has contractual approval rights over the selection of prepaid cards that it will accept and offer for sale in its stores. Also, if a prepaid card sale transaction is affected through fraudulent payment instruments or means, the Distribution Partner bears the risk of loss.

In a typical closed loop card transaction, a consumer will buy a Content Provider’s prepaid card (e.g. a \$100 load value Home Depot gift card) at a Distribution Partner’s store for the full load value of the card. The card will be immediately activated at the Distribution Partner’s point of sale via our electronic network and related software and the electronic network of the Content Provider. The Distribution Partner also collects the \$100 load value of the prepaid card, retains its share of the commission (e.g., \$5), and then remits the net amount (e.g., \$95) to us. We, in turn, deduct our share of the distribution commission (e.g., \$3), and then remit the net amount (e.g., \$92) to the Content Provider. The consumer redeems the full \$100 load value of the card in exchange for product at the Content Provider’s business establishment. For closed loop prepaid cards, the distribution commission is thus always funded by the Content Provider.

For a retail open loop card or GPR card transaction, the consumer purchases a network-branded (e.g. Visa, MasterCard or American Express) gift or GPR card from a Distribution Partner who collects the load value and a purchase fee. Unlike closed loop cards, the commission shared between the Distribution Partner and us is not a percentage of the load value, but instead is a percentage of the purchase fee. Thus, after collecting the funds from the purchaser, the Distribution Partner then forwards to us the load value and purchase fee, less the Distribution Partner's share of the purchase fee. We then remit the load value of each card to the card issuing bank partner and a portion of the purchase fee, retaining the balance of the purchase fee. The cardholder can access the value they loaded on an open loop or GPR card by transacting for goods or services with any merchant that accepts the network-branded card. For such transactions, the card issuing bank transfers funds through the network association to the merchant's bank following the consumer's use of the card to purchase goods or services.

As described above, for most prepaid products sold in our retail distribution network, we remit the funds loaded onto the prepaid product (less our commissions on closed loop or less part of the purchase fee on open loop cards) to the Content Provider or issuing bank based on contractual settlement terms after activation which occurs at the Distribution Partner's point-of-sale.

Unlike the products described above, we also offer certain other prepaid products, as described below, that require the consumer to take additional actions before redeeming the funds stored on the product. For such products, we retain the funds loaded onto the cards until either the required consumer action is taken or the card is redeemed.

- In the first case, certain prepaid phone cards (the "Telecom Transactions") that are sold by Distribution Partners require the consumer to complete a process to link, or associate, the card with the consumer's existing telecom account using our proprietary network. We remit the funds from such Telecom Transactions to the telecom Content Providers when the consumer completes the process to activate the card. Because of this incremental step to activate the prepaid card, a certain amount of Telecom Transactions are never activated by the end consumer and as a result we are not required to remit any funds to the related telecom Content Provider. After purchase from the Distribution Partner, these cards are nonrefundable for the consumer. After the consumer associates the card with their account and we remit the funds to the Content Provider, the Content Provider may elect to provide refunds and other adjustments to the consumer. However, until the consumer associates the card with their existing telecom account, no refunds or other adjustments are available to the consumer.
- In the second case, we also sell prepaid cards through our own websites or with the involvement of an online or "digital" Distribution Partner (e.g. Amazon). For these transactions, we collect the prepaid card's load value directly from the consumer or from the electronic Distribution Partner and remit the card's load value less our commission directly to the Content Provider upon activation of the card by the end consumer (the "Activation Transactions"). For security reasons, we ship a portion of these cards to the consumer unactivated. Because some of these cards are shipped by us to the consumer unactivated, a certain amount of Activation Transactions are never completed by the end consumer and we are not required to remit those collected funds to the

Content Provider. Upon shipment to the consumer, these cards are nonrefundable for the consumer. After the consumer activates the card and we remit the funds to the Content Provider, the Content Provider may elect to provide refunds and other adjustments to the consumer. However, until the consumer activates the card, no refunds or other adjustments are available to the consumer.

- Lastly, in the third case, we enter into transactions (the “Performance Transactions”) with Content Providers whereby consumers purchase cards from a Distribution Partner who collects the load value and remits the load value less their commission to us. We agree to remit the load value less our commission directly to the Content Provider at the time and to the extent that the consumer redeems the card at the Content Provider’s place of business (that is, unlike the aforementioned transactions, we do not remit the proceeds to the Content Provider upon activation). Because the consumer may never fully redeem the card from the Content Provider, a certain amount of Performance Transactions are never redeemed by the end consumer and we have the contractual right to retain such unredeemed amounts. After purchase from the Distribution Partner, these cards are nonrefundable for the consumer. The Content Provider may elect to provide refunds and other adjustments to the consumer. At the time of such election, we would remit these funds to the Content Provider who would then provide the refunds or other adjustments to the consumer.

Prior to the consumer taking the additional actions described above for Telecom, Activation, and Performance Transactions, we have no obligation to remit the funds we have received to any party. We are not required (whether by contract or by law) to retain the cash received from the Telecom, Activation, or Performance Transactions in a third-party escrow account. Rather, the cash proceeds are commingled with our other general corporate cash accounts and may be used for general corporate purposes. Further, because the prepaid cards related to these transactions do not expire, there are situations where all or a portion of the original card value may never be redeemed by the end consumer (either because the card is never activated/associated or because the consumer does not demand full performance from the Content Provider). Accordingly, similar to retailers that issue gift cards and gift certificates with no expiration date that may go unredeemed in whole or in part, the Telecom, Activation, and Performance Transactions result in the Company incurring a liability (the “Prepaid Card Liabilities”) that may remain unclaimed or unredeemed for an indefinite period of time.

We recognize that if the funds from the transactions are escheatable under state laws for unclaimed property, we would continue to hold the liability until we escheat the funds pursuant to such laws. However, for purposes of the analysis in this paper, we are only considering instances where the unclaimed property is not subject to escheatment.

Background Accounting Considerations

We view the Content Provider as our customer and we report total gift card commissions from Content Providers as revenue and the amount shared with the Distribution Partner as an expense or cost of services. With respect to Content Providers (our standard closed loop business), we are not the primary

obligor related to the prepaid cards and do not take on credit or inventory risk related to the load value of the cards. Therefore, we have concluded that revenues recognized for our involvement in providing our services to the Content Provider should be limited to the total amount of commissions paid by the Content Provider rather than the gross load value (\$100 in the above example) of the card purchased by the end consumer. We believe this treatment is consistent with the guidance in Accounting Standards Codification (“ASC”) Subtopic 605-45, Revenue Recognition – Principal Agent Considerations.

Since Telecom and Activation Transactions require the consumer to take the appropriate action prior to using the funds loaded onto the cards, we have experienced a very short timeframe, generally a few days between the purchase of the card and the consumer’s full redemption of the funds. For Performance Transactions, we experience redemption transactions for a significant period of time after the purchase of the card. However, for each of these Transactions, we believe we can objectively demonstrate a point at which redemption by the consumer is remote¹. We have historically experienced minimal activity after such time period.

Since we market, distribute and sell each of these Transactions almost exclusively in the United States and have over two years of history for each of these transactions, we consider our history to have consistency and to be based on a large pool of homogenous transactions for each of these transaction types. Additionally, given the nature of Telecom and Activation Transactions which require the association or activation by the consumer prior to use of the funds loaded onto the cards, we believe that this trend will continue for any similar products that we introduce.

In the event of our bankruptcy, we believe consumers who purchased Telecom, Activation and Performance Transactions and have not yet associated the cards or redeemed for products would be considered general creditors.

Accounting Discussion

Application of a Breakage Model Prior to Adoption of ASC 606, Revenue from Contracts with Customers (“ASC 606”)

For Telecom, Activation, and Performance Transactions that are not subject to escheatment we believe that based on our unique facts and circumstances that it would be acceptable to analogize to the accounting principles that govern the recognition of prepaid gift card breakage and therefore to recognize into our income statement the Prepaid Card Liabilities once redemption is deemed to be remote. In reaching this conclusion, we noted that as discussed in the “Background Accounting Considerations”

¹ In our fact pattern and throughout this section of the letter “redemption” refers to activation/association of the prepaid card for the Telecom and Activation transactions or for the Performance Transactions when the consumer does not demand full performance from the content provider.

section of this letter, we have determined that we can reasonably and objectively determine when redemption is deemed to be remote².

At the 2005 National Conference on Current SEC and PCAOB Developments, Ms. Pamela R. Schlosser, a Professional Accounting Fellow of the Office of the Chief Accountant, expressed the SEC's views on recognition of prepaid gift card breakage as follows (emphasis added):

Let me start off with the topic of "breakage." In an arrangement in which a customer makes a payment in advance of vendor performance, the vendor would recognize deferred revenue at the time the payment is received. In some cases, the customer will, for various reasons, not end up demanding full performance. This is often referred to as "breakage." The question is when can the vendor derecognize the deferred revenue liability in the absence of performance?

In the past, the staff has stated that a vendor should apply the derecognition guidance found in Statement 140 [footnote omitted] to these arrangements, **but derecognition may also be acceptable in certain circumstances if the vendor can demonstrate that it is remote that the customer will require performance.**

In a recent registrant matter, the staff addressed breakage for gift cards sold to consumers. Based on historical redemption rates, the registrant determined that some percentage of gift cards sold, for example 10%, would go unredeemed. As a result, each time a gift card was sold, 10% of the value of the gift card was recorded as a credit to the income statement with the remaining 90% value being recorded as deferred revenue. In this case, the staff objected to the immediate recognition of breakage as we did not believe the delivery criterion had been met. That is, the company believed it was still required to perform under the gift card arrangement, just perhaps not for the full amount of value of the gift card sold. Since there has as of yet been no performance, we did not believe income recognition, in any amount, was appropriate, immediately upon the sale of the gift card.

Given that immediate recognition of breakage was not considered appropriate in this fact pattern, we were asked what approaches may be acceptable. Consistent with the staff's previous views, recognizing gift card breakage as the vendor is legally released from its obligation, for example at redemption or expiration, **or at the point redemption becomes remote** may both be acceptable methods.

Another approach may be to recognize breakage for unused gift card amounts in proportion to actual gift card redemption. Gift cards sold over a certain period of time would be considered on a homogenous pool basis. The estimated values of gift cards expected to go unused would then be recognized over the period of performance, that is, as the remaining gift card values are redeemed. To utilize this approach, a vendor would be required to not only reasonably and objectively determine the

² "Remote" is defined in ASC Topic 450, Contingencies as "the chance of the future event or events occurring is slight".

amount of gift card breakage, but also reasonably and objectively determine the estimated time period of actual gift card redemption.

Using my previous example of a 10% breakage rate, assume an entity issues \$1,000 of gift cards in a certain period and has objective evidence to support that those gift cards would be redeemed on a prorata basis over the next twenty-four months. The estimated breakage amount of \$100 would, therefore, be recognized ratably over the twenty-four month redemption period.

One final comment. **My discussion relates to breakage in a broad sense.** However, if you believe your particular circumstances warrant an approach that is unique to the general models covered today, I would encourage you to talk with members from our office.

Ms. Schlosser addressed a fact pattern where a vendor has an obligation to a customer that can be redeemed by a customer upon demand. Notwithstanding the fact that a customer could technically present a gift card to the vendor for redemption of goods or services sold by the vendor, the vendor has been able to determine based on historical experience that not all gift cards are redeemed by the gift card holder. While historically the SEC Staff had only supported application of the principles of Statement 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, Ms. Schlosser indicated that other methods of recognition of gift card breakage would be acceptable to the SEC Staff premised on an entity being able to reasonably and objectively determine when redemption is deemed to be remote.

In considering whether the application of the guidance to account for breakage as illustrated by the prepaid card example is appropriate in our facts and circumstances, we considered Ms. Schlosser's comment that "my discussion relates to breakage in a broad sense." When considering our facts and circumstances, we recognize that Prepaid Card Liabilities differ from prepaid gift cards in that our ultimate transfer of funds to a Content Provider does not result in the future delivery of a good or service, whereas the Content Provider does deliver a good or service when it redeems a gift card (e.g. in the event of a product sale, the redemption of a gift card will result in the recognition of revenue and cost of goods sold, in addition to the relief of inventory and relief of the gift card obligation). However, we do not believe that the payment of funds as opposed to delivery of a good or service precludes us from applying the principles prescribed for accounting for breakage for gift cards given the fundamental similarity between a Prepaid Card Liability and a gift card deferred revenue liability; both are liabilities under GAAP. Fundamentally, both the sale of a gift card by a third party vendor or the sale of a prepaid card through our website or through our Distributors creates a liability that is redeemable based on the future actions of the holder of the prepaid card. Additionally the period of time during which a customer can redeem the prepaid card is unlimited.

In both the unredeemed gift card described in Ms. Schlosser's speech and in our fact pattern, a substantive legal liability is established by acceptance of funds from a customer. The nature of the obligation in the gift card transaction described by Ms. Schlosser is also a legal liability in that the vendor must stand ready to provide goods or services upon redemption of the gift card by the ultimate gift card holder. When we receive funds from the sale of a prepaid card through either our website or through a Distributor, we

believe that our initial liability (i.e., the Prepaid Card Liabilities) should be viewed similarly to a vendor obligation. We acknowledge that we are not the primary obligor in these transactions and we do not have an obligation to provide goods or services to the consumer; however, we believe that until the consumer demands redemption, we have an on-going obligation to ensure that the consumer's card is activated (via our propriety network) and that the funds are appropriately remitted to the Content Provider. That is, the consumer depends on us, as well as the Content Provider, to ensure that the prepaid card is valid and can be exchanged for goods and services. Accordingly, until the consumer activates the card or demands performance from the Content Provider (in the case of the Performance Transactions), we do not have an obligation to the Content Provider. Rather, prior to that event occurring, our obligation is similar to the obligation incurred by the Content Provider (i.e., the obligation to stand ready to perform based on the consumer's decision). Similarly, because we are acting on behalf of a Content Provider as an agent to facilitate the use of a prepaid card, we believe that the nature of the obligation we incur should be subject to a similar accounting framework that would be applied to a Content Provider's obligation. That is, both obligations are contingent on action by the consumer that purchased the card. For these reasons, we believe that it would be acceptable to apply breakage to our obligation.

Further, the fact that the SEC Staff acknowledged that the acceptability of both the liability extinguishment framework and the breakage model described in Ms. Schlosser's speech seems to suggest that the SEC Staff does not believe that the liability extinguishment model is the only model that applies to situations where a substantive legal liability exists. In our view, the application of a gift card breakage model as described by the SEC Staff in the 2005 speech is acceptable by analogy to our Prepaid Card Liabilities upon the determination that redemption of the prepaid card is remote. Accordingly, we do not believe that we are required to apply the principles in paragraph 40-1 of ASC Subtopic 405-20 Liabilities – Extinguishment of Liabilities ("ASC 405-20") which states:

A debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:

- a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes the following:
 1. Delivery of cash
 2. Delivery of other financial assets
 3. Delivery of goods or services
 4. Reacquisition by the debtor of its outstanding debt securities whether the securities are cancelled or held as so-called treasury bonds.
- b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. For purposes of applying this Subtopic, a sale and related assumption effectively accomplish a legal release if nonrecourse debt (such as certain

mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt

The guidance at ASC 405-20-40-1 addresses a situation where debt has been issued to a borrower. In the typical fact pattern most likely contemplated by this guidance, debt repayments are based on a scheduled maturity date and are intended to provide a mechanism for financing for the borrower. In contrast, in our fact pattern, there is no stated “maturity date” for the Prepaid Card Liabilities as the card holder’s right to utilize the prepaid card never lapses with the passage of time. Rather, similar to an obligation incurred by a retailer that issues prepaid gift cards, our obligation to remit funds to the Content Provider is contingent on whether the consumer chooses to exercise their right to utilize the prepaid card. Moreover, we have a large volume of relatively homogenous prepaid card transactions, rather than an individually significant liability that would more be within the scope of ASC 405-20. For these reasons we believe that the Prepaid Card Liabilities have similar characteristics and more closely resemble a vendor’s obligation for an unredeemed gift card (where a customer has a right to make a claim of goods or services and never exercises that right) as opposed to an outstanding debt transaction as contemplated in ASC 405-20. As noted in the “Background Accounting Considerations” section to this letter, we are subject to limited legal or regulatory requirements that would require us to remit payment received from a customer for rights that remain unexercised to a government entity (i.e., unclaimed property or “escheat” laws”). To the extent that we are subject to escheat laws, we do not believe that it would be acceptable to analogize to the breakage model and to recognize estimated breakage on the Prepaid Card Liabilities because any unredeemed consideration received from a customer must be eventually remitted to a governmental entity.

Additionally, the application of an ASC 405-20 framework to the Prepaid Card Liabilities where the right has no expiration date results in an impractical outcome which is evident in our fact pattern. If we were to continue to apply an ASC 405-20 framework, the Prepaid Card Liabilities would continue to grow over time with no apparent mechanism to relieve the obligation as discussed in the following paragraph. This view is consistent with a PwC interpretative view at section .728 *Breakage in Sales Incentives* in their *Revenues and Receivables* manual dated July 24, 2009, in which they describe their interpretive views regarding the acceptability of three models for breakage. In the “liability model” below, PwC acknowledges that this model may be impractical for situations where unclaimed rights do not expire and states (emphasis added):

Liability Model - ASC 405-20-40-1 states that a liability may be de-recognized when the entity has been "legally released from being the primary obligor" under the arrangement. By analogy, it is generally acceptable to de-recognize an unredeemed incentive obligation and record income when the right expires. This approach may be most appropriate for vendors who cannot reliably estimate breakage. **However, for rights which do not expire, this model may be impractical.**"

Lastly, in developing our point of view we considered the alternative that some may view our obligation under the arrangements described above as meeting the GAAP definition of a financial liability. We believe the Content Providers may be able to argue that their obligation to stand ready to perform does not meet the definition of a financial liability because the customer only has the right to demand fulfillment of

goods or services when the customer undertakes a redemption transaction or activity with the Content Provider and because the customer has no rights to demand cash or another financial instrument. However, in our case, the funds that we hold and must remit to the Content Provider upon customer action as described above do represent an obligation for us to deliver cash to the Content Provider even though there is no obligation for either us or the Content Provider to ultimately deliver anything other than goods or services to the customer or card holder. Accordingly, we acknowledge that in that manner our obligation can be viewed as a financial liability. In our view, if one takes the position that the obligation is a financial liability, we would argue that the financial liability should not be subject to the scope of ASC 405-20 because we believe the nature of this obligation was not contemplated to be subject to that standard when the standard was written. We also believe that for the following reasons the obligations should be excluded from being in the scope of financial liability derecognition under ASC 405-20:

1. Our obligation to the cardholder that is settled by our payment to the third party Content Provider who provides the cardholder with fulfillment of goods or services is more akin to an insurance or warranty contract obligation than to a financial liability. ASC 825-10-15-4 (d) and (e) describe the terms of such insurance or warranty contracts that under that related guidance are not deemed to be a financial instrument. We and the customer/cardholder are parties to the cardholder agreement. Under those related card terms the cardholder only has a right to redeem the card value for goods and services at certain designated Content Providers. Our obligation to the cardholder is for the card to be honored as payment for goods and services when it is presented as payment at the Content Provider. As we are not the Content Provider who will fulfill that obligation to deliver the related goods or services, we have an obligation to transfer the collected funds to the Content Provider in accordance with the terms described above in this letter.
2. Although this is redundant with some of the discussion earlier in the letter, we note that the guidance at ASC 405-20-40-1 addresses a situation where debt has been issued to a borrower. In the typical fact pattern most likely contemplated by this guidance, debt repayments are based on a scheduled maturity date and are intended to provide a mechanism for financing for the borrower. In contrast, in our fact pattern, there is no stated "maturity date" for the Prepaid Card Liabilities as the card holder's right to utilize the prepaid card never lapses with the passage of time. Rather, similar to an obligation incurred by a retailer that issues prepaid gift cards, our obligation to remit funds to the Content Provider is contingent on whether the consumer chooses to exercise their right to utilize the prepaid card. Moreover, we have a large volume of relatively homogenous prepaid card transactions, rather than an individually significant liability that would more be within the scope of ASC 405-20.
3. In the type of Prepaid Card Liability transactions described above that we are involved in that are affected by Issue No. 15-B, we view that we have an agency relationship with the related Content Providers and that we are in exactly the same economic position that the Content Provider would be in if the Content Provider issued the prepaid cards directly to the cardholder rather than using us or our distribution channels to issue the cards. Although the SEC speech referenced above was written for Content Providers who act as the card issuer in prepaid gift card transactions, we

believe applying the same approach to the breakage that we have the right to retain for generally the same types of prepaid cards is a reasonable approach. In particular, for obligations with no expiration, we believe that an accounting approach that results in an indefinite deferral of breakage recognition by application of the ASC 405-20 guidance is not reasonable nor does it reflect the economics of the transactions.

Accordingly, based on the reasons described above, we believe that it is acceptable to analogize to the accounting principles that govern the recognition of prepaid card breakage and therefore to recognize into our income statement the Prepaid Card Liabilities once redemption is deemed to be remote.

Alternative View Prior to Adopting ASC 606

Under this view the Prepaid Card Liabilities are financial liabilities that are subject to the scope of ASC 405-20. Because the Prepaid Card Liabilities do not represent a right to a consumer which can only be exchanged, or redeemed, for goods and service we cannot apply the breakage model that was accepted by the SEC Staff. Instead, we would view the Prepaid Card Liabilities as a financial liability subject to the derecognition provisions of ASC 405-20. ASC 405-2-40 provides that a liability shall be derecognized if and only if it has been extinguished. The guidance states two conditions that must be met in order to derecognize a liability: (1) the debtor pays the creditor and is relieved of the obligation for the liability and (2) the debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. Accordingly, we would be unable to derecognize the Prepaid Card Liabilities until we remitted cash to the Content Provider, and in the absence of that, such liabilities would remain on our balance sheet (and grow) in perpetuity.

Accounting Analysis under ASC 606

In reaching the above conclusions, we also noted that we are required to adopt ASC 606 as of January 1, 2017. ASC 606-10-15-2 states that “an entity shall apply the guidance in this Topic to all **contracts** with **customers**, except the following (in part):

[...]

- c. Financial instruments and other contractual rights or obligations within the scope of the following Topics:

5. Topic 405, Liabilities

In consideration of the ASC 606 scope exception for contracts that are subject to the scope of ASC 405, we made the same considerations regarding the question of whether our Prepaid Card Liabilities are financial liabilities as are described in our accounting analysis above. Accordingly, as stated in the earlier sections of this letter, we believe that an argument can be made that either 1) the Prepaid Card Liabilities are not a financial liability or 2) if they are a financial liability, we believe the arguments presented above would support an exception to applying the ASC 405-20 liability derecognition guidance and in lieu of

that guidance we would support the application by analogy of the breakage guidance for contracts that is addressed in ASC 606-10.

Paragraph 55-48 of ASC 606-10 includes authoritative guidance on breakage for contract liabilities and states:

If an entity expects to be entitled to a breakage amount in a contract liability, the entity should recognize the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. If an entity does not expect to be entitled to a breakage amount, the entity should recognize the expected breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote. To determine whether an entity expects to be entitled to a breakage amount, the entity should consider the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration.

Under ASC 606 breakage represents a form of variable consideration that is subject to the constraint on variable consideration. That is, if it is probable that a significant revenue reversal would occur for any estimated breakage amounts, an entity should not recognize those amounts until the potential for reversal has passed. If breakage is not subject to the variable constraint, breakage is recognized as revenue in proportion to the pattern of rights exercised by the customer or, if an entity is unable to estimate the breakage amount, when the likelihood of the customer exercising its remaining right becomes remote. This is a change from current GAAP that permits the use of three acceptable accounting models to recognize breakage including (i) recognition as redemption occurs, (ii) recognition when the right expires, and (iii) recognition when it becomes remote that the holder of the right will demand performance.

Financial Statement Presentation

We believe that the relief of Prepaid Card Liabilities can be recognized into the income statement as other revenue given that the Prepaid Card Liabilities directly relates to the Company's major operations. Paragraph 78 of Statement of Financial Accounting Concepts No. 6 Elements of Financial Statements ("CON 6") defines revenues as follows (emphasis added):

Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that **constitute the entity's ongoing major or central operations**.

We also considered the description of gains in paragraph 82, and the comparison of revenues and gains in paragraph 87 of CON 6 which states (emphasis added):

Gains are increases in equity (net assets) from **peripheral or incidental transactions** of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from revenues or investments by owners.

Revenues and gains are similar, and expenses and losses are similar, but some differences are significant in conveying information about an enterprise's performance. Revenues and expenses

result from an entity's ongoing major or central operations and activities—that is, from activities such as producing or delivering goods, rendering services, lending, insuring, investing, and financing. In contrast, gains and losses result from incidental or peripheral transactions of an enterprise with other entities and from other events and circumstances affecting it. Some gains and losses may be considered "operating" gains and losses and may be closely related to revenues and expenses. Revenues and expenses are commonly displayed as gross inflows or outflows of net assets, while gains and losses are usually displayed as net inflows or outflows.

The recognition of Prepaid Card Liabilities into the income statement arises as a consequence of our providing a service (i.e. remitting money to the Content Providers and providing activation via our proprietary network) that is part of our ongoing major/central operations and the failure of the customer to activate and/or use the prepaid cards, as opposed to peripheral or incidental transactions of the Company. Accordingly, we believe that classification of the credit within revenue is acceptable.

To summarize, we believe a breakage model is acceptable to apply by analogy to our specific facts and circumstances. Relevant facts that support this conclusion are as follows:

- The liabilities arise in the normal course of our business activities, and are not borrowing or financing activities.
- The liabilities are comprised of a large pool of homogenous transactions (high volume, low magnitude).
- We have sufficient internal historical data to be able to reasonably estimate the portion of such liabilities for which ultimate payment is remote.

Because the liability has no maturity date and is not subject to escheat, an ASC 450-20 model would present an obligation in our financial statements that would grow in perpetuity, when in fact historical experience informs us that we will be able to use the funds in our operations because it is remote that we will transfer those funds to someone else.

Fair Value Model Alternative

If the EITF does not conclude on Issue No. 15-B that it would be acceptable to analogize to the breakage model for the Prepaid Card Liabilities, we have also considered and we believe that it would be acceptable to elect the fair value option pursuant to ASC 825, Financial Instruments (formerly FASB 159) ("ASC 825") for the Prepaid Card Liabilities as they arise in the future (the fair value model would not be available for previously incurred liabilities). We suggest that the FASB Staff consider adding the application of the fair value option to Prepaid Card Liabilities as part of the scope of Issue No. 15-B to assist entities in considering another reasonable accounting alternative to account for such obligations.

Paragraph 15-4 of ASC 825-10 outlines the items for which an entity may elect the fair value option and states in part:

All entities may elect the fair value option for any of the following eligible items:

- a. A recognized financial asset and financial liability, except any listed in the following paragraph

[...]

The ASC Master Glossary defines a financial liability as follows:

A contract that imposes on one entity an obligation to do either of the following:

- a. Deliver cash or another financial instrument to a second entity
- b. Exchange other financial instruments on potentially unfavorable terms with the second entity.

Under this view, the Prepaid Card Liabilities would be viewed as a financial liability because it imposes an obligation on us to deliver cash to the Content Providers and therefore the Prepaid Card Liabilities would be within the scope of ASC 825. Additionally, ASC 825 allows entities to elect the fair value option for any financial liabilities, except for those listened in paragraph 15-5 of ASC 825-10, which states:

No entity may elect the fair value option for any of the following financial assets and financial liabilities:

- a. An investment in a subsidiary that the entity is required to consolidate.
- b. An interest in a variable interest entity (VIE) that the entity is required to consolidate.
- c. Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in Topics 420; 710; 712; 715; 718; and 960.
- d. Financial assets and financial liabilities recognized under leases as defined in Subtopic 840-10. (This exception does not apply to a guarantee of a third-party lease obligation or a contingent obligation arising from a cancelled lease.)
- e. Deposit liabilities, withdrawable on demand, of banks, savings and loan associations, credit unions, and other similar depository institutions.

- f. Financial instruments that are, in whole or in part, classified by the issuer as a component of shareholders' equity (including temporary equity) (for example, a convertible debt instrument with the scope of the Cash Conversion Subsections of Subtopic 470-20 or a convertible debt security with a noncontingent beneficial conversion feature).

We do not believe that any of these exceptions apply and therefore we could elect the fair value option for the Prepaid Card Liabilities. In reaching this conclusion, we noted that the Prepaid Card Liabilities may be viewed as having similar characteristics as deposit liabilities; however, we believe that our Prepaid Card Liabilities are substantially different from a deposit liability because we do not provide the Content Provider with the right to withdrawal of deposited funds at some point in the future. Rather, funds are remitted to the Content Provider only upon the consumer exercising his or her redemption right. Further, we are not subject to the same laws and regulations as depository institutions such as banks.

Moreover, we believe that the scope exclusion is based on the legal form of the financial liability rather than the substance of the financial liability. That is, we do not believe that the FASB intended to create a principle based scope exception that would be applicable to all financial liabilities with similar characteristics as bank held deposit liabilities. Instead, the deposit liabilities were excluded from the scope of FASB 159 because of concerns expressed during the FASB's deliberations on FASB 159 by the Federal Deposit Insurance Corporation (the "FDIC") and the Federal Reserve regarding demand deposit accounts. Specifically, during the FASB's deliberations on July 6, 2006, the FDIC expressed concern about the nonfinancial components of demand deposit accounts and the Federal Reserve expressed concern regarding the reliability surrounding fair value measurements of demand deposit accounts. Because of these concerns, during the FASB's deliberations on August 31, 2006, the Board agreed by a vote of 6 to 1 with the staff recommendations to consider demand deposit liabilities in the second phase³ of the fair value option project and to define demand deposit liabilities as financial liabilities of financial institutions with demand features in a manner consistent with the IASB. Accordingly, based on our review of the board minutes from the FASB's deliberations, demand deposit liabilities were discussed in the context of financial institutions such as banks, savings and loan associations, credit unions, and other similar depository institutions, and were specifically excluded from the scope of FASB 159 because of concerns expressed during the deliberations by the regulators of those institutions. Therefore because we are not a depository institution and we are not subject to the same laws and/or regulations as a depository institutions, we do not believe that the scope exception in paragraph 15-5(e) of ASC 825 is applicable to our facts and circumstances.

This conclusion is consistent with E&Y's publication, Summary of FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115*, which states (emphasis added):

The Board decided to exclude deposit liabilities, withdrawable on demand, from the scope of Statement 159 because those liabilities are often significantly affected by nonfinancial components.

³ The FASB decided not to pursue the second phase of the fair value option project.

However, the scope exclusion was limited specifically to demand deposit liabilities of banks, thrifts, or other similar depository institutions. Based on our interpretation of Board deliberations and our discussions with the FASB Staff, it is our understanding that insurance and investment contracts, as defined under Statement 97, that allow the holder to withdrawal or demand amounts specified in the contract (e.g., cash surrender value) would be eligible for the fair value option.

We thank you for your time in reviewing our facts and circumstances and related analysis. We welcome the opportunity to answer any questions you may have. In that event, please reach out to Joan Lockie, our Corporate Controller and Chief Accounting Officer ((925)226-9337; Joan.Lockie@BHNetwork.com).

Sincerely yours,

A handwritten signature in dark ink, appearing to read 'J. Ulrich', with a stylized, flowing script.

Jerry Ulrich
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