September 14, 2012

David A. Stawick
Secretary, Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW.
Washington, DC 20581

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants/File number RIN 3038—AC97

The undersigned group of companies[1] is pleased to provide additional comments to the Commodity Futures Trading Commission ("CFTC") regarding its Notice of Proposed Rulemaking ("NPR") entitled, "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants."[2] The NPR would implement the new statutory framework of Section 4s(e) of the Commodity Exchange Act ("CEA"), added by Section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which requires the CFTC to adopt initial and variation margin requirements for certain swap dealers and major swap participants. These requirements would apply to certain derivatives that are not cleared through a central clearinghouse.

This letter expands upon the information provided to the CFTC in our letter dated June 23, 2011 ("2011 Letter"),[3] which is incorporated herein by reference.

The 2011 Letter

In the 2011 Letter, we described the unique mission of captive finance companies, which is namely to provide financial products that promote and facilitate the sale or lease of products that are manufactured by our parent companies. Unlike traditional financial entities, captive finance companies engage in derivatives *solely* to hedge and mitigate underlying commercial risk related to interest rate or foreign currency exposures. In fact, a captive finance company is analogous to the treasury department of a manufacturing company that is considered a commercial end-user.

The 2011 Letter addressed how margin requirements would significantly increase end-user (and their captive finance companies) costs and liquidity requirements as well as divert capital that otherwise could be reinvested in business and job creation. Additionally, margin requirements could necessitate new and costly incremental

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[1] Caterpillar Financial Services Corporation, John Deere Financial, Ford Motor Credit Company, American Honda Finance Corporation, Nissan Motor Acceptance Corporation, Toyota Financial Services, and Volvo Financial Services.
[2] See 76 *Federal Register* 23732-23749.
[3] See comment letter (June 23, 2011) available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=45793.

funding requirements on end-users, who unlike swap dealers and major swap participants, do not have expedient and low-cost access to liquidity sources like the discount window or consumer deposits. Further, the imposition of margin requirements could also create a disincentive for end-users to hedge business risks – which is contrary to regulators' intent.

The 2011 Letter also highlighted that Congress recognized the unique role of captive finance companies in supporting the nation's manufacturing base and providing reliable and low-cost financing for the purchase and lease of capital intensive products. Congress also recognized that captive finance companies pose little risk to major financial institutions or to the financial system as a whole. For this reason, Congress treated captive finance companies as other commercial end-users in the Dodd-Frank Act by excluding them from the definition of a "financial entity" for the purposes of the mandatory clearing requirement of Section 2(h)(7)(C) of the CEA, as well as from the definition of "major swap participant," via the captive finance company exemption, or the so-called 90/90 language. [4]

The 90/90 language in the Dodd-Frank Act provides a narrow and limited exemption for true captive finance companies, and it states that the statutory definitions of "financial entity" and "major swap participant" shall not include:

"[A]n entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company."

In addition to highlighting the 90/90 language, the 2011 Letter further articulated why captive finance companies should be considered commercial end-users with respect to the imposition of margin requirements. Any margin requirements with respect to captive finance companies would not only contravene Congressional intent, it would also negate the clearing exemption provided by the captive finance company exemption. In particular, the 2011 Letter requested that the definition of "financial entity" in Section 23.150 of the NPR be consistent with the definition of "financial entity" in Section 2(h)(7)(C) of the CEA, including the exemption language. The 2011 Letter also expressed our belief that the Dodd-Frank Act did not give regulators the authority to impose margin requirements on commercial end-users, such as captive finance companies.

Recent CFTC Rulemakings

We are pleased that the CFTC's (and the Securities and Exchange Commission's) joint Final Rule on "entity definitions" (which, among other things, defined and interpreted

[4] See 7 U.S.C. 2(h)(7)(C)(iii) and 7 U.S.C. 1a(33)(D), respectively.

"major swap participant")[5] and the CFTC's Final Rule on the End-User Exception to the Clearing Requirement for Swaps[6] both recognize the importance of the captive finance company exemption and interpret the 90/90 language in a reasonable and fair manner, consistent with Congressional intent. Although constrained by the text of the Dodd-Frank Act, we believe that in both instances, the CFTC has provided guidance on the 90/90 language that reflects the actual business practices of captive finance companies. This guidance will help ensure that only true captive finance companies meet the stringent 90/90 test standards, while at the same time, limiting the risk of unintended negative consequences from an overly-rigid interpretation. We applaud the CFTC for striking the proper balance in these two rulemakings.

Recent Legislative Activity

In addition, recent legislative activity has reaffirmed Congress' intent to treat captive finance companies as non-financial entities and exempt them from margin requirements. Earlier this year, the House of Representatives overwhelmingly passed H.R. 2682 by a 370-24 vote. This legislation removes any ambiguity in the Dodd-Frank Act and confirms that margin requirements should not apply to a swap where one of the counterparties qualifies for an exception to the central clearing requirement of CEA Section 2(h)(7)(C). A bipartisan group of Senators introduced similar legislation, S.3480, just last month. While not yet law, we maintain that this legislation further demonstrates Congress' intent not to impose margin requirements on commercial end-users, such as captives.

Basel and IOSCO Consultative Document

We recognize that CFTC reopened the comment period on the NPR largely in response to the Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO") recent consultative document on Margin Requirements for Non-Centrally-Cleared Derivatives ("Consultative Document").[7] We fully intend to submit comments on the Consultative Document before the deadline later this month.

We note that the Consultative Document states:

"There was broad consensus within the BCBS and IOSCO that the margin requirements need not apply to non-centrally-cleared derivatives to which non-financial entities that are not systemically-important are a party, given that (i) such transactions are viewed as posing little or no systemic risk and (ii) such transactions are exempt from central clearing mandates under most national regimes."[8]

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[5] See 77 *Federal Register* 30596-30764.
[6] See 77 *Federal Register* 42560-42591.
[7] Consultative Document (July 6, 2012) available at: http://www.bis.org/publ/bcbs226.pdf
[8] See page 9 of Consultative Document.

We are pleased the Consultative Document recognizes that transactions involving non-financial entities (i.e., commercial end-users) should not be subject to margin requirements because such transactions do not pose systemic risk and are generally not required to be centrally-cleared (including in the United States).

Neither the Consultative Document nor the current European Market Infrastructure Regulation ("EMIR") framework specifically address captive finance companies or explicitly categorize captive finance companies as "non-financial" entities as the U.S. Congress did in the Dodd-Frank Act. We believe that it is important that all international regulators follow the U.S. lead and recognize that captive finance companies' use of swaps to hedge their interest rate and foreign currency risk does not pose a systemic risk and that captives, like other commercial end-users, should be exempt from margin requirements. We also support the apparent recognition in the Consultative Document that entities that are exempt from clearing should also be exempt from new margin requirements. A contrary result would effectively nullify the clearing exemption and reduce the ability of commercial end-users to efficiently hedge their commercial risks.

While we applaud efforts to promote international harmonization and certainly support efforts to apply a uniform set of margin rules across borders, the CFTC and other U.S. regulators cannot, and should not, allow any disagreements with its international colleagues over how margin rules should be applied be used as a basis for ignoring the clear judgment of the U.S. Congress that captives should not be treated as "financial entities" for the purpose of swap trading and should be exempt from mandatory clearing and margin requirements.

Impact on Securitization

We would like to elaborate on the dramatic impact the imposition of margin requirements would have on the securitization process for captive finance companies. Captive finance companies commonly use, and frequently rely on, securitization to fund their own operations and support their parent manufacturing companies. These securitizations are an extension of the financing process and play an important role in our ability to support our parent companies as well as consumers and dealers of our parent's products. As such, it is imperative that securitization trusts – special purpose entities affiliated with the captive finance company – be treated as captives for purposes of both mandatory clearing and margin requirements. These trusts use derivatives to hedge interest rate risk and ensure investors receive timely payment of interest. These derivatives are crucial to achieving a high credit rating given the protection they provide investors.

Applying the margin requirements in the proposed uncleared swap margin rules to securitization trusts would have serious negative consequences for the asset-backed securities (ABS) market. Securitization trusts would not be able to comply with margin posting requirements as they are not presently structured to have access to cash and liquid securities. The source of repayment for securitization trusts is generally the cash

flows from the securitized assets or receivables which are generated over time. Subjecting securitizations to margin posting would, at a minimum, make securitization transactions significantly less efficient, resulting in dramatically higher funding costs. Given potential difficulties associated with developing a methodology and attempting to quantify potential peak margin requirements over the life of a securitization, there are questions regarding whether ratings needed to access the ABS market are even achievable.

The application of a margin requirement will restrict a securitization trust's ability to use derivatives, and therefore, will render many securitizations uneconomic. Captive finance companies may limit or forgo securitizations, causing adverse effects on the functioning of this market and increasing captives' financing costs. This would, in turn, ultimately translate to higher financing costs for consumers and dealers on the purchase or lease of parent company products, impacting the parent's ability to reinvest in business and job creation.

There is also clear Congressional intent that securitization trusts used by captive finance companies should benefit from the same exemptions from the clearing and margin requirements. Senators Debbie Stabenow (MI) and Blanche Lincoln (AR) stated in the *Congressional Record* that, "Derivatives are integral to the securitization funding process," and that the Dodd-Frank Act should exempt these entities from clearing and margin. [9]

In addition, EMIR rules clearly identify securitization entities as exempt from clearing and margin requirements. We, therefore, request that the CFTC and other U.S. regulators make clear that these entities are also exempt in the United States. Such a position will both preserve the functioning of a market critical to the U.S. economy as it allows captive finance companies to continue to support retail customers and dealers and harmonize U.S. regulations with those in Europe.

Conclusion

Because of the role that captive finance companies play in the U.S. economy, we urge the CFTC and the other U.S. regulators to fully respect the intent of Congress and exempt such entities and their securitization trusts from margin requirements. In its NPR, the CFTC correctly concluded that entities exempt from the clearing requirements of Section 2(h)(7)(C) of the CEA should also be exempt from margin requirements. Accordingly, we submit that the CFTC should clarify that captive finance companies and their securitization trusts that meet the 90/90 test are not "financial entities" for the purpose of the margin rules. The CFTC should not deviate from the definition of "financial entity" provided in Title VII of the Dodd-Frank Act, which includes an explicit exemption for captive finance companies. We further submit that sound policy underlies the statutory exemption for captives and urge the international regulators to

[9] See 156 *Congressional Record* 105 (July 15, 2010), pg. S5905-S5906.

clarify that captive finance companies be treated as non-financial commercial end-users for the purpose of application of margin rules in all relevant jurisdictions.

We thank you again for the opportunity to provide additional comment on the NPR.

Sincerely,

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