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August 13, 2018

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: De Minimis Exception to the Swap Dealer Definition; Notice of Proposed Rulemaking [RIN 3038-AE68]

Dear Mr. Kirkpatrick:

Capital One Financial Corporation ("Capital One")[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC" or the "Commission") in response to a notice of proposed rulemaking (the "Proposal"),[2] amending several aspects of the Commission's de minimis exception to the swap dealer definition ("SD Definition").[3] As addressed in more detail in this letter, Capital One strongly supports the Proposal's intended objectives of "increase[ing] efficiency, flexibility, and clarity in the application of the [SD Definition]."[4] The Commission's proposed changes are of critical importance to U.S. swaps markets because, once adopted, those changes will not only impact market participants that engage in swap dealing activities, but also their counterparties, many of which pose minimal or zero systemic risk concerns to U.S. financial markets.

The issues addressed in the Proposal directly impact the swaps activities of Capital One's commercial banking business. This business primarily originates loans (and participates in loans originated by other banks) for its commercial banking customers. In connection with the

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[1] Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries, which include Capital One, N.A., and Capital One Bank (USA), N.A., had $248.2 billion in deposits and $364.0 billion in total assets as of June 30, 2018. Headquartered in McLean, Virginia, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients through a variety of channels. Capital One, N.A. has branches located primarily in New York, Louisiana, Texas, Maryland, Virginia, New Jersey and the District of Columbia. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

[2] *See* CFTC Proposed Rule, *De Minimis Exception to the Swap Dealer Definition*, 83 Fed. Reg. 27444 (June 12, 2018).

[3] The Commission further defined the term "swap dealer" in Commodity Exchange Act section 1a(49) by promulgating CFTC regulation 1.3. *See* 17 CFR 1.3. Paragraph (4) of the SD Definition sets forth the various provisions of the swap dealer de minimis exception, some of which are discussed in our comments below.

[4] 83 Fed. Reg. at 27477.

origination of (or participation in) these loans, Capital One enters into swaps with its commercial banking customers so that those customers can hedge risks associated with the financial terms of the related loans. Capital One also enters into swaps with customers in order to help them hedge their other interest rate, foreign exchange and commodities risks arising from their business operations. In order to ensure that it can offer competitively-priced swaps to its customers, Capital One generally manages the risk exposures arising from each of its customer-facing swaps by entering into offsetting swaps with swap dealers. Further, Capital One enters into swaps in order to mitigate its own enterprise-wide interest rate and foreign exchange risks.

Capital One generally supports the Commission's proposed changes to the swap dealer de minimis exception in such a way that "increas[es] efficiency, allow[s] limited ancillary dealing, encourag[es] new participants, and focus[es] regulatory resources."[5] In the sections that follow, we provide more detail regarding our comments to specific aspects of the Proposal, which seek to achieve these stated objectives. In particular, we support the Commission's proposals to: (1) maintain at least an $8 billion de minimis exception threshold; (2) ideally with a few minor changes, amend the exception to include an IDI de minimis provision;[6] (3) amend the exception to include a hedging de minimis provision; and (4) exclude foreign exchange ("FX") non-deliverable forwards ("NDFs") (and preferably FX window forwards) from the de minimis threshold calculation.

The Commission should maintain the swap dealer de minimis exception threshold at an aggregate gross notional amount of at least $8 billion

Capital One supports the Commission maintaining its swap dealer de minimis threshold at an aggregate gross notional amount ("AGNA") of at least $8 billion for important policy reasons. First, the CFTC's current $8 billion swap dealer de minimis threshold appropriately balances the Commission's policy objectives of requiring comprehensive swap dealer registration and regulation while encouraging smaller or mid-sized banks that engage in ancillary de minimis swap dealing activity to provide needed market liquidity to smaller end-users. If these small and mid-sized banks were forced to register as swap dealers, end-user commercial borrowers might be priced out of entering into swaps with these smaller bank counterparties.

These borrowers also might be unable to efficiently establish a swap trading relationship with larger banks. Given that these end-user commercial borrowers are only executing a swap in connection with a commercial loan, it would not be cost-efficient or practical for a third-party dealer—one that is not the lending bank and does not have an existing relationship with these end-users—to onboard these new end-user counterparties since it is unlikely that the counterparties will use the third-party dealer for additional swap transactions.[7]

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[5] *Id.* at 27450.

[6] In particular, we believe that, in adopting a final rule, the Commission should modify this aspect of the Proposal to ensure that the timing requirements are not restrictive. More details on our suggested modifications are discussed below.

[7] Many smaller end-user counterparties will only engage in one swap in connection with a loan, thereby making additional swap business with them unlikely.

Second, we believe that maintaining the swap dealer de minimis threshold AGNA at least at $8 billion is consistent with the goals of the CFTC's Project KISS initiative.[8] Project KISS intends to reduce the drag that the Commission's derivatives regulatory regime may have on the American economy. Maintaining the threshold at its current level would provide continuity and certainty to U.S. swaps markets since market participants have operated under, and have built compliance monitoring systems calibrated to, the current rule's $8 billion AGNA threshold. Further, maintaining the threshold would foster the efficient application of the SD Definition by addressing the uncertainty associated with the current rule's expected automatic drop to a $3 billion AGNA threshold. We agree with the Commission's comprehensive analysis of swaps data over a five-year period that reducing the threshold below $8 billion would increase regulatory coverage of smaller, unregistered liquidity providers without a concomitant benefit to the risk-reducing objectives of the Commission's SD Definition.[9]

Third, a reduction in the swap dealer de minimis threshold would also run counter to the Commission's objectives by reducing swap market liquidity for smaller end-users, which are currently the counterparties to unregistered swaps liquidity providers. These end-users provide jobs and otherwise fuel the American economy. As noted by the Commission several times in its Proposal, the policy objective of the swap dealer de minimis exception is to encourage participation and competition by allowing persons to engage in a de minimis amount of dealing without incurring the costs of registration.[10]

The Proposed IDI De Minimis Provision is appropriate with further clarifications

Capital One supports the Proposal's new paragraph (4)(i)(C) of the SD Definition, which would exclude from the calculation of the swap dealer de minimis threshold certain loan-related swaps entered into by IDIs (the "IDI De Minimis Provision"). In comparison to the current IDI exclusion in paragraph (5) to the SD Definition, we believe that the Proposal more accurately addresses the needs of end-users that are looking to access cost-effective and tailored hedges for their commercial loans. IDIs enter into swaps in connection with a loan to help the bank provide an extension of credit to an end-user in the most cost-effective and administratively efficient manner. To that end, we believe that there are minor changes that the Commission should make to proposed paragraph (4)(i)(C), which would better reflect the ways in which end-users and IDIs entered into lending arrangements. Accordingly, we support the Proposal's IDI De Minimis Provision; however, we believe the CFTC should further clarify certain areas of the IDI De Minimis Provision to better address the actual lending and hedging needs of end-user commercial borrowers.

Timing Requirement. As noted by the Commission, the existing IDI exclusion in paragraph (5) of the SD Definition only includes swaps entered into contemporaneously with a loan, which may result in higher borrowing costs for commercial banking customers. Among other restrictions, this contemporaneous timing requirement in the current exclusion includes a 180-day restriction. This restriction has resulted in end-users having to choose between entering into a swap on a date that they may deem unfavorable to their business or, in those instances where the lender bank is not a

[8] *See* CFTC Request for Information, Project KISS, 82 Fed. Reg. 23765 (May 24, 2017).

[9] *See* 83 Fed. Reg. at 27454.

[10] *See id.* at 27448, 27454.

swap dealer and does not want to become one, to incur higher costs and/or the additional administrative burden by entering into a swap with dealers other than the lender bank, assuming that the end-users can efficiently establish swap trading relationship with willing dealers (as noted above).[11]

It is for this reason that Capital One supports the IDI De Minimis Provision's removal of the 180-day restriction. The current date range in the SD Definition's exclusion limits Main Street businesses' ability to hedge the risks in their commercial loan financings efficiently. The removal of the 180-day requirement is particularly important because clients that did not realize volatility in their interest rate exposures when they originally entered into loans may find themselves seeking protection from their exposures in a rising-rates environment. From a practical and policy perspective, it would be a bad outcome if it is difficult for these customers to find protection or are left unprotected as interest rates increase.

We also support the exception to the 90-day restriction, so that counterparties can enter into swaps prior to loan funding where the counterparties have executed commitments or forward agreements. In addition, we believe that the Commission should clarify this exception to include situations where the counterparties have also agreed to and documented all of the material loan terms. In other words, an IDI should be able to avail itself of the exception where the counterparties have memorialized their loan by creating an agreed-upon term sheet, which provides clear evidence that the swap is being executed in connection with the origination of a loan. Ultimately, we believe the inclusion of "agreed terms" within the exception to the 90-day restriction would more accurately reflect market practice. We also believe that this change would address the Commission's concerns around ensuring that there is a written evidence tying the swap and the loan, without creating restrictive, defined documentation categories of "executed commitments" or "forward agreements."

Syndicated Loan Requirement. Capital One supports the Proposal's recognition of current market practice by proposing to set the syndicated loan requirement at 5 percent. The Proposal correctly acknowledges that lenders in many loan syndications do not have control over their final share of the syndication.[12] Indeed, industry practice on some participations can, and often do, fall below 10 percent (and can in some cases fall below 5 percent). This change would provide greater flexibility on loan-related swaps with less concern about whether those swaps should be counted towards the swap dealer de minimis threshold AGNA calculation.

Total Notional Amount of Swaps. Capital One supports the Proposal's removal of the restriction that the AGNA of swaps entered into in connection with a loan not exceeding the principal amount of the outstanding loan. In certain cases, it is common market practice for the AGNA of loan-related swaps to exceed the outstanding principal amount of the loan. For example, a customer

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[11] The higher costs imposed by the other dealer could include, for example, a request for additional collateral as compared to the lender bank, which in most cases structures the loan so that the underlying collateral also cross-collateralizes the related swap. Further, the end-users would bear substantial administrative costs and the use of resources in setting up a new credit relationship with an unknown bank outside of their lender. These administrative costs would include things such as negotiating new swap trading relationship documentation, satisfying additional due diligence requests and identifying credit risk.

[12] *See* 83 Fed. Reg. at 27461.

may enter into a forward starting swap to hedge future draws under a loan. In those cases, the notional amount of the forward starting swap will exceed the outstanding principal amount of the loan until future draws are made on that loan. As noted above, the purpose of the loan and related swap is to provide a cost-effective extension of credit to the customer.

Other Considerations. The Proposal requests responses to specific questions regarding the IDI De Minimis Provision.[13] We provide comments to certain questions below.

> Question 3. Capital One believes that mandatory cancellation provisions should not be included as such requirement would create a significant administrative burden. Not including mandatory cancellation provisions would provide flexibility to customers seeking to appropriately manage their hedges. Additionally, there would be potential impacts on cross-defaults in the event that the swaps were accelerated and closed out, and those impacts would run contrary to global efforts to reduce the contagion of cross-defaults in derivatives contracts.
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> Question 10. We believe that notice requirements should not be required with respect to the IDIs that take advantage of the IDI De Minimis Provision. Such notice requirements would introduce additional regulatory costs and would run contrary to the CFTC's stated policy objectives in the Proposal regarding the swap dealer de minimis exception and the proposed IDI De Minimis Provision, as discussed herein.[14] With respect to a notice to the CFTC, the CFTC receives robust swap transaction data through Parts 43 and 45 of the CFTC's regulations.[15] With respect to notice to the National Futures Association ("NFA"), entities that are not CFTC registrants are generally not members of NFA and, therefore, not subject to its rules. It would be inappropriate to require non-members to report in such circumstances. In addition, imposing a notice requirement would be inconsistent with the primary objective of Project KISS, which seeks to reduce regulatory burden on market participants.[16]
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> Capital One also believes IDIs should not be required to directly reference the related loan in the written confirmation for any related swaps. Written swap confirmations are, in many cases, automatically generated using straight-through-processing from deal capture systems. Straight-through-processing furthers the CFTC's explicit objectives for timely confirmation of outstanding swaps. Introducing additional terms to such swap confirmations—particularly, terms that are not relevant to the relationship between the counterparties to the swaps that the written swap confirmation is intended to memorialize—would create unnecessary burdens on IDIs to update deal capture systems and swap confirmations workflows, potentially to the detriment of straight-through-processing. The Commission could achieve similar regulatory objectives by requiring

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[13] *See id.* at 27462.

[14] These stated policy objectives are to "increas[e] efficiency, allow[] limited ancillary dealing, encourag[e] new participants, and focus[] regulatory resources." *Id.* at 27450.

[15] *See* 17 CFR Part 43; 17 CFR Part 45.

[16] *See* CFTC Press Release 7555-17, *CFTC Requests Public Input on Simplifying Rules: "Project KISS" Enters New Phase* (May 3, 2017).

market participants to hold records evidencing the linkage between the loan and related swaps.

The proposed hedging de minimis provision is appropriate

Capital One supports the Commission's proposed new provision in paragraph (4)(i)(D) of the SD Definition to except certain hedging swaps from the swap dealer de minimis threshold AGNA calculation ("Hedging De Minimis Provision").[17] We believe that the Hedging De Minimis Provision would bring clarity to which hedging swaps must be counted towards the de minimis threshold AGNA calculation by clarifying that excluded hedging includes both physical and financial positions and risks.

NDFs and FX window forwards should be excluded from AGNA

Capital One supports an exemption from the AGNA calculation for FX NDFs given how these products are currently traded. The FX NDF market is important to all swap market participants, especially end-users looking to limit their FX risk exposures. FX NDFs are economically and functionally identical to FX forwards, and current market practice is to use FX NDFs and deliverable FX forwards in the same ways. The current difference in regulatory treatment between these products is a difference of form over economics, substance and function.

For similar reasons, we also believe that the Commission should clarify that FX window forwards are exempted from the AGNA calculation. FX window forwards provide optionality for the customer as when to draw down, and the actual option or interest rate risk is minimal, especially when accounted for properly or conservatively. FX window forwards are fully physically settled like FX forwards, which are currently excluded from the definition of swap. The only difference between FX window forwards and excluded FX forwards is that the physical settlement for an FX window forward must occur on a date (or dates) within a specific date range (or ranges), while the physical settlement for an excluded FX forward occurs at a specific date. The end result, however, is the same. Similar to excluded FX forwards, customers use these time options to provide much needed flexibility to mitigate the uncertain timing of FX flows.[18] Exempting FX window forwards from the de minimis threshold AGNA calculation would allow greater flexibility for customer hedging activities.

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[17] *See* 83 Fed. Reg. at 27479.

[18] The largest risk is typically incurred at inception of an excluded FX forward, where the consequent drawdowns in an FX window forward actually lower the overall risk of the forward as compared to an excluded FX forward. This reduction of risk is the result of the remaining notional amount becoming smaller across the life of the FX window forward.

We appreciate the opportunity to highlight the topics raised in this letter, and we would be happy to meet with the Commission to discuss these comments further.

Sincerely,

Christopher F Swanson
Managing Vice President,
Head of Derivatives