Capital One Financial Corp
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January 13, 2020

Mr. Shayne Kuhaneck
Acting Technical Director
File Reference No. 2019-790
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Via email: director@fasb.org

RE: Proposed Accounting Standards Update, Derivatives and Hedging (Topic 815) – Codification Improvements to Hedge Accounting

File Reference No. 2019-790

Dear Mr. Kuhaneck:

Capital One Financial Corporation ("The Company")[1] appreciates the Board's continued responsiveness to implementation feedback provided by stakeholders and the opportunity to provide comments on the Exposure Draft, *Proposed Accounting Standards Update, Codification Improvements to Hedge Accounting* ("the Exposure Draft" or "the proposed ASU"). We support the Board's efforts to provide clarifications to ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging* Activities and ask that you consider the suggestions provided below.

Change in Hedged Risk in a Cash Flow Hedge

We are supportive of the Board's recent commitment and actions that align the accounting and presentation of hedge accounting with an entity's risk management activities. Furthermore, we support the Board's confirmation through this Exposure Draft of the amendments provided in ASU 2017-12, specifically the clarity that the hedged risk and hedged item are distinct for cash flow hedges, and are supportive of the Board's statement in paragraph 64 of the Basis for Conclusions that forecasted transactions varying with different indexes could be aggregated in a group and hedged with a single derivative (provided that the derivative is a highly effective offset to changes in the overall cash flows of the group).

However, the changes proposed in the ASU for issue 1, in particular with the introduction of the best estimate of hedged risk concept, appear to narrow the ability for institutions to hedge cash flows of interest rate risks for a group, and increases the ongoing operational burdens for cash flow hedges.

[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 $254.5 billion in deposits and $373.6 billion in total assets as of September 30, 2019. Capital One, N.A. has branches located primarily in New York, New Jersey, Texas, Louisiana, Maryland, Virginia, and the District of Columbia. A Fortune 500 company headquartered in McLean, Virginia, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

Best Estimate could limit portfolio cash flow hedging

For cash flow hedges of interest rate risk in a group, the proposed ASU is not clear how entities could define hedge exposure to multiple indexes in a group (as intended per paragraph 64 of the Basis for Conclusions) while still meeting the best estimate of the hedged risk and shared risk exposure requirements prescribed in the Exposure Draft. Similarly, the Exposure Draft indicates that interest rate tenor (per ASC 815-30-55-1N[2]), rate reset frequency and payment date (per paragraph 63 of the Basis for Conclusions) are part of the hedged risk best estimate. Applying each of these requirements with the shared risk assessment of ASC 815-20-55-23A[3] could limit portfolios to assets that identically share these characteristics, which would greatly reduce the size of cash flow portfolios.

The amendments prescribed in ASU 2017-12 removed the concept of separately measuring ineffectiveness from Topic 815, as the entire change in the fair value of a hedging instrument in a cash flow hedge is deferred in Other Comprehensive Income (OCI). With no upfront earnings impact, industry practice has established a “worst case scenario” hypothetical derivative to prove that the hedging relationship is expected to be highly effective, even in a worst case scenario. This approach eliminates the subsequent operational burden of recasting hypothetical derivatives when certain non-material characteristics of forecasted transactions change during the life of the hedging relationship, including rate reset frequency and payment date differences. Given the development of this industry practice, the changes in the proposed ASU to require an assessment and documentation of hedge effectiveness based on a best estimate would be a substantial change in practice and create a significant on-going operational burden once adopted. We recommend that the introduced concept of best estimate be removed, providing flexibility through a broader definition of hedged risk.

Impact of Best Estimate on Reference Rate Reform

The proposed best estimate guidance in this Exposure Draft will have specific negative implications for the LIBOR transition. As the markets for Secured Overnight Financing Rate (“SOFR”) based transactions are still developing, as are markets in transactions indexed to other rates (such as Bank Yield Index), it is likely that commercial loan volume originations in the future may be indexed to multiple, highly correlated interest rate indexes. The potential for a broader incorporation of multiple, highly correlated interest rate indexes on an entity is even greater when incorporating impacts from

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[2] ASC 815-30-55-1N as proposed: The guidance in paragraphs 815-30-35-37A through 35-37D applies regardless of the manner in which the forecasted transaction and the hedged risk are documented at hedge inception. The forecasted transaction and hedged risk may be documented on an integrated basis (for example, the variability in the first 3-month LIBOR interest receipts on $100 million of outstanding loan principal in June 20X1 as both the forecasted transactions and the hedged risk) or separately (for example, the first interest receipts on $100 million of outstanding loan principal in June 20X1, the forecasted transactions, which fluctuate based on 3-month LIBOR, the hedged risk). Regardless of the manner in which the forecasted transaction and hedged risk are documented in a cash flow hedge of interest rate risk, the tenor of an interest rate index is considered an attribute of the hedged risk.

[3] Proposed Accounting Standards Update—Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting [1] 815-20-55-23A as proposed: When assessing whether forecasted transactions hedged in a group share the risk exposure for which they are being hedged, an entity should determine its best estimate of the hedged risk for each individual forecasted transaction included in the group rather than its best estimate for the portfolio as a whole. It would be inappropriate for an entity to assume that its best estimate of the hedged risk for the majority of forecasted transactions in the portfolio applies to all forecasted transactions in the group.

existing commercial contracts as they are modified from LIBOR to other indexes. Defining hedge risk by a single index during this period of transition will significantly increase the operational burden for an entity's existing cash flow hedges as the shared risk exposure requirements of ASC 815-20-55-23A are applied, as well as limiting the size of the portfolios that will qualify for future hedges. If the best estimate concept is adopted by the Board, we ask that specific transition relief from those requirements are available during the LIBOR transition, so entities can continue managing their exposure to interest rate risk of forecasted transactions through cash flow hedging strategies while reference rate markets develop.

Sincerely,

/s/ Christie Simpson Lloyd

Christie Simpson Lloyd
Vice President, Head of Accounting Policy
Capital One Financial Corporation