Capital One Financial Corp
1680 Capital One Drive
Mclean, VA 22102

July 2, 2021

Ms. Hillary Salo
Technical Director
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) – Fair Value Hedging - Portfolio Layer Method

File Reference No. 2021-002

Dear Ms. Salo,

Capital One Financial Corporation ("The Company")[1] appreciates the Board's continued responsiveness to implementation concerns raised by stakeholders and the opportunity to provide comments on the Exposure Draft, *Proposed Accounting Standards Update, Fair Value Hedging - Portfolio Layer Method* ("the Exposure Draft"). We support the Board's efforts to expand the last-of-layer method for fair value hedges of interest rate risk to permit multiple layers within a closed portfolio. This expansion and clarification generally improves the usability of the hedge accounting guidance to better align with companies' risk management strategies. We ask the Board to please consider the comments and suggestions we have provided below.

Scope

We recommend the Board consider expanding the scope of the portfolio layer method to permit the hedging of the prepayable financial liabilities. The Company has certain prepayable liabilities that currently lack an effective hedge accounting model to hedge against the changes in fair value attributable to fluctuations in the benchmark interest rate.

Dedesignation Sequencing

We understand the Board's rationale for prescribing a dedesignation sequence and believe the prescribed sequencing is a reasonable approach. However, we recommend the Board provide

[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 $305.4 billion in deposits and $421.6 billion in total assets as of December 31, 2020. 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.

preparers with the accounting policy election to document their own dedesignation sequence at hedge inception in order to provide additional flexibility. If a dedesignation sequence is not documented at hedge inception, then in the event of a breach, the entity would be required to follow the prescribed dedesignation sequence contained in the Exposure Draft. This optionality would allow entities to establish a dedesignation sequence at inception that is based on the facts and circumstances of their portfolio and hedge strategy, and to customize the layering structure of the closed pool.

Additionally, by permitting the option and not requiring an entity to document its own dedesignation sequence, an entity could choose (directly or indirectly) to apply the prescribed dedesignation sequence to avoid potential complexities with resequencing[2]. Furthermore, the option, and in its absence the application of the prescribed sequencing, would address concerns related to potentially applying error correction guidance to past results if the entity did not document a dedesignation sequence at hedge inception[3]. This flexibility will allow individual entities to assess the relative costs and benefits of tailoring a dedesigination sequence to their individual hedging strategies.

"Follow the Asset" Method

The Company agrees with the Board's decision to prohibit the consideration of basis adjustments on existing portfolio layer method hedges when measuring credit losses on the respective assets[4].

Further, we understand the Board's rationale in the "follow-the-asset" approach; however, we have concerns that the simplicity of using recency[5] to identify the cause of breach may have unintended consequences and result in outcomes that could be misleading for financial statement users. For example, an entity may form a closed pool of prepayable securities collateralized by loans. If actual defaults exceed forecasted defaults but the unexpected breach is due to a prepayment (latest event), the portion of the basis adjustment related to the breach would be recorded in earnings as interest. This could be misleading for an investor to understand the credit risk profile of the assets as defaults are the primary driver of the breach but the income statement classification follows the discrete prepayment event that resulted in a breach of the portfolio layer.

We respectfully urge the Board to consider an alternative treatment other than the "follow-the-asset" method in accounting for the portion of basis adjustment associated with a breach. The Company recommends the Board consider a cumulative approach to capture the holistic view of the portfolio, such as tracking the entire portfolio's payment activities and allocating the basis adjustments on a pro rata basis. This approach would better align with the entity's established impairment process and provide the entity a perspective to apply the cumulative approach in a well-managed manner. Alternatively, the Board could consider permitting entities to treat the portion of the basis adjustment associated with a breach to be

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[2] Basis for Conclusion paragraph 25
[3] Basis for Conclusion paragraph 24
[4] Basis for Conclusion paragraphs 32-34
[5] Basis for Conclusion paragraph 36-37

recorded as an economic hedge, expensing the portion immediately in the same income statement line item used to present a freestanding derivative, instead of recognition in accordance with the impairment guidance.

Sincerely,

/s/ Timothy Golden

Timothy Golden
Senior Vice President, Controller
Capital One Financial Corporation