June 23, 2011

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RIN 3038—AC97

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Docket ID OCC- 2011-0008
RIN: 1557-AD43

Jennifer J. Johnson
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Docket No. R-1415
RIN: 7100 AD74

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Attention: Comments RIN: 3064-AD79

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General Counsel
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Attention: Comments/ RIN 2590-AA45

Gary K. Van Meter
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Farm Credit Administration
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RIN: 3052-AC69

Re: Margin and Capital Requirements for Covered Swap Entitles/File numbers RIN: 1557-AD43; RIN: 7100 AD74; RIN: 3064-AD79; RIN 2590-AA45; RIN: 3052-AC69. Margin

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

The undersigned group of companies is pleased to respond to the Notices of Proposed Rulemaking (the "NPRs") from the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency (hereafter referred to as the "prudential regulators") and the Commodity Futures Trading Commission (CFTC) regarding margin requirements for certain derivatives that are not cleared through a clearinghouse to implement Section 4s(e) of the Commodity Exchange Act (CEA) and Section 15F of the Securities and Exchange Act, as amended by sections 731 and 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), respectively. Specifically, we would like to address the questions posed in both NPRs relating to: (1) whether the categorization of various types of counterparties by risk, and the key definitions used to implement the risk-based approach, should be applied to captive finance companies, and (2) whether the commercial end user exemption from the mandatory clearing requirement and other provisions of the Dodd-Frank Act require that swaps and security-based swaps involving commercial end users, including captive finance companies, be exempt from initial margin and variation margin requirements for non-cleared swaps and security-based swaps.

Introduction:

Captive finance companies differ from many other finance companies in both our mission and how we use derivatives. Our primary mission is to provide financial products that promote and facilitate the sale or lease of products manufactured by our parent companies and their other subsidiaries ("Affiliate Products"). The captive finance companies often serve as the primary source of financing for the customers of these products. They remain an important source of liquidity for thousands of small, medium, and large businesses seeking to acquire capital equipment to help operate and grow their businesses, as well as consumers seeking to finance the purchase or lease of cars, trucks, equipment, and other products. Captive finance companies also provide financing to dealers or distributors in order to help ensure the health of those distribution networks. As a result of these activities, captive finance companies play an essential role in the success of their manufacturing parents and directly contribute to thousands of U.S. manufacturing jobs.

The recent financial crisis severely impacted the nation's manufacturing base, and alternative means of financing the purchase and lease of capital intensive products disappeared rapidly, particularly in our nation's smaller communities. Without captive finance companies, many dealers and customers would have had limited access to competitively-priced financing, hindering their ability to purchase and lease these products. The ultimate impact of such a constriction on financing would have resulted in greater job loss throughout our economy and, inevitably, a much deeper and longer recession.

We fully support Congress' primary goal of the Dodd-Frank Act, namely to introduce greater transparency and oversight in the financial system as a means to reduce the potential for a repeat of the recent financial crisis. We believe that Congress, in order to achieve its objectives, clearly intended to distinguish between entities that do present risk to the financial stability of the United States, and those entities that do not present such risk, and to reduce the regulatory burden on lower risk entities. Nowhere is this distinction or Congress' intent clearer than in the case of captive finance companies of commercial end users. The Dodd-Frank Act specifically exempts captive finance companies from the definition of "financial entity" for the purpose of Title VII, and affords captive finance companies with all of the same exemptions as non-financial commercial end users.[1]

In drafting the Dodd-Frank Act, Congress recognized the crucial and unique role that captive finance companies play in America's manufacturing sector. Congress also acknowledged that captive finance companies use derivatives to hedge legitimate business risks, and therefore, pose little risk to major financial institutions or to the financial system as a whole.[2] Congress demonstrated its understanding of this distinction when it granted captive finance companies, as defined in the Dodd-Frank Act,[3] an exemption from the definition of major swap participant, regardless of the size of their hedge positions. Congress also exempted captive finance companies from the mandatory clearing and exchange trading requirements contained in Title VII.

It should be noted that several captive finance companies have filed separate comments with the CFTC urging the Commission to provide needed clarity with regard to the Captive Finance Provision (the so-called "90/90" language), including the need for a simple test that reflects the operating realities of some captive finance companies. These comments are incorporated by reference. [4]

Our concerns with both the prudential regulators' and the CFTC's proposed margin rules are that they contravene the language and intent of the Dodd-Frank Act by not excluding captive finance companies from the respective definitions of "financial end user" and "financial entity." The proposed rules do not treat captive finance companies like other commercial end users as intended by Congress, but instead as "high risk" counterparties subject to mandatory minimum margin requirements.

Definitions of "Financial end user" and "Financial Entity"

In the NPRs, the prudential regulators and the CFTC seem to base the distinction between "financial end users" and "financial entities" and "non-financial end users" and "non-financial entities" on the same criteria that are used to exempt certain entities from the mandatory clearing

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[1] In recognition of their unique role in the U.S. financial system, captive finance companies are accorded a broad exemption from the definition of major swap participant not available to other commercial end users.

[2] While end users in general account for no more than one-seventh of total derivatives' notional value, captives comprise just a fraction of this. According to our estimates, combined captive finance companies' notional derivative amount is less than $300 billion in the overall $600 trillion derivatives market. That is just 0.05 percent of the overall market and far less than the amount of many large derivative users.

[3] The exemptions for captive finance companies apply only to entities whose primary business is providing financing and that use derivatives to hedge 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 entity's parent company or another subsidiary of the parent company.

[4] See comment letter (February 22, 2011) available at: comments.cftc.gov/PublicComments/ViewComment.aspx?id=30517

requirement in the Dodd-Frank Act. For example, in footnote 35 of their proposed rule, the prudential regulators state that a "commercial end user" which is similar to a non-financial end user is "generally understood to mean a company that is eligible for the exception to the mandatory clearing requirement for swaps…under section 2(h)(7) of the Commodity Exchange Act…" Furthermore, in Footnote 41, the prudential regulators state that in section _.2(1)(b), the "definition of 'financial end user' is based upon, and substantially similar to, the definition of a 'financial entity' that is ineligible to use the end user exemption from the mandatory clearing requirements of sections 723 and 763 of the Dodd-Frank Act." In addition, the CFTC, in their proposed rule, maintains that their definition of "financial entity" "tracks the definition in Section 2(h)(7)(C) of the Act that is used in connection with an exception from any applicable clearing mandate."[5] However, captive finance companies are eligible for the exemption from the mandatory clearing requirement in the Dodd-Frank Act. Unfortunately, both the proposed definition of "financial end user" in section_.2(1)(b) of the prudential regulators' NPR and the proposed definition of "financial entity" in section 23.150 of the CFTC's NPR fail to exclude captive finance companies from the definition of "financial entity" in the manner they are excluded from the mandatory clearing provisions of the Dodd-Frank Act.

Moreover, the definitions in section _.2(1)(c) of the prudential regulators' NPR and the provisions governing thresholds applied to margin in section 23.153(c) of the CFTC's NPR could be interpreted as categorizing a captive finance company as a "high-risk financial end user" simply because it is not subject to capital requirements established by a prudential regulator or state insurance regulator. In essence, both notices of proposed rulemaking categorize captive finance companies as high-risk entities subject to significant margin requirements, negating Congressional intent in the Dodd-Frank Act, which classifies captive finance companies in the same category as commercial end users for the purposes of the mandatory clearing exemption.

We ask that both the prudential regulators and the CFTC make the definition of "financial end users" in section _.2(1)(b) and the definition of "financial entity" in section 23.150 of their respective NPRs consistent with the authorizing statute itself, i.e. CEA section 2(h)(7)(C), as amended by section 723 of the Dodd-Frank Act, and that the definitions of "financial end user" and "financial entity" in the rules promulgated by the prudential regulators and the CFTC exclude captive finance companies from those definitions as described in section 2(h)(7)(C)(iii).

<u>Margin exemption for non-financial end users including their captive finance companies</u>

Section _.1(2) of the prudential regulators' NPR requires swap dealers to adopt counterparty exposure thresholds above which the swap dealer will be required to collect initial or variation margin from a non-financial end user counterparty. Similarly, section 23.151 of the CFTC NPR requires swap dealers to execute credit support arrangements with all counterparties and section 23.154 specifies initial and variation margin requirements in credit support arrangements with non-financial end-user counterparties. These requirements not only negate the clearing exemption provided by the Dodd-Frank Act, but are also contrary to Congressional intent not to impose margin on commercial end users and their captive finance companies. We respectfully urge that the prudential regulators and the CFTC not require swap dealers to collect margin from

[5] See 76 Federal Register 23735 (May 11, 2011).

commercial end users-including captive finance companies-consistent with Congressional intent and present practice.

The fact that most captives do not post margin today demonstrates that our counterparties recognize the low risk nature of our transactions. Moreover, the debt indentures of many of the undersigned companies include negative pledge covenants that limit the ability to pledge assets as collateral. These longstanding covenants have provided protection and certainty to investors and any attempt to alter them would only reduce certainty in a still fragile financial market.

Another key concern related to imposing margin requirements is the potential disruption in the asset-backed securitization markets. Several of the undersigned companies rely on securitization markets to fund loans and leases to our dealers and consumers at competitive rates. Securitization transactions use derivatives to protect investors from market risks and support high credit ratings required to access these markets. We are concerned that margin requirements on these derivatives will force major structural changes on securitization transactions at a time when credit markets are recovering but remain fragile. Adding a cost and complexity burden will directly impact the amount of financing made available to our dealers and customers.

We are concerned that margin requirements will significantly increase our costs and liquidity requirements, and could create a disincentive to hedge legitimate business risks. Most corporations do not have immediate and low-cost access to liquidity sources such as the Federal Reserve discount window and FDIC-insured consumer deposits. For end users, raising additional capital requires lead time and would be very expensive.

The Dodd-Frank Act granted regulators the authority to impose margin and capital requirements on swap dealers and major swap participants. It did not extend that authority to imposing margin requirements on commercial end users. The Congressional intent is clear on this point. *See* 156 Cong. Rec. S 6192 (July 22, 2010)(Letter of Senators Dodd and Lincoln)(the statute "does not authorize the regulators to impose margin on end users, those exempt entities that use swaps to hedge or mitigate commercial risk") *See also* statement of 156 Cong. Rec. H5248 (June 30, 2010)(colloquy of Representatives Frank and Peterson)(Mr. Peterson."[W]e have given the regulators no authority to impose margin requirements on anyone who is not a swap dealer or a major swap participant. Mr. Frank. … [T]he gentleman is absolutely right. We do differentiate between end users and others. The marginal requirements are not on end users."]

It is our expectation that regulations adopted under the Dodd-Frank Act will reflect Congressional intent. It is vitally important that regulators do not impose margin requirements on manufacturers or on the risk-reducing transactions engaged in by captive finance companies in support of their parent manufacturers. Margin is not required in our hedging transactions today. If this were to change, there would be unavoidable finance cost increases, which would be negatively felt throughout the economy. Any disincentive to hedge legitimate business risks would serve to push risk and volatility back into the manufacturing sector.

Conclusion:

We recognize the difficult and important role you have in the implementation of the Dodd-Frank Act. The importance of the new law and rules extends well beyond the financial sector to all sectors of the economy. Because of the role our companies play in the U.S. economy, we would like to continue to ensure that the Dodd-Frank Act functions as intended by Congress and as needed by manufacturers. Just two years ago, the manufacturing sector was among the hardest hit by the financial crisis. Today, we are leading the nation's economic recovery. Manufacturers in the U.S. want to continue doing so, and our captive finance companies are vital to this effort.

We again thank you for the opportunity to comment on the proposed rulemaking and would welcome the chance to answer any questions you might have about captive finance companies.

Sincerely,

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