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On Behalf of the Coalition for Derivatives End-Users

Before the House Committee on Agriculture
U.S. House of Representatives

On the Topic of
“Examining Legislative Improvements to
Title VII of the Dodd-Frank Act”

March 14, 2013
Chairman Lucas, Ranking Member Peterson, and members of the Committee, I want to thank you for inviting me to testify today on the topic of legislative improvements to Title VII of the Dodd-Frank Act.

I am the President and Chief Executive Officer of Financial Executives International, the professional association of choice for 15,000 senior-level financial executives, from over 8,000 public and privately-held companies, across all industries. For 30 years before coming to FEI, I worked in the treasury functions of several major corporations, including Westinghouse, Citicorp, ABN AMRO, and Ruesch International and worked in the Financial Risk Management Practice leading treasury for non-financial institutions for KPMG.

Today I speak both on behalf of FEI and as a representative of the Coalition for Derivatives End-Users. The Coalition includes more than 300 end-user companies and trade associations and, collectively, we represent thousands of end-users from across the economy. Our members are united in one respect; they use derivatives to manage risk, not create it.

FEI as an organization is dedicated to advancing ethical and responsible financial management. As such, a number of FEI members, namely corporate treasurers, utilize over-the-counter derivatives to hedge and mitigate business risk. During the debate leading up to the Dodd-Frank Act, FEI worked alongside the Coalition to educate lawmakers on how derivatives are an effective tool used by non-financial companies for risk-management purposes and not for speculation, which is why end-users should not be regulated in a way that imposes unwieldy costs or unnecessary burdens. Congress heard our concerns in several respects and provided for key exceptions for end-users from some of the most burdensome derivatives requirements, such as central clearing requirements.
Unfortunately, over two and a half years since the enactment of the Dodd-Frank Act, it appears that the intent of these end-user exceptions is not being upheld in the rulemaking process, as evidenced by the proposed margin rule and in the lack of clarity regarding companies that employ inter-affiliate swaps or use a centralized treasury hedging center. Despite these outstanding issues, the compliance clock keeps ticking away and companies must be ready to meet key deadlines.

For these reasons, the Coalition strongly supports two pieces of legislation that have been referred to your committee, H.R. 634 and H.R. 677. We would like to thank the Committee for reporting similar bills by voice vote last Congress. Both bills subsequently passed the House by significant bipartisan majorities.

Today, I will focus my comments on the Inter-Affiliate Swap Clarification Act, H.R. 677, introduced by Congressmen Stivers, Fudge, Gibson and Moore. This legislation would ensure that inter-affiliate derivatives trades, which take place between affiliated entities within a corporate group, do not face the same demanding regulatory requirements as market-facing swaps. The legislation would also ensure that end-users are not penalized for using central hedging centers to manage their commercial risk.

There are two serious problems facing end-users that need addressing. First, under the CFTC’s proposed inter-affiliate swap rule, financial end-users would have to clear purely internal trades between affiliates unless they posted variation margin between the affiliates or met specific requirements for an exception. The Coalition is comprised of both financial and non-financial end-user members, and financial end-users, such as pension plans, captive finance affiliates, mutual life insurance companies, and commercial companies with non-captive finance arms, use derivatives the same way non-financial end-users do. If these end-users have to post variation margin, there is little point to exempting inter-affiliate trades from clearing requirements, as the costs could be similar. And let’s not forget the larger point—internal end-user trades do not create systemic risk and, hence, should not be regulated the same as those trades that do.

Second, many end-users—approximately one-quarter of those we surveyed—execute swaps through an affiliate. This of course makes sense, as many companies find it more
efficient to manage their risk centrally, to have one affiliate trading in the open market, instead of dozens or hundreds of affiliates making trades in an uncoordinated fashion. Using this type of hedging unit centralizes expertise, allows companies to reduce the number of trades with the street and improves pricing. These advantages led me to centralize the treasury function at Westinghouse while I was there. However, the regulators’ interpretation of the Dodd-Frank Act confronts non-financial end-users with a choice: either dismantle their central hedging centers and find a new way to manage risk, or clear all of their trades. Stated another way, this problem threatens to deny the end-user clearing exception to those end-users who have chosen to hedge their risk in an efficient, highly-effective and risk-reducing way. It is difficult to believe that this is the result Congress hoped to achieve.

The Coalition believes that regulation of inter-affiliate swaps should square with the economic reality that inter-affiliate swaps do not pose systemic risk. H.R. 677 would make sure that end-users will not be forced to clear swaps simply because they use inter-affiliate trades or a centralized hedging structure. Thank you Chairman Lucas, I will be happy to answer any questions members of the Committee might have.