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"Assessing the Impact of the Dodd-Frank Act Four Years Later"

Testimony of Thomas C. Deas, Jr. – Vice President & Treasurer, FMC Corporation

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Good morning Chairman Hensarling, Ranking Member Waters, and members of the Financial Services Committee. I am Thomas C. Deas, Jr., Vice President and Treasurer of FMC Corporation and Immediate Past-Chairman of the National Association of Corporate Treasurers ("NACT"), an organization of treasury professionals from several hundred of the largest public and private companies in the country. FMC and NACT are part of the Coalition for Derivatives End-Users (the "Coalition"). Our Coalition represents thousands of companies across the United States that employ derivatives to manage business risks they face every day. Hundreds of companies have been active in the Coalition, which has sought to inject the voice of end-users into the debate over derivatives regulation. I am also privileged to serve as the current Chairman of the International Group of Treasury Associations of which NACT along with the national treasury organizations of approximately 30 other countries are a part. Our message is straightforward: financial regulatory reform measures should promote economic stability and transparency without imposing undue burdens on derivatives end-users. Thank you very much for giving me the opportunity to speak with you today about the impact of derivatives regulation on end-user companies.

End-Users' Concerns with Derivatives Regulation

The Coalition supports your efforts to oversee the implementation of the Dodd-Frank Act. We very much appreciate the strong bipartisan efforts by the Members of the Committee on Financial Services on behalf of American companies who use derivatives to manage many of the risks they face in running their businesses every day.

The Dodd-Frank Act sought to prevent problems with derivatives experienced during the financial crisis in 2008 from recurring now or in the future. I want to assure you that FMC and other end-users were not and are not engaging in risky speculative derivatives transactions out of which some of that turmoil arose. End-users comprise less than 10 percent of the total over-the-counter ("OTC") derivatives market and do not significantly contribute to systemic risk. Hence, we should not be subject to regulations designed for Wall Street, not Main Street.

We believe there is broad agreement with the concept that end-users should not be subject to regulations designed to reduce the risk of swap dealers and others who maintain open or systemically significant derivatives positions and engage in market-making activities. At the time of passage of the Dodd-Frank Act, we understood from a plain reading of the legislative language as well as from letters and colloquies by the principal drafters, that end-users would be exempted from certain provisions intended to reduce the inherent riskiness of swap dealers' activities. In addition, recognizing the potential adverse consequences on the competitiveness of American business and ultimately on jobs here in the United States, regulators vowed to keep their actions in sync with those of our international trading partners and not impose any undue regulatory burdens on U.S. end-users.

However, at this point four years after passage of the Dodd-Frank Act, there are several areas where continuing regulatory uncertainty compels end-users to appeal for legislative clarifications to actions we believe will raise costs unnecessarily and hamper our ability to manage business risks with properly structured OTC derivatives. Among several areas of concern, I would like to invite your attention to three in particular:

- Margining of uncleared swaps;
- The application of clearing requirements to centralized treasury units; and
- Cross-border concerns.

Margining of Uncleared Swaps

Please allow me to illustrate end-users' use of derivatives with a specific example from my company. FMC is the world's largest producer of natural soda ash, the principal input in glass manufacturing, and is one of the largest employers in the state of Wyoming. We are also developing innovative new chemically related applications that scrub sulfur compounds from flue gases of factories and power plants. We can mine and refine soda ash products in southwestern Wyoming, ship them to South Asia, and deliver them at a lower cost and with higher quality than competing Chinese producers. Energy is a significant cost element in producing soda ash and FMC protects against unpredictable fluctuations in future energy costs by using OTC derivatives to hedge natural gas prices. These derivatives are executed with several banks, all of which are also supporting FMC through their provision of over $1.5 billion of credit. Our banks do not require FMC to post cash margin to protect against mark-to-market fluctuations in the value of derivatives, but instead price the overall transaction to take this risk into account. This structure gives us certainty so that we do not have to post cash margin while the derivative is outstanding. However, if we are required by the regulators to post margin, we will have to hold aside cash and readily available credit to meet those margin calls. Depending on the extent of price movements, margin might have to be posted within the trading day as well as at the close of trading. Because failure to meet a margin call would be like bouncing a check, and would constitute a default, our corporate treasury would act very conservatively in holding cash or immediately available funds under our bank lines of credit to assure we could meet any future margin call in a timely fashion and with a comfortable cushion.

Now following the financial crisis, it is time to reassess whether end-user companies should be subject to margin and clearing requirements. End-users did not cause the financial crisis. And end-users do not contribute to systemic risk because their use of derivatives constitutes prudent, risk-mitigating hedging of their underlying business. Forcing end-users to put up cash for fluctuating derivatives valuations means less funding available to grow their businesses and expand employment. The reality treasurers face is that the money to margin derivatives has to come from somewhere and inevitably less funding will be available to operate their businesses.

A recent Coalition survey of chief financial officers and corporate treasurers, released on March 26, 2014, underscores the urgent need for the end-user provisions contained in your reauthorization bill. More than two-thirds of respondents to the Coalition's survey indicated that a margin requirement on uncleared OTC derivatives would have a moderate or significant impact on capital expenditures and 86% of respondents indicated that fully collateralizing OTC derivatives would adversely affect business investment, acquisitions, R&D and job creation.

Let me give you a direct example of why our bank counterparties have agreed that cash margin is not necessary for FMC's derivatives trades. Because we are always hedging an underlying business risk, if a current valuation of a derivative is underwater, then the risk we are hedging must be in the money, resulting in a net neutral position. To continue with our natural gas hedging example, as the price of gas fluctuates, the valuation of the derivative changes by an equal and opposite amount in relation to our natural gas purchases. If the price of gas falls by 10 percent, then the value of the derivative is out of the money by the same amount. This results in no net gain or loss when the derivative and the underlying exposure are valued together at any point in time. Although we have to pay the bank an amount equal to the 10 percent fall in gas prices for the agreed volume hedged, we owe that much less for the gas we are buying. FMC benefits from not having unpredictable demands on liquidity. For this balanced structure, we agree to a small markup payable at maturity of the derivative transaction I have just described. This is far more cost-effective than if we had to keep idle cash or immediately available credit to meet cash margin postings and undertake significant information systems investments. Customized OTC derivatives allow us to operate with predictable energy costs, thereby reducing our business risk.

By forcing end-users to post cash margin, the regulators will take the balanced structure I have just described and impose a new risk. Treasurers will have new and unpredictable demands on their liquidity. Swap dealers are market makers who take open positions with derivatives and we agree central clearing and margining are appropriate for them. However, since end-users are balanced, with derivatives exactly offsetting underlying business risks, forcing them into the swap dealers' margin rules by requiring them to post and exchange margin adds the considerable risk for end-users of having to fund frequent and highly variable daily cash margin payments. This will introduce an imbalance and new risks onto transactions that are matched and will settle with offsetting cash payments at maturity. Further, the imposition of margin requirements on nonfinancial end-users would effectively negate the intended benefits of the end-user clearing exception to those same entities.

As the Members of this Committee well know, the Prudential Regulators – consisting of the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency – have proposed rules that would subject end-users to uncertain future margining requirements. This position puts these regulators out of step not only with proposed margin rules from the Commodity Futures Trading Commission ("CFTC"), but also with internationally agreed-upon standards from the G-20 Working Group on Margining Requirements ("WGMR"), which was formed to develop internationally harmonized standards which it released in September 2013. The WGMR concluded that nonfinancial end-users need not be subject to margin requirements. In April 2014, European regulators proposed margin rules that would exclude from margin requirements nonfinancial end-users that do not pose risk to financial stability.

The Coalition commends the bipartisan efforts of Members of this Committee to redress the problem for American industry through support for such bills as H.R. 634, the *"Business Risk Mitigation and Price Stabilization Act,"* which passed the House last year by a vote of 411-12, and which clarifies that Dodd-Frank Act does not authorize the Prudential Regulators, the CFTC and the SEC to impose margin requirements on risk-mitigating hedges of nonfinancial end-users. Because the Prudential Regulators have concluded that the statutory text of the Dodd-Frank Act obligates them to impose margin on all market participants – including nonfinancial end-users – the clarification reflected in H.R. 634 is necessary to permit the U.S. to conform with international standards.

<u>Centralized Treasury Units ("CTUs")</u>

Throughout the legislative and rulemaking processes surrounding the Dodd-Frank Act, the Coalition has advocated for strong regulatory standards that enhance financial stability while avoiding needless costs. Many nonfinancial end-users utilize CTUs as a risk-reducing, best practice to centralize and net the hedging needs of affiliates. In fact, nearly half of the Coalition's survey respondents use CTUs to execute OTC derivatives.

While the CFTC has recognized the undue burdens clearing requirements would place on corporate end-users and has attempted to ease the burdens through no-action relief, the relief is highly conditional and difficult to implement. Moreover, corporations may be uncomfortable relying on no-action relief, because that relief only stipulates that agency staff will not undertake enforcement action for violations of the law; it does not change the law. The Coalition survey found that of those respondents that utilize a CTU structure, 69% do not qualify for the CFTC's no-action relief or are unsure about whether they could rely on the relief. Additionally, in Europe, CTUs are not treated as financial entities. The treatment of CTU as a financial entity is unique to U.S. law, which encompasses any entity that is "predominantly engaged in activities that are financial in nature." Consequently, European law does not apply clearing and other such requirements to CTUs of nonfinancial end-users.

Treasurers of nonfinancial end-users who operate CTUs that serve the risk-mitigating function of aggregating exposures on the books of an affiliate within their corporate group, netting the inter-affiliate exposures, and then entering into smaller and fewer derivatives with a bank or other swap dealer counterparty for the net amounts, could have to wind down those efficient units or meet burdensome new regulatory requirements that will be hard to justify. The remaining alternative would be to retain more risk because hedging would no longer be cost-effective. As pointed out above, these CTUs are subject to designation as financial entities, in which case they would be denied the end-user clearing exception despite the fact that they are only executing trades for nonfinancial end-user affiliates, which would otherwise be able to elect the end-user clearing exception.

The Coalition strongly supports H.R. 677, the *"Inter-Affiliate Swap Clarification Act,"* as amended by and incorporated in the Customer Protection and End-User Relief Act (H.R. 4413) which passed the House of Representatives last month, which would clarify that certain swaps with CTUs of nonfinancial end-users are eligible for an exemption from clearing requirements.

<u>Cross-Border Concerns</u>

The Coalition appreciates the important efforts being undertaken by U.S. and foreign regulators to resolve differences in the circumstances in which regulations apply to cross-border transactions. Applying derivatives reform rules in a global marketplace is an inherently complex undertaking. Unlike most stock market transactions, derivatives create an ongoing relationship between parties that is not severed once the transaction has been consummated. Thus, many transactions exist between parties in different jurisdictions for many years. While the United States has completed many of its derivatives rules first, other regulators around the world – particularly those in Europe – have now finalized and implemented many of their rules. Consequently, derivatives end-users now find themselves simultaneously subject to multiple regulatory regimes. Understanding and implementing compliance structures for derivatives rules across multiple jurisdictions is a significant and costly undertaking. Accordingly, end-users are subject to incentives to avoid complication by limiting their transactions to counterparties located in their same jurisdiction. This duplication ultimately causes fragmented and less efficient markets for end-users, and raises the cost of delivering stable prices to consumers. It is critical that regulators move quickly to recognize equivalency and substituted compliance with foreign regulatory regimes when the objectives of foreign regulations are designed to achieve comparable objectives to the Dodd-Frank Act.

Summary

Let me take a moment to summarize our principal concerns with the application of derivatives regulation to end-users:

- First, we are concerned that the proposed regulations relating to margin requirements, particularly those of the Prudential Banking Regulators, will impose unnecessary margin requirements on nonfinancial derivatives end-users that did not contribute to the financial crisis and do not create systemic risk. Such margin requirements could potentially divert billions of dollars from productive investment and job creation into a new regulatory levy.
- Second, the imposition of clearing requirements on CTUs that execute swaps on behalf of nonfinancial affiliates denies those companies the benefits of risk-reduction embodied in what the treasurers of U.S.-based multinational companies overwhelmingly consider to be best practice.
- Finally, international harmonization is of great importance and is particularly relevant for derivatives end-users, as many have affiliates located across the globe in several different jurisdictions. Inconsistencies lead to increased costs, confusion and duplication that could lead end-users to abandon efficient hedging practices or cause them to not hedge at all. U.S. regulators should continue to find equivalency with foreign regulatory regimes using an outcomes-based analysis.

Conclusion

Thank you again for the opportunity to testify today on these important issues.

We are very concerned that an impending regulatory burden on end-users of derivatives will result in higher costs to Main Street companies that will limit their growth, harm their international competitiveness, and ultimately hamper their ability to sustain and, we hope, grow jobs.

The consequences of getting derivatives regulation wrong will be borne by American business and ultimately our fellow citizens.

I will do my best to respond to any questions you may have.