

Carolyn Lee

Senior Director, Tax Policy

April 26, 2013

The Honorable Debbie Stabenow
U.S. Senate Committee on Agriculture,
Nutrition and Forestry
Chairwoman
328-A Russell Senate Office Building
Washington, DC 20510

The Honorable Thad Cochran
U.S. Senate Committee on Agriculture,
Nutrition and Forestry
Ranking Member
328-A Russell Senate Office Building
Washington, DC 20510

Dear Chairwoman Stabenow and Ranking Member Cochran:

On behalf of the National Association of Manufacturers (NAM) – the nation’s largest industrial trade association – thank you for requesting NAM’s input on the Committee’s consideration of the reauthorization of the Commodity Futures Trading Commission (CFTC) and the Commodity Exchange Act (CEA). As outlined in more detail below, we are concerned about pending regulations on derivatives that could have a significant negative impact on manufacturers. As the Committee considers the CFTC/CEA reauthorization, we strongly urge you to address outstanding issues surrounding margin and inter-affiliate trades.

Manufacturers use derivatives to manage and mitigate against fluctuations in currency and interest rate valuations and commodity prices and not for speculative trading. The NAM is a steering committee member of the Coalition for Derivatives End-Users, which coordinated the efforts of the end-user community to ensure that the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) (Dodd-Frank) did not impede end-users’ use of over-the-counter derivatives.

As we have stated on many occasions, imposing unnecessary regulation on end-users, like manufacturers, would limit our ability to use these important risk management tools, increase costs and reduce investment, U.S. competitiveness and job growth. In fact, although end-users’ trades only comprise about nine percent of the total over-the-counter derivatives market, end-users provide approximately 94 percent of private sector jobs and regulations that negatively impact these entities will have a broad impact on the economy. Consequently, NAM continues to work to ensure that, as Dodd-Frank is implemented, end-users do not face undue burdens.

Over the past few years, the NAM has worked along with the Coalition to seek enactment of legislation that would clarify the sections in Title VII of Dodd Frank on interaffiliate trades and margin requirements that, if left as currently written, will have a significant negative impact on end-users. These two issues are addressed in legislation currently pending in the U.S. House.

H.R. 634 would ensure that regulators do not impose margin requirements on non-financial end-users, like manufacturers. Specifically, the legislation would clarify the stated intent of the authors of Dodd-Frank that “margin and capital requirements are not to be imposed on

end users,” and “rules may not be set in a way that requires the imposition of margin requirements on the end user side of a lawful transaction.”¹

Despite the clear Congressional intent on this issue, Prudential Banking Regulators “believe that the statute does require us to impose some type of margin requirement”² and have proposed regulation to do so. While the CFTC has proposed a regulation on margin that is preferable to the Prudential Regulators’ proposal, even the CFTC regulation does not provide the certainty and assurance to end-users that the enactment of H.R. 634 would offer.

In recent comments, Federal Reserve System Chairman Ben Bernanke acknowledged that Dodd-Frank is complicated and could be improved.³ Manufacturers believe that H.R. 634 represents the best way to provide much-needed clarity to regulators and certainty to end-users. This bill has long garnered strong support and in fact, in the 112th Congress, similar legislation passed the House by a vote of 370-24.

A second priority for end-users is also addressed in a pending House bill, H.R. 677, which would prevent internal, inter-affiliate trades from being subject to the same regulatory burdens designed for external, market-facing trades. In addition, the legislation, as introduced in the 113th Congress, would ensure that companies that utilize a centralized treasury unit (CTU) to consolidate trading operations through a single affiliated entity can also take advantage of the end-user clearing exemption.⁴

The legislation regarding inter-affiliate trades is necessary to assure end-users that they can continue to employ best practices like utilization of a centralized treasury unit to manage internal and external trading to mitigate risk within a corporate entity. The simple fact is that purely internal, inter-affiliate trades do not increase systemic risk and should be exempt from clearing, margin and certain reporting requirements that were designed to be applied to certain types of external, market-facing trades. This position is supported by the recently released

¹ Volume 156 Congressional Record p. S6192. Reprinting a June 30, 2010 letter from Senator Christopher Dodd and Blanche Lincoln to House Chairmen Collin Peterson and Barney Frank regarding treatment of end users in the Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173.

² U.S. Senate Committee on Banking, Housing & Urban Affairs Hearing: *The Semiannual Monetary Policy Report to the Congress*. July 17, 2012

³ U.S. Senate Committee on Banking, Housing & Urban Affairs Hearing: *The Semiannual Monetary Policy Report to the Congress*. February 26, 2013. “Dodd-Frank is a very big, complicated piece of legislation that addresses many different issues. And I’m sure there are many aspects of it that could be improved in one way or another.” He went on to cite “(i)n terms of specifics... clarity on what Congress would like us to do about end users, for example.”

⁴ Section 723 of Dodd-Frank makes the end-user clearing exemption available only to centralized hedging units that “act [] on behalf of the [affiliate] and as an agent.” However, many manufacturers who have tens or hundreds of affiliates – all of whom consolidate their balance sheets – utilize a centralized treasury structure but these CTUs act as the “principal” in the transaction, not as an agent. The difference, although seemingly nuanced in the statute is enormous in practice. Many corporations have their CTUs act as principals so they can consolidate their relationships with counterparties and cover the entire corporate entity, eliminating the need for every affiliate to have their own set of relationships with counterparties. These centers also allow a company with numerous affiliates to net-down the volume of trades so that they have fewer trades facing the market, engage in trading with fewer partners and have better oversight of those trades. Many companies also have structured their operations to use a centralized treasury center in order to take advantage of the efficiency and centralization of expertise and this model is considered an industry “best practice”.

CFTC final rule on "Clearing Exemption for Swaps Between Certain Affiliated Entities" which allows non-financial entities to elect the end-user exemption to avoid having to clear their inter-affiliate trades. However, the final rule does not address the challenges facing companies that utilize a CTU model, making the passage of the legislation all the more necessary and as with margin, only the passage of this legislation would provide the certainty and assurance end-users seek.

Almost three years after the enactment of Dodd-Frank, implementation of the Act is well underway and deadlines for compliance with various regulations are looming. End-users remain extremely concerned about final regulations on margin that could be released shortly and that the CFTC has not acted on the CTU issue. While we remain hopeful that Congress will act shortly on legislation addressing the margin and inter-affiliate issues, in the meantime we urge the Committee to review these issues in the context of the CFTC and CEA reauthorizations.

Manufacturers look forward to working with you and your staff to address these important issues. Thank you in advance for your consideration of our concerns.

Sincerely,

A handwritten signature in blue ink that reads "Carolyn Lee". The signature is written in a cursive, flowing style.