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Hearing before the Senate Committee on Banking, Housing, and Urban Affairs

"Building the New Derivatives Regulatory Framework: Oversight of Title VII of the Dodd-Frank Act"

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

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Good afternoon, I am Tom Deas, Vice President and Treasurer of FMC Corporation and also President 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 also 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 basic business risks they face every day. Thank you very much for giving me the opportunity to speak with you today about derivatives regulation.

FMC Corporation was founded almost 130 years ago to provide spray equipment to farmers. Today in addition to making agricultural chemicals farmers apply to protect their crops, our 5,000 employees have worked hard to make FMC a leading manufacturer and marketer of a whole range of agricultural, specialty and industrial chemicals. FMC has achieved this longevity by continually responding to our customers' needs with the right chemistry delivered at the right price. This year marks our eightieth anniversary of listing on the New York Stock Exchange. In 1931 FMC sought access to the U.S. equity market as the largest and most available pool of capital to support our growing business. Today in 2011 the most responsive financial market in the world is the over-the-counter ("OTC") derivatives market. I had the valuable experience of negotiating and executing some of the very first derivatives – currency swaps – going back to 1984. I have seen the market grow from its inception in the mid-1980s to its current size by adapting and responding to market participants' needs. The customization available in the OTC derivatives market is key to FMC's and other end users' ability to hedge business risks in a cost-effective way. The standardized contracts available on existing and proposed derivatives exchanges will not provide this customized match to our underlying business exposures.

We support this committee's efforts to redress the problems with derivatives we experienced during the financial crisis in 2008. I want to assure you that FMC and other end users were not and are not engaging in risky speculative derivatives transactions from which some of that turmoil arose. We are very concerned by the assertion several regulators have made that the Act's requirement for swap dealers to post margin should also be extended to end users. This would require us to hold aside scarce cash and immediately available credit to meet margin calls and would be a significant new economic burden. At the time the Dodd-Frank Act was passed, end users understood we would be exempt from having to post cash margin. I want to emphasize that FMC and other end users employ OTC derivatives solely to manage underlying business risks. We are *offsetting* risks – *not* creating new ones.

Please allow me to illustrate our use of derivatives with specific examples. 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 environmental 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 with OTC derivatives to hedge natural gas prices. These derivatives are done with several banks, all of which are also supporting FMC through their provision of almost $1 billion of credit. Our banks do not require FMC to post cash margin to secure 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 never 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.

Adopting more conservative cash management practices might sound like an appropriate response in the wake of the financial crisis. However, end users did not cause the financial crisis. 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 operate their businesses.

FMC and other members of the Business Roundtable estimated that BRT-member companies would have to hold aside on average $269 million of cash or immediately available bank credit to meet margin calls. In our world of finite limits and financial constraints, this is a direct dollar-for-dollar subtraction from funds that we would otherwise use to expand our plants, build inventory to support higher sales, undertake research and development activities, and ultimately sustain and grow jobs. In fact, the study extrapolated the effects across the S&P 500, of which FMC is also a member, to predict the consequent loss of 100,000 to 120,000 jobs. The effect on the many thousands of end users beyond the S&P 500 would be proportionately greater. We would also have to make a considerable investment in information systems that would replicate much of the technology in a bank's trading room for marking to market and settling derivatives transactions.

Let me give you a direct example of why our banks 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 illustrate, FMC sells agricultural chemicals to farmers who need them at planting time, but want to defer payment until harvest time. FMC agrees with the farmer that he can pay in bushels of soybeans when he harvests his crop. FMC then enters into a customized derivative with one of our banks that exactly matches the amount and timing of the future delivery of soybeans. As the price of soybeans fluctuates, the valuation of the derivative changes by an equal and opposite amount in relation to the bushels of soybeans. This results in no net gain or loss when the derivative and the underlying exposure are valued together at any point in the future. We benefit from not having unpredictable demands on our liquidity. For this balanced structure, we agree to a small markup payable at maturity of the soybean derivative transaction I've just described. This is far cheaper in both financial and administrative cost 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 expand sales and provide added value to our customers, while reducing our risk.

By forcing end users to post cash margin, the regulators will take the balanced structure I've 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 is appropriate for them. However, since end users are balanced, with derivatives exactly offsetting underlying business risks, forcing them into the swap dealers' margin rules adds the considerable risk for end users of having to fund frequent 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.

Let me take a moment to summarize some of our principal concerns with the implementation of derivatives regulation:

- First, we are concerned that the regulators will impose margin on end-user trades, diverting billions of dollars from productive investment and employment into an idle regulatory levy.
- Second, even if the final regulations clearly exempt end users from margin requirements, we still have the risk that the regulators will require swap dealers to hold excessive capital in reserve against uncleared over-the-counter derivatives – with the cost passed on to end users as they manage their business risks. We believe that swap dealers' capital requirements should be appropriate to the actual loss experience of the specific type of derivative. The unintended consequence of punitive capital requirements could be for some end users to cease hedging risks and for others to use foreign markets.
- Finally, we are concerned that regulators will make customized derivatives prohibitively expensive through margin and increased capital requirements, with the effect of forcing us into standardized derivatives from common trading facilities that will not provide the exact match we seek with our underlying business exposures. It is the customization available with OTC derivatives that is so valuable to us and makes the derivatives effective in hedging our exposures.

The cumulative effect of these regulations could mean that U.S.-based manufacturers with substantial exports could no longer economically hedge their foreign exchange risk with derivatives. As a result they could be forced to move production offshore to match their costs directly with the currencies of their customers. I urge you to inquire into this looming problem that could increase the credit spreads for OTC derivatives by a factor of five or more.

I know many people who suffered through the financial turmoil of 2008 are tempted to label all derivatives as risky bets that should be curtailed. However, I hope these examples of prudent use of derivatives by my company and other end users who form the backbone of our country's economy have demonstrated the wisdom of the end-user exemptions that we believe to have been the legislative intent.

Chairman Gensler and other regulators have been very forthcoming and open in soliciting input from us. We appreciate being involved, but we have only a few weeks until the deadline for finalizing rules. The end-user exemption we thought was clear is still uncertain and only a very few of the 105 rules required by July 15th have been published. I urge you to extend the statutory date by which rules must be promulgated until the remaining uncertainties can be clarified and we can be assured the rules will operate effectively when taken together.

Thank you for your time. I would be happy to respond to any questions you may have.