Testimony of
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Committee on Agriculture
Subcommittee on General Farm Commodities and Risk Management
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Chairman Conaway, Ranking Member Scott, and members of the Subcommittee, thank you for convening this hearing. My name is Chris Monroe and I am the corporate Treasurer of Southwest Airlines. I am pleased to be here today to explain how the Dodd-Frank Act has caused a major impact to a commercial end-user like Southwest Airlines.

Mr. Chairman, as a Texan you know we began operating in 1971 with three planes serving three Texas cities. Back then, as now, our purpose was to connect people with what's important to their lives with friendly, reliable, and affordable air transportation. "Friendly" in this context doesn't just mean having nice Employees. It means allowing Customers to change their flights and check a bag without paying a penalty.

Today, Southwest is the Nation's largest domestic airline in terms of passengers. We are the ONLY major airline with a truly national route structure that has not gone through bankruptcy, or imposed mass-Employee layoffs or furloughs, or reduced workers' wages and benefits. One key to our unparalleled success has been our ability to hedge fuel through legitimate end-user derivatives purchased in the futures markets. Hedging at Southwest is enterprise risk management--essential in our view given our $6 billion annual fuel bill. To hedge, we commonly enter into transactions many months or years in advance of needing the physical product. Trading in these illiquid markets allows us to manage our fuel costs, which in turn helps us to keep fares low and maintain large jet (Boeing 737) flights in the communities we serve.

I am here today to highlight a few issues that have begun to impact these important markets that companies such as Southwest relay on to manage risk. One area where we are seeing a negative commercial impact is the Commodity Futures Trading Commission's ("CFTC's") Real-Time Public Reporting of Swap Transaction Data Rule ("Real-Time Reporting Rule"). That regulation prescribes the maximum time delay before swap trade data is publicly disseminated. Under this rule, swap dealers and major swap participants (generally referred to as "dealers") have a much shorter time in which to report trade data after execution than trades between two commercial end-users. Importantly, trades between a legitimate commercial end-user and a dealer must be reported within the dealer's shorter time limit. Given that the vast majority of bilateral trades entered into by commercial end-users are transacted with a dealer, this means nearly all commercial end-user trades are reported on the accelerated time limit.

The dealer time delays may be sufficient for liquid markets, but the timeframes are not sufficient for illiquid markets, which, as I said before, is where Southwest commonly trades. Only a few market participants trade that far out the curve, which makes the contracts highly illiquid, even in contracts that may be liquid in the front months such as crude oil. Additionally, Southwest has a particularly identifiable trading strategy, a hedging "DNA" if you will, which makes us quite visible in a market with few participants. This is particularly harmful. It is my understanding that Dodd-Frank expressly mandated that the identity of legitimate end-users like Southwest would be kept confidential--and for good reasons as will become clear.

When a dealer has to report illiquid trades to the market quickly, the dealer is less likely to be able to lay off the risk of that trade in the prescribed time. If the dealer is still holding a large amount of the risk when the trade is shown to the public, the dealer can be front-run and, as a result, take a loss on the trade. That increased risk to the dealer will either curtail trades or materially increase the costs of the trade to the end-users.) If an end-user like Southwest can no longer access the markets to hedge fuel it would be contrary to the purposes of the legislation and in our view hostile to Congressional intent.

Since the rule became effective, Southwest is already seeing changes in market behavior and swap pricing. A recent trade cost Southwest an additional 35 basis points in spread. Applying an additional 35 basis points in cost to the typical volumes traded by Southwest – in illiquid areas of the crude curve and in illiquid products such as jet fuel – will add roughly $60 million in annual costs. Following the rule's implementation, Southwest heard from dealers who plainly were aware of trades we had entered into that will settle in 2015.

Southwest does not object to real-time reporting of swap transactions to the CFTC. We support transparency. However, based on the fact that liquidity diminishes further out in time, there is a point where the benefits derived from public reporting do not outweigh the detriment to those who are trading illiquid contracts as the market participants become easier to identify, ultimately allowing others to take advantage of their market position.

Other issues still open for debate at the regulatory level which have the potential to completely change how we hedge relate to margin for uncleared swaps. Congress clearly intended to exempt commercial end-users from mandatory minimum margin requirements to retain the flexibility of end-users and their counterparties to avoid unnecessarily tying up scarce working capital. In that vein, Congress included specific language in Dodd-Frank[1] to allow non-cash collateral to be posted as margin as agreed to by the counterparties. This is an important practice to Southwest, as we use unencumbered assets such as aircraft to collateralize our hedge positions. This allows us to retain cash in the company to invest in our business, grow our route network, and create new jobs, and keep our fares low for customers. However the proposed rule related to uncleared margin requirements from the Prudential Regulators, who regulate nearly all of our trading counterparties, seems to both require commercial end-users to post margin and explicitly disallows the use of non-cash collateral as margin. We believe all involved regulatory bodies should follow the intent of Congress and retain the flexibility in counterparty trading relationships with respect to margin for commercial end-users.

In conclusion, it would be fair to say that neither the drafters of Dodd-Frank nor the CFTC officials intended to impede Southwest's ability to hedge our high fuel costs as a legitimate end-user, but unfortunately that has been the result of the Real-Time Reporting Rule. I look forward to today's discussion on this issue as well as other issues affecting commercial end-users. We also encourage the Subcommittee to consider legislative solutions to address the unintended consequences of the Real-Time Reporting Rule.

Thank you for this opportunity to testify and I look forward to answering your questions.

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[1]Within Section 731 of the Dodd-Frank Act: ''(D) COMPARABILITY OF CAPITAL AND MARGIN REQUIREMENTS .—
''(i) IN GENERAL .—The prudential regulators, the Commission, and the Securities and Exchange
Commission shall periodically (but not less frequently than annually) consult on minimum capital requirements and minimum initial and variation margin requirements.
''(ii) COMPARABILITY .—The entities described in clause (i) shall, to the maximum extent practicable, establish and maintain comparable minimum capital requirements and minimum initial and variation
margin requirements, <u>including the use of non cash collateral</u>, for—
''(I) swap dealers; and
''(II) major swap participants