Testimony

Before the House Committee on Agriculture

On

Legislative Proposals for Derivatives Regulation
By the U.S. Department of Treasury

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My name is Jon Hixson, Director of Federal Government Relations at Cargill. I am testifying on behalf of Cargill, Incorporated and want to thank you for the opportunity to testify.

Cargill is an international provider of food, agricultural, and risk management products and services. As a merchandiser and processor of commodities, the company relies heavily upon efficient, competitive, and well-functioning futures markets and over-the-counter (OTC) markets.

Cargill is an extensive end-user of derivatives products on both regulated exchanges and in OTC markets, and is also active in offering risk management products and services to commercial customers and producers in the agriculture and energy markets.

Examples of OTC Products

Cargill's activity in offering risk management products and services to commercial customers and producers in the agriculture and energy markets can be highlighted with the following OTC examples:

- Customized hedges to help bakeries manage price volatility, so that their retail prices for baked goods can be as stable as possible for consumers and grocery stores.

- Hedges to help regional New England heating oil distributors avoid price spikes and volatility, so that they can offer individual households stable prices throughout the winter season.

- Customized hedges to help a restaurant chain receive stable prices on chicken, so that the company can offer consistent prices and value for their retail customers when selling chicken sandwiches.

Under the Treasury Department's proposal, it is highly likely that Cargill would be forced to greatly reduce, if not eliminate, offering our customers the risk management solutions described above. Under the proposal, the risk management products that would remain in the market would dramatically increase the borrowing and working capital required for hedging.

In addition, we would expect prudent hedging to decline significantly in those situations where Cargill, like other end-users, manages its own commodity, interest rate, and foreign exchange risks, due to the imposition of mandatory margining and the drain on working capital. With less hedging, end users will be faced with more price risk exposure and volatility.

We appreciate the Treasury Department's proposal and continue to support its stated objectives. The proposal includes recognition that traditional end-user hedging in the OTC markets can and should occur. However, we are concerned that several of the restrictions in the legislation could have many unintended negative consequences.

Exceptions to Central Clearing and Margining Need to Be Clearly Defined
Exceptions to clearing and margining requirements need to be clearly defined for hedgers. Hedging is a valuable economic activity which is backed by an offsetting position. Such hedging does not create systemic risk and should be exempted from the mandatory margining and clearing requirements. The Treasury Department's proposal includes language to define legitimate hedging activity and to exempt it from certain requirements. However, this definition and available exemptions need to be clarified.

- The exemption from clearing should not be linked to the eligibility requirements set by the clearing organization. This would help avoid a conflict of interest.

- The exemption from margining should recognize the inherently balanced nature of hedges, i.e. the offsetting position, and should include an exemption for this category of end-users.

    - The exemption should not be tied to accounting practices, which may not always account for bona fide hedging activity.

    - Effective guidelines that improve documentation, transparency and ensure hedge effectiveness can be established as an appropriate alternative in defining this exemption.

- The definition of the term Major Swap Participant should be structured to exempt entities seeking to maintain an effective hedge.

Capital Charges and Treatment of Non-Bank Dealers
The proposed legislation calls for higher capital charges for OTC products that are not cleared by a registered derivatives clearing organization than those applicable to swaps that are centrally cleared. In addition, the bill calls for capital and margin requirements for non-bank dealers that could be higher than for bank dealers. This action could make non-bank dealers uncompetitive against bank dealers and is without sound justification for this disparate treatment.

- Non-bank dealers who are involved in hedging transactions have an important role to play in serving customers in many commodity markets. Since no such non-bank dealer in the commodities markets required a taxpayer bailout or caused systemic risk due to offering commodity hedging products to their customers, we recommend that the transparency and oversight proposals move forward, but that regulatory agencies study this segment of the market and develop capital and regulatory guidelines only to the extent appropriate for this type of hedging transaction.

Cargill has previously testified this year before the House Agriculture Committee, calling for better reporting and transparency, as well as enforceable position limits. We continue to support those views, and would like to call to the Committee's attention a few regulatory steps taken in this area since we last testified.

- Commitments of Traders (COT) Report – On September 4, 2009, the Commodity Futures Trading Commission (CFTC) issued its first new COT that covers the major agriculture and energy contracts. The COT reports currently break traders into two broad categories: commercial and noncommercial. The new reports will break the data into four categories of traders: Producer/Merchant/Processor/User; Swap Dealers; Managed Money; and Other Reportables.

- OTC Reporting and Transparency - The CFTC continues to collect data on OTC transactions through its Special Call authority. The CFTC will begin publishing this data, which highlights index fund activity, on a quarterly basis with a goal of eventually releasing this data on a monthly basis.

Conclusion
Much has happened in the last 18 months across the financial and commodities markets. The US Treasury Department's proposal calls for improved regulation, accountability, and transparency that will be helpful in preventing the build-up of systemic risk and allowing regulators to appropriately monitor speculative activity.

However, it is critically important that Congress and regulators take actions that focus on the areas of concern, while encouraging prudent risk management.

Actions that dramatically increase the cost of managing risk may ultimately have the unintended consequence of deterring prudent hedging, and leaving US businesses over-exposed to volatile market conditions.

We appreciate the opportunity to testify before the Committee, appreciate the work of the Chairman, the Ranking Member, and all members of this committee, and look forward to working together as this legislation continues to develop.

Thank you.