SOUTHWEST AIRLINES CO.

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June 1, 2013

The Honorable Debbie Stabenow
Chair, Committee on Agriculture
United States Senate
Washington, DC 20510

The Honorable Thad Cochran
Ranking Member, Committee on Agriculture
United States Senate
Washington, DC 20510

Dear Chairwoman Stabenow and Senator Cochran:

Last month, I met with Committee staff to discuss the Commodity Futures Trading Commission (CFTC's) "Real Time Reporting Rule" and its impact to an end-user like Southwest Airlines (Southwest). As a follow-up to that meeting, please see the attached memorandum.

By way of background, Southwest is the ONLY major U.S. airline with a national route network that has not done one or more of the following:

1. Gone out of business;
2. Gone bankrupt and reorganized;
3. Laid off Employees;
4. Reduced workers' wages and benefits; or,
5. Reduced flights and seat capacity as a result of financial failure.

Southwest is the ONLY major U.S. airline with a national route network that has:

1. Been profitable for 42 consecutive years;
2. Paid shareholders dividends for 146 consecutive calendar quarters;
3. Industry leading pay and benefits for its largely unionized work force;
4. Been recognized perennially by Fortune Magazine as one of the most admired companies in the world; and,
5. Been recognized repeatedly as one of the best places to work in America.

Southwest is distinct from the rest of the airline industry in one other material respect: it is ***the only airline in the U.S. that has consistently, over decades, successfully hedged its fuel costs through legitimate end-user derivatives purchased in the futures markets***. That is a good thing. Southwest spends 35% of every dollar received from Customers on jet fuel—about $6 billion annually. Failure to manage fuel costs is the essence of risk in the airline business. Navigating around risk has allowed Southwest Airlines to avoid the fateful ends other airlines, their Employees, and the communities they served have suffered.

Southwest's ability to manage that risk is in jeopardy due to a recent rule enacted by the CFTC. That rule, known as the "Real Time Reporting Rule," is discussed fully in the attached memorandum. We do not believe the negative consequences of this rule were intended by the Congress, or for that matter, by the CFTC. We would urge your consideration of this issue and respectfully request your assistance and cooperation in rectifying this inequity.

Sincerely,

Ron Ricks

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CFTC's Real-Time Reporting Rule
Impediment to Commercial End-Users in Illiquid Markets
June 2013

Issue Summary

The Commodity Futures Trading Commission's ("CFTC's") "Real-Time Public Reporting of Swap Transaction Data" rule sets forth the time delay before swap trade data is publicly disseminated. Southwest Airlines ("Southwest") supports the goal of transparency and regulators' monitoring for systemic risk and recognizes that under the rule, commercial end-users (or "non-dealers") like ourselves trading with other entities not registered as swap dealers or major swap participants have a longer time before we have to publicly report our trade data. Swap dealers and major swap participants (generally referred to as "dealers") have a much shorter time limit by which to report trade data after execution. However, the rule requires trades between a non-dealer and a dealer 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 to the market on the accelerated time limit.

The dealer time delays may be sufficient for liquid markets, but they are not sufficient for illiquid markets and timeframes. Southwest commonly enters into transactions many months or years in advance of needing the physical product. Few market participants trade that far out, so the contracts are highly illiquid, even in contracts which may be liquid in the front months such as crude oil. When a dealer has to report such 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 cause the dealer to charge their counterparty a premium to do the trade, if they are willing to execute the trade at all. This increased cost and possible inability to trade out the curve will cripple Southwest's ability to effectively manage risk, which is a critical component of our business.

While the CFTC's rule has only been in effect for a couple of months, 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 additional costs. Following the rule's implementation, Southwest immediately began receiving phone calls from dealer counterparties after reviewing the reported swap trades with statements like, "I see you just did a trade in 2017." That is anecdotal evidence that our positions, although not listed by name, are readily identifiable to the market given our unique strategy and large positions, which stand out in illiquid months on the curve.

Proposed Legislative Solution

Section 2(a)(13) of the Commodity Exchange Act (7 U.S.C. 2(a)(13)) is amended—

a. *In subsection (C), by striking ""General Rule.—The" and inserting "Except as provided in subparagraph (D), the";*
b. *Redesignating subparagraphs (D) through (G) as subparagraphs (E) through (H), respectively; and*
c. *Inserting the following new subparagraph:*

"(D) Public Reporting Requirements for Swap Transactions in Illiquid Markets.— Notwithstanding subparagraph (C) –

"(i) The Commission is required to provide by rule for the public reporting of swap transactions, including price and volume data, in illiquid markets that are entered into by a non-financial entity that is hedging or mitigating commercial risk in accordance with section 2(h)(7)(A)(ii).

"(ii) The Commission shall ensure that such swap transaction information is available to the public no sooner than 30 days after the swap transaction has been executed or at such later date as the Commission determines appropriate to protect the identity of participants and positions in illiquid markets and to prevent the elimination or reduction of market liquidity.

"(iii) For purposes of this subparagraph, the term "illiquid markets" means any market in which there is relatively little volume and infrequent trading in swaps."

Proposed Report Language

Real-time public reporting of swap transactions may ultimately lead to more efficient prices for commercial end-users, although that remains to be seen. 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 other participants to take advantage of their market position. The Committee believes that in Brent crude oil swap and swaption contracts, the liquidity profile changes significantly twenty-four months out from the front month contract. In complying with this section, the Commission shall create a standard for reporting all swap asset classes based off the liquidity point in any particular swap or swaption curve that is consistent with the twenty-four month point on the Brent crude oil swap curve.

Intent of Congress

Below is the relevant statutory provision from the Dodd-Frank Act (P.L. 111-203) requiring real-time reporting of swap data:

From Dodd-Frank, SEC. 727. PUBLIC REPORTING OF SWAP TRANSACTION DATA.

"(E) RULEMAKING REQUIRED.—With respect to the rule providing for the public availability of transaction and pricing data for swaps described in clauses (i) and (ii) of subparagraph (C), the rule promulgated by the Commission shall contain provisions—

> "(i) to ensure such information does not identify the participants;
> "(ii) to specify the criteria for determining what constitutes a large notional swap transaction (block trade) for particular markets and contracts;
> "(iii) to specify the appropriate time delay for reporting large notional swap transactions (block trades) to the public; and
> "(iv) that take into account whether the public disclosure will materially reduce market liquidity."