Testimony before the U.S. Senate Committee on Agriculture, Nutrition & Forestry

"Reauthorization of the Commodity Futures Trading Commission"

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Chairwoman Stabenow, Ranking Member Cochran, and other members of the Committee, thank you for inviting me to testify at this important hearing. I am an assistant treasurer at Honeywell International and today I speak on behalf of Honeywell, the Coalition for Derivatives End-Users and other commercial end-users who are asking Congress to take quick action on S.888 to provide non-financial end-users hedging commercial risk an exception from margin requirements in keeping with the original intent of the Dodd-Frank Act.

Honeywell is a diversified technology and manufacturing leader, serving customers worldwide with aerospace products and services; control technologies for buildings, homes and industry; turbochargers; and performance materials. Honeywell's growth is driven by technologies that address some of the world's toughest challenges such as energy efficiency, clean energy generation, safety & security, globalization and customer productivity. The company's more than 132,000 employees include 20,000 scientists and engineers who are focused on developing innovative products and solutions that help Honeywell's customers – and their customers – improve performance and productivity.

Honeywell is truly a global company, with more than 50 percent of our sales outside of the United States and therefore exposed to market risks from changes in interest rates, foreign exchange rates and commodity prices. When appropriate, we hedge exposures through the use of derivative contracts. The purpose of our hedging activities is to eliminate risks that we cannot control, allowing us to focus on our core strengths, namely delivering high-quality products, on time, to our customers in a manner that not only meets, but exceeds expectations. We do not use derivatives for speculative purposes.

With regulators expected to finalize margin rules and a compliance deadline for end-users before the end of the year, Honeywell and other non-financial end-users ask the Senate to take quick action on S. 888 to end the uncertainty facing our companies and prevent the resulting negative economic impacts. Without swift action by the Senate on this legislation, which passed the House with an overwhelming bipartisan vote in June, non-financial end-users will be forced to divert capital away from job creating investments, sidelining billions of dollars in margin accounts. According to a Coalition for Derivatives End Users survey, a 3% initial margin requirement could reduce capital spending by as much as $5.1 to $6.7 billion among S&P 500 companies alone and cost 100,000 to 130,000 jobs.

To demonstrate how non-financial end-users use derivatives to effectively manage risk I will provide some examples of how Honeywell uses derivatives. We sell satellite and launch vehicle inertial measurement units manufactured in Florida to customers in Germany. Europe is a key growth market for commercial space products and, in order to qualify for consideration on certain opportunities, we may be required to enter into contracts denominated in Euros even though all costs of production are incurred in U.S. Dollars. The period for this type of contract can span multiple years, during which changes in the value of the Euro versus the U.S. dollar can significantly impact its economics. To mitigate this risk, we may enter into a forward contract to sell an amount of Euros equal to our net exposure to lock in the market rate.

Honeywell carefully manages its ratio of fixed-to floating rate debt in order to lower its overall cost of debt, while providing sufficient interest rate certainty to accurately forecast and manage interest expense. Floating rate debt has historically been cheaper than fixed-rate debt, but cannot be easily issued in longer maturities, thereby exposing Honeywell to refinancing risk. Honeywell uses interest rate derivatives to convert a portion of its fixed-rate debt to floating, thereby creating a synthetic floating rate note with a longer-term maturity than can be issued directly in the capital markets.

To shed some light on Honeywell's potential exposure to margin requirements, we had approximately $2 billion of hedging contracts outstanding at year-end that would be defined as a swap under Dodd-Frank. Applying 3% initial margin and 10% variation margin implies a potential margin requirement of $260 million. Cash deposited in a margin account cannot be more productively deployed in our businesses and as a result limits our ability to promote economic growth and protect American jobs.

In approving the Dodd-Frank Act, Congress made clear that end-users were not to be subject to margin requirements. Nonetheless, regulations proposed by the Prudential Banking Regulators could require end-users to post margin. This stems from what they view to be a legal obligation under Title VII, not because they view it as necessary for the safety and soundness of the financial system.

A dialogue between Senator Mike Crapo and Federal Reserve Chairman Ben Bernanke at the Senate Banking Committee on July 17, 2012 and a subsequent one between Senator Tester and Governor Daniel Tarullo last week underscore why passage of the margin bill is necessary and why the Senate should have confidence in taking quick action. As Governor Tarullo made clear last week, passage of this bill would simply remove what they believe to be the requirement under Dodd-Frank to impose margin requirements while leaving intact the "ability to use [the] full panoply of supervisory tools." He further stated that the Fed does not need any additional authority to promote safety and soundness in the financial system and good risk management practices among regulated entities. Passage of S.888 would not remove the ability of banks to set margin requirements on end-users as part of their credit risk management practices.

This legislation in no way begins to dismantle Dodd-Frank. It would simply ensure that the final Act and rules function as Congress intended and that commercial end-users do not face the same regulatory burden as those who speculate and create systemic risk. Commercial end-users were not the cause of the financial crisis. In fact, they were a safe-haven during the financial turmoil. Investors who were afraid to invest in the debt of financial institutions were actively purchasing the debt of companies like Honeywell, companies that prudently use derivatives to manage and reduce risk and who continued to be profitable throughout the financial crisis, with no need for government assistance.

I also would like to raise an issue relating to centralized treasury units. The issue does not currently impact Honeywell but is of great importance to a number of end-users. Many companies employ centralized treasury units so that they have a single or small number of entities transacting with swap dealer counterparties. These "CTUs" allow companies to centralize their expertise, net down the types and number of external facing trades, and achieve better pricing. The problem is, this treasury "best practice" can deny a company the end-user clearing exception because a CTU could be considered a financial entity, even if it is an affiliate of a purely non-financial end-user. End-users are seeking support in the Senate for the introduction of a bill to clarify that if a CTU is part of a non-financial end-user and is hedging commercial risk, then the trade would be eligible for the end-user clearing exception in the Dodd-Frank Act.

In conclusion, we need the Senate to quickly enact legislation so that end-users like Honeywell will continue to have the ability to manage risk without having mandatory and unnecessary margin requirements imposed. Mandatory requirements would divert cash from investment and job creation. Regulators have made clear that they are not necessary for the safety and soundness of our financial system.

Thank you for inviting me to testify today. We ask the members of the Committee to support quick action on S.888. I look forward to answering any questions that you may have.