TESTIMONY OF NEIL M. SCHLOSS
VICE PRESIDENT AND TREASURER, FORD MOTOR COMPANY
SENATE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY
NOVEMBER 18, 2009

Madam Chairman, Ranking Member Chambliss, and members of the Committee, Ford Motor Company appreciates the opportunity to share our views on the important role of financial derivatives and their regulation. Derivatives are integral to our business: the manufacture, sale, and financing of vehicles worldwide.

Ford Motor Company is a global automotive industry leader that manufactures or distributes automobiles across six continents. We have about 200,000 employees and about 90 plants worldwide. The company provides financial services through Ford Motor Credit Company.

The financial crisis certainly impacted our stakeholders, consumers and our company. With that said, though. we were prepared for a deterioration in economic conditions.

Ford's plan is working.

Our underlying business is growing stronger despite continued weakness in the economy. We are positioning ourselves to profitably grow as the economy recovers. Our plan is unchanged and our priorities are clear – deliver great products, a strong business, and a better world.

At Ford Motor Company, managing risk is a key part of our business in both the manufacturing and financial services segments. We use over-the-counter derivatives to help mitigate risks that are the result of natural two-way flows that are generated from being a global manufacturing and financial service business. We do not use derivatives to speculate or bet on the potential changes in the economy or financial markets – they are a risk mitigation tool only.

We are pleased that most of the draft legislation focuses on swap dealers and major swap participants, and excludes end users such as Ford and its affiliates (including securitization trusts).

We fully support legislation to strengthen over-the-counter derivatives regulations, promote transparency and facilitate federal oversight of these critical markets. Well-functioning derivatives markets are important to us.

We welcome the opportunity to present our view on the legislative reforms and the impact on end users like Ford.

BACKGROUND

As of September 30, 2009, we had about $108 billion of derivative notional outstanding, including:

- $93 billion of interest rate derivatives
- $14 billion of foreign exchange derivatives, and
- $1 billion plus of commodity derivatives.

Today, a substantial proportion of our derivatives are at Ford Credit, with about 60% of our interest rate derivatives being utilized to hedge asset-backed securitization transactions. As of September 30, 2009, Ford Credit's securitization funding totaled about $57 billion, or about 60%, of our $94 billion in managed receivables. The securitization and other funding Ford Credit uses enables it to provide financing to the vast majority of Ford's 3,000-plus dealers and over 3 million active consumer accounts in the U.S. alone.

All of these derivatives are over-the-counter customized derivatives. Only a small fraction of our derivative trading relationships require us to post margin; instead, the common practice is that we pay an upfront credit charge commensurate with the risk of the underlying transaction.

As of September 30, 2009, the market value of our derivatives has a net fair value of about positive $900 million and was a receivable to Ford and its subsidiaries – this is the amount the banks would owe us if we needed to terminate the derivatives.

I would like to give you some examples of how we use derivatives to manage risks that result from our normal course of operations, beginning with interest rate risk.

Ford Credit – Importance of Derivatives for Funding

Interest rate exposure is the biggest risk we manage using derivatives today. Interest rate risk results from differences in terms of interest rates on the loans we extend to dealers and consumers versus the rates on the funding we raise in the capital markets.

In the U.S., we offer our retail customers fixed payments at fixed interest rates. However, much of our funding is driven by investor preferences for floating rate notes and bonds.

Ford Credit's largest funding source is the asset-backed securitization market, which often uses trust structures. Most of our securitization funding involves issuing floating rate debt purchased by investors in private and public transactions. This structure requires the trust to enter into customized interest rate derivatives to eliminate differences between the floating interest rate on the debt and the fixed rate consumer loans being securitized. The interest rate risk between the securitization funding and the underlying securitized assets must be fully hedged to protect the trust and the investors against adverse changes in interest rates.

The global credit crisis has increased our reliance on securitization funding and, therefore, has increased our need for securitization-related customized derivatives.

Apart from securitizations, we also use interest rate derivatives to manage the overall interest rate risk of Ford Credit.

Ford Credit looks to access the debt and capital markets on a global basis to access diverse investors with the ultimate aim of lowering our overall borrowing costs. We purchase derivatives to hedge the resulting currency exposure. An example of this would be our Ford Credit U.S. operations issuing Euro denominated bonds and the currency being swapped back to U.S. Dollars to fund our business here.

Auto Company -- Foreign Exchange and Commodity Derivatives

We are a capital intensive business with various manufacturing and assembly facilities around the world producing vehicles that are sold globally. Many of the product and sourcing decisions are made several years prior to the final delivery of products.

Without hedging, we would be exposing ourselves (and potentially our customers) to meaningful volatility to profits and cash flow.

For example, our F-Series trucks manufactured in Kentucky, Michigan, and Missouri are shipped to various markets across U.S., Canada, Mexico, and other countries. Currency exposure resulting from F-Series production costs being in U.S. Dollars and revenues in Canadian Dollars and Mexican Pesos is hedged using foreign currency swaps, forwards, and option contracts.

Similar exposures exist all over the world both on products and components.

We also have exposures related to our heavy use of commodities and precious metals in the manufacturing of automobiles. Price movements in these commodities can have a significant cost impact. There are two ways we hedge these exposures. First, we use over the counter derivatives to hedge those commodities that have a deep and liquid financial hedging market. Examples of these would be precious metals, aluminum and copper. For these commodities we use commodity forward and option contracts. Second, where derivative markets are not fully developed or unavailable, we also entered into longer term supply arrangements to lock in the price with a supplier. Examples of these commodities would be steel and plastics.

Our goal in hedging currencies and commodities in our auto manufacturing operations is to lock in some near term certainty for the revenues and costs of our vehicle production worldwide. Once again, we do not use derivatives for speculation.

Although we can see the merits of credit default swaps ("CDS") in facilitating risk management and facilitating access to capital, we do not buy or sell CDS derivatives ourselves.

FORD'S POSITION

As an end user of derivatives, Ford Motor Company recognizes that well-functioning derivative markets are important. We fully support legislation to strengthen the OTC derivatives regulations that would promote transparency to facilitate oversight of markets and activities of participants. Ford believes that reporting all transactions to a central repository would promote market transparency and allow for federal oversight of these important capital markets

We appreciate the fact that the general intent of most of the draft legislation is to focus on swap dealers and major swap participants, and to exclude end users such as Ford from clearing, margin, and capital requirements.

Similar to other end-user corporations and manufacturers, we are concerned that imposing clearing, margin, and capital requirements on end users would significantly increase our cash requirements and costs. We are also concerned that such requirements could provide a disincentive to hedge business risks.

Mandatory margin requirements would necessitate incremental funding and, unlike swap dealers and major swap participants, most corporations do not have expedient and low-cost access to liquidity sources such as the Federal Reserve discount window and FDIC-insured consumer deposits. In our case, raising additional capital requires lead time and is relatively more expensive for corporate end users. Additionally, given that the nature of our derivative requirements are generally driven by one-sided exposures, we are disadvantaged in being able to manage margin compared to swap dealers who generally see more trading flow and have a broader base of counterparties to allow for lower margin requirements.

<u>Impact on Asset-Backed Funding</u>

One of our biggest concerns related to derivative market reform is the potential disruption in the asset-backed securitization markets. As we have indicated earlier, Ford's captive finance business relies heavily on securitization markets to fund loans and leases to our U.S. dealers and consumers.

Securitization transactions use derivatives to protect investors from market risks and support triple-A ratings required to access these markets. We are concerned that mandatory clearing and margin requirements on these customized derivatives will force major structural changes on securitization transactions at a time when credit markets remain fragile. The present market practice is for one-way posting of margin for the benefit of the investors (securitization trust) only. Mandating a margin requirement on securitization trusts would result in substantial additional cost, legal and administrative complexity for existing transactions, and would require investor and rating agency approvals on existing transactions, which could be very difficult to obtain. Going forward, these provisions could prevent Ford Credit and many others that use the securitization markets from efficiently accessing floating-rate note investors. Limiting investor demand will directly impact the amount of financing that would be made available to our dealers and customers.

At a time when many financial institutions were curtailing credit availability, Ford Credit continued to consistently support most of Ford's 3,000 plus dealers and Ford Credit's portfolio of more than 3 million retail customers during the credit crisis. It is important for us and many others that the recovery in securitization markets remains strong.

Although securitization market access and liquidity have significantly improved since the TALF launch in March 2009, the market remains fragile for many asset classes. With the TALF exit planned for March of 2010, it is our view that a mandate to rewrite securitization market conventions on margin posting could significantly damage the recovery in securitization markets that TALF has been so helpful in fostering.

In summary, we are hopeful that securitization trusts (ours and others) can qualify for an end-user exemption. After all, it is difficult to envision any securitization trust as systemically important and the nature of a securitization swap is purely for protection and hedging. In the absence of an end user exemption, we would strongly advocate that securitization derivatives be allowed an exemption similar to what is being widely proposed for foreign exchange swaps and forwards in various Senate and House legislation.

CLOSING

In summary, we appreciate recognition in Congress that end users such as Ford only use derivatives to mitigate risk. As legislation is crafted, the distinction between pure risk mitigation and speculation is important to maintain. End users represent only a fraction of the derivatives market, virtually all of our derivatives are used for risk mitigation, and the credit risk they entail is already fully priced into the transaction up front. We thank this Committee for giving derivatives market reforms the serious attention it deserves and for inviting us to share our views.