**Testimony**

**Before the House Committee on Financial Services**

**On**

# Reform of the Over-the-Counter Derivative Market: Limiting Risk and Ensuring Fairness

**October 7, 2009**

**Mr. Jon Hixson**
**Cargill**

My name is Jon Hixson, Director of Federal Government Relations at Cargill. I am pleased to testify today on behalf of Cargill, Incorporated. My testimony will focus on the discussion draft of the Over-The-Counter Derivatives Markets Act of 2009, as released late last week. 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 the OTC markets. We are 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.

**Highlights of the Over-The-Counter Derivatives Markets Act of 2009**

The discussion draft of Over-The-Counter Derivatives Markets Act of 2009, as released by Chairman Frank, is a very positive step in addressing comprehensive market reforms of the OTC market. While we have some areas of concern, there are many well-supported elements included in this proposal.

The discussion draft includes improved transparency, including dealer registration and audit trails. In addition, the proposal would create a regulated trade data repository and has a stronger focus on reducing systemic risk, by setting clearer direction for regulators and more rigorous requirements for inter-dealer transactions. The bill also provides for flexibility of end-users and traditional hedgers utilizing OTC risk management products, and clearly establishes regulatory authority to ban any swaps deemed abusive. Cargill supports these provisions and appreciates the work of the chairman and other members of the committee in developing the discussion draft.

In many respects, the discussion draft represents a significant improvement over many other proposals that, in our view, would overly restrict the use of OTC markets for hedging purposes.

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Our main concerns with the discussion draft relate to two areas of the legislation:

1. The application of capital and margin requirements; and
2. Provisions relating to the segregation of assets for collateral.

The discussion draft gives regulators discretion in whether to impose margining requirements in traditional hedging and risk management transactions.

> We appreciate this flexibility, but have some concerns that, given recent regulatory statements and testimony, the imposition of mandatory margining for hedging transactions would still occur.
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> To ensure Congressional intent, the legislation could include a list of factors, in a similar style, as the provisions within the discussion draft that provide guidance on the "Clearing Requirement." (p. 24, line 14, Oct 2 Draft)

Capital requirements should clearly recognize and reflect the internal risk management processes utilized by dealers.

> When Cargill offers tailored risk products to our customers, like the bakery hedge described above, we offset a substantial amount of the risk by taking positions on a regulated, centrally cleared exchange. Offsetting risk positions taken on a regulated exchange are fully margined for daily mark-to-market exposure. We also use margin agreements with most of our customers. These steps greatly reduce risks in the overall hedging transaction and should be encouraged.
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> Regulators should consider such prudent risk management actions as they analyze and develop appropriate capital requirements, to ensure that the charges are based on actual risk of loss.

Segregation of assets is also a critical issue.

> A variation margin payment is made because the customer has an unrealized loss on their hedge. The variation payment is an offset to the loss. To prudently manage risks, dealers take offsetting positions to customers OTC positions. If the customer's position has a loss and is required to post variation margining, it means that the offsetting hedges also have a loss. This provision should be clarified to offer a customer greater protection for margin money they are owed, but to not impede the application of margin payments needed to reduce risks throughout the entire transaction.
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> Diversion of segregated collateral, or margin, for activities other than those taken to manage the underlying risks of a customer's hedging transaction should not be allowed.

The chairman's proposal also clarifies authority for position limit enforcement. Cargill testified before Congress earlier this year 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 already taken in this area since we first 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**
We appreciate the opportunity to testify before the Committee, to offer examples of our use of OTC products in risk management, and to highlight our areas of support and concern within the discussion draft. Again, I thank the Chairman, and all the members of this committee for their work on this important issue. We look forward to working together as this legislation continues to develop.

Thank you.

**BIOGRAPHY**
**Jon Hixson**
**Director, Federal Government Relations**
**Cargill - Corporate Affairs**

Mr. Hixson works for Corporate Affairs in Washington, and supports a range of Cargill Businesses, including Cargill Cotton and the Cargill Agriculture Supply Chain Platform.

Jon’s background includes operating experience with Cargill Flour Milling in Albany, New York, and with ConAgra Flour Milling in Denver, Colorado.

A native Kansan with a background in crop and livestock production, Jon has been in Washington since 1994 and spent nine years working in both the US Senate and the US House of Representatives for members of the Kansas congressional delegation.

In 2005, he joined Cargill as a Director of Federal Government Relations.

Jon has a Bachelors of Science Degree from Kansas State University and a Masters in Business Administration from George Washington University in Washington, DC.