

# **Coalition for Derivatives End-Users: The Impact of Margin Requirements on Main Street Businesses**

Survey analysis conducted by FTI Consulting

**Coalition for Derivatives End-Users**

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The Coalition for Derivatives End-Users (Coalition) represents hundreds of end-user companies that employ derivatives to manage risk. Throughout the legislative and regulatory processes surrounding the Dodd-Frank Act Wall Street Reform and Consumer Protection Act (Dodd-Frank), the Coalition has advocated for strong regulation that brings transparency to the derivatives markets through thoughtful new regulatory standards that enhance financial stability while avoiding needless costs. In short, we are advocating for a vibrant and safe derivatives marketplace, which helps our members focus on powering the economy and creating jobs.

[Coalition for Derivatives End-Users](http://www.CoalitionforDerivativesEndUsers.com)

The Coalition is committed to ensuring that the voice of the end-user is present during policy and regulatory debates relating to derivatives law and regulation. We are continuously seeking feedback from our members on the effects—or expected effects—of regulation on their businesses. In 2010 and again in 2011, we conducted and issued reports on surveys of our members relating to the likely impact of margin and other derivatives regulations. This report discusses the results of the third Coalition survey (2014 Survey) on these important topics.

This report analyzes the responses of 43 chief financial officers (CFOs), or corporate treasurers of both public and private companies from a variety of sectors, including manufacturing, real estate, healthcare, energy, consumer products, media & telecom, and financial.

The survey provides a quantitative look into companies' utilization of Over-the-Counter (OTC) derivatives, Centralized Treasury Unit (CTU) usage, and the effect a margin requirement would have on companies' abilities to manage business uncertainty. It also considers how companies are impacted by new reporting burdens and inconsistencies created by the divergent approaches of the U.S. and E.U. reporting regimes.

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## I. Commentary

Margin. The Coalition's 2014 survey shows that CFOs and corporate treasurers are still largely concerned that upcoming regulations from the prudential regulators, Commodity Futures Trading Commission (CFTC), and Securities and Exchange Commission (SEC) relating to margin for uncleared swaps could require their companies to post or exchange margin for swaps they use to manage risks associated with their business activities.

An overwhelming percentage of the respondents are concerned about the impact a margin requirement would have on their companies and indicate they would adjust their hedging strategies to account for such a requirement. Respondents also tell us that a margin requirement would curtail job creation, R&D, acquisitions, and business investment.

Centralized Treasury Units. Adding to the unease and uncertainty, the treatment of Centralized Treasury Units as "financial entities" is particularly problematic. Many companies employ CTUs in order to centralize their risk mitigation activities. Through a CTU, a company can execute swaps centrally rather than having each non-financial affiliate execute swaps directly with external unaffiliated counterparties. The CTU model enables consolidation and netting of exposures internally, which results in fewer external transactions and therefore lower transaction costs. This decreases settlement risk with counterparties and decreases the overall risk in the market.

Many end-users that employ CTUs responded to the survey by indicating that they are unsure as to whether clearing and margin rules apply to them. This confusion alone makes it more difficult for businesses to operate efficiently and likely stymies growth.

Roughly half of the survey respondents indicated that they employ a CTU model. These are companies that would be eligible for the end-user clearing exception if they traded directly from non-financial affiliates. If uncertainty persists, end-users may choose to abandon an efficient, cost-effective means of managing business uncertainty and instead move toward less-safe alternatives.

**An overwhelming majority (86%) of companies indicate that having to set aside collateral for their OTC derivatives transactions would adversely impact business investment, acquisitions, R&D, and job creation.**

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## II. Respondent Data Highlights

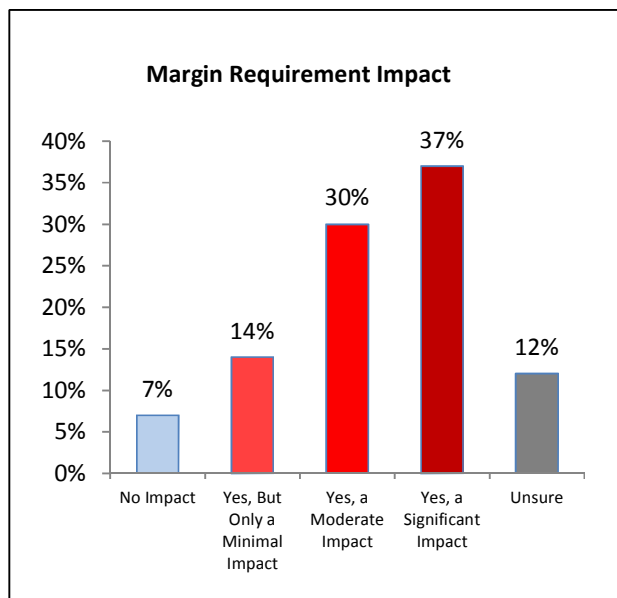
- Over two-thirds (67%) of end-user respondents report that a margin requirement on uncleared OTC derivatives transactions would have a moderate (30%) to significant (37%) impact on capital expenditures.
- 91% of respondents indicate that a margin requirement would alter their hedging strategy.
- Thirty-nine companies provided data on the notional amounts of their derivatives transactions with a total gross of \$418.6 billion. The average company has a notional amount of \$10.8 billion and the median company has a notional amount of \$2.5 billion.
- In order to fully collateralize their OTC derivatives transactions, the average respondent would need to set aside \$651.9 million of committed credit or cash with the median company forecasting \$125 million of committed credit (34 companies reporting for a total amount of \$22.1 billion). This average represents 3.1% of the total revenue of the respondent companies.
- Among respondents, our survey found that companies heavily rely on derivatives to manage interest rate, currency, and commodity price risks associated with operating their businesses. The median ratio of notional OTC derivatives to total assets of respondents' companies was 15%.
- Just under half (47%) of respondents indicated their companies use a CTU model to execute OTC derivatives. Of these, one-third (30%) have CTUs that are separate legal entities, which puts them at risk of being denied use of the end-user clearing exception solely due to their employment of this efficient method of hedging.
- Of those companies that use CTUs and that responded to a question as to whether CFTC no action relief would prevent them from being forced to clear trades, the great majority (85%) indicated that they were either unsure about whether they could rely, uncomfortable about relying, or could not rely on the CFTC relief.
- Nearly four-in-five (79%) respondents report they are very (44%) or moderately (35%) concerned about the differences between the derivatives reporting regimes for OTC derivatives in the U.S. and European Union.

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## III. Additional Responses

**Respondents say that a margin requirement would have an adverse effect on capital expenditures and would cause firms to alter their hedging strategies.**

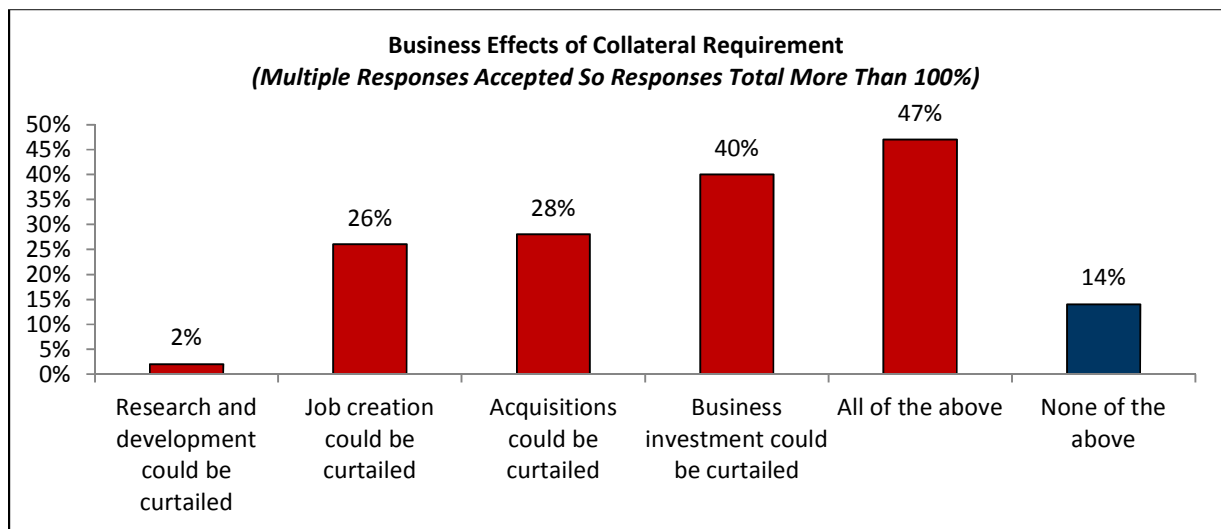
- Four-in-five respondents (81%) indicate that a margin requirement would have an impact on a capital expenditure.
  - 37% say significant, 30% moderate, and 14% a minimal impact. 7% say no impact and 12% are unsure.



- Nine-in-ten (91%) respondents indicate a margin requirement would cause them to alter their hedging strategy.
  - 42% indicate they would use different hedging products or change the structure of hedges.
  - 44% say they would hedge less.
  - 5% say they wouldn't hedge at all.

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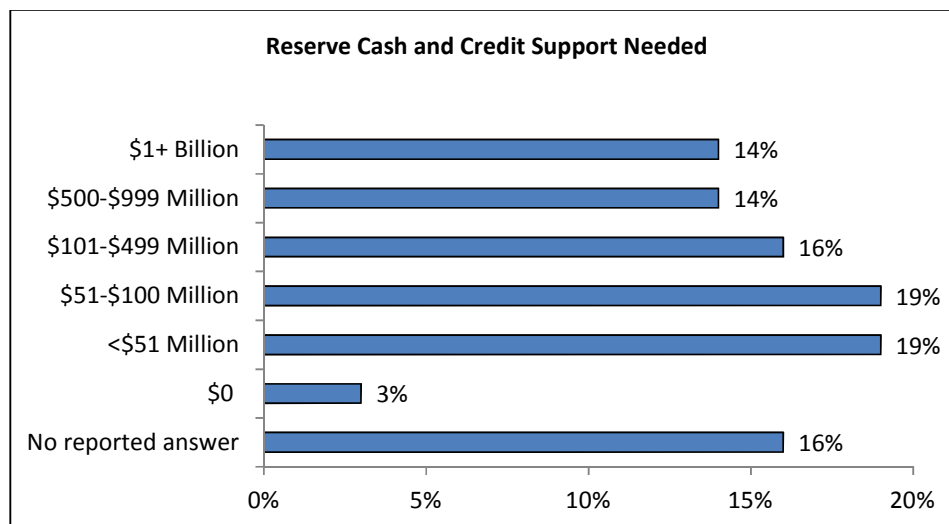
- 86% of respondents indicate that if they were required to set aside capital to fully collateralize OTC derivatives transactions, their businesses would be adversely affected<sup>1</sup>. Respondents were asked to indicate whether they would curtail any of the following business activities: research and development, job creation, acquisitions, and business investment. And they were allowed to select any or all of these activities.
  - 47% indicated that *all* of the business activities specified would be curtailed.
  - 40% indicated that business investment would be impacted.
  - 28% indicated that acquisitions would be impacted.
  - 26% indicated that job creation would be impacted.



<sup>1</sup> 86% of respondents selected one of the adverse effects of fully collateralizing OTC derivatives transactions or “all of the above.” Multiple responses were accepted for this question.

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- In order to fully collateralize their OTC derivatives transactions, the average respondent would need to set aside \$651.9 million of committed credit with the median company forecasting \$125 million of committed credit.



### **End-user companies cannot plan for the future when regulatory requirements are unclear.**

- While many of the administrative burdens of Dodd-Frank have now taken effect, regulators continue to send conflicting signals on the potential for, and the magnitude of, end-user margin requirements. The great majority (88%) of companies surveyed have not taken steps to reserve an adequate amount of cash or credit for possible new margin requirements on OTC derivative transactions.
- And, most companies (65%) have not taken steps to establish credit support arrangements that are required in proposed margin rules, suggesting that significant new burdens await end-user companies.
  - 16% indicate they have a credit support arrangement in place for all uncleared OTC derivatives transactions while another 19% have some in place.

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## **Nearly half of the respondents interviewed utilize a CTU Model which puts them at possible risk of being ineligible for the end-user clearing exception and subjecting them to margin requirements.**

- Of the companies that use a CTU model, 55% have the CTU as a part of the parent company, 30% hold it as a separate legal entity, and 15% hold it as part of another non-financial affiliate.
- 44% of companies enter into OTC derivative transaction between affiliates.
  - And about half (44%) of those companies enter into transactions between U.S. and European affiliates.
- One quarter (24%) of companies that enter inter-affiliate OTC derivative transactions report them to a swap data repository pursuant to the CFTC's regulations.
  - 57% don't report these transactions because they rely on CFTC no-action relief.
  - The remaining 19% are unsure.
- The CFTC issued no-action relief which was intended to address end-user concerns about whether their corporate structure might subject them to clearing requirements. Of those with centralized treasury centers, 69% of respondents do not qualify for no-action relief or were unsure about whether they could rely on the CFTC's relief.
  - 15% report they are relying on the no-action relief.
  - 15% qualify for the relief but do not feel comfortable relying on a no-action letter.
  - 15% do not qualify for the relief.
  - 54% are unsure about whether they qualify for the relief.

## **End-users do not use the types of derivatives that were closely associated with an aspect of the financial crisis.**

- Respondents rely primarily on interest rate, foreign currency, and commodity derivatives to manage risks arising from operating their businesses.
  - 79% use foreign currency derivatives.
  - 62% use interest rate derivatives.
  - 44% use commodity derivatives.
  - 9% use equity derivatives.
  - 0% use credit derivatives.



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**Learn More about the Coalition for Derivatives End-Users at**  
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