Testimony before House Committee on Financial Services
"Reform of the Over-the-Counter Derivative Market: Limiting Risk and Ensuring Fairness"

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On Behalf of the Business Roundtable
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Chairman Frank, Ranking Member Bachus, members of the Committee, my name is Steven Holmes and I am the Director of Treasury Operations for Deere & Company (also known as John Deere). I want to thank you for inviting me to testify today at this hearing on Reform of the Over-the-Counter Derivatives Market. I am here today in my capacity as an executive of Deere & Company. My testimony reflects the views of Deere and the views of the Business Roundtable, of which we are a member, and which represents leading U.S. companies with more than $5 trillion in annual revenues and more than 10 million employees.

Deere & Company is a world leader in providing advanced products and services for agriculture, forestry, construction, lawn and turf care, landscaping and irrigation. John Deere also provides financial services worldwide and manufactures and markets engines used in heavy equipment. Since it was founded in 1837, the company has grown into a global enterprise with sales in over 100 countries and employing over 56,000 people.

You have asked that I provide my perspective on the 187-page discussion draft that was circulated this past Friday evening. While I will comment on certain aspects of the draft legislation, I can best contribute to the debate on derivatives regulation by explaining how Deere & Company employs derivatives to manage risks to achieve stable earnings and cash flows in the increasingly volatile global economy. According to a recent survey of the world's top 500 corporations, 94% use derivatives to manage risks. I hope my testimony will help you understand how companies like Deere use derivatives to manage risk.

I am not a lawyer and I am not a government relations specialist. I have 32 years of finance experience at Deere, and I direct a group of highly trained finance professionals that are responsible for the funding activities of the Company's equipment and captive finance operations, and the management of the Company's interest rate risks. I have also directed the team that manages Deere's currency risks.

Although Deere is a major U.S. company with significant overseas sales, the risks we encounter and manage every day are no different than the risks faced by hundreds of companies large and small throughout the U.S. that compete in the global economy. We raise capital, manufacture products, and sell in the U.S. and in foreign markets and compete against foreign manufacturers of equipment. Our international activities and competition subject us to economic risks.

To manage such risks that arise out of the normal course of business, we use derivatives. We do not use derivatives as speculative investments, nor to bet on the ebbs and flows of different sectors of the economy, but instead to convert transactions that carry inherent risk into ones that produce predictable earnings and cash flows. This enables us to offer stable and competitively priced products and financing to our customers, and effectively compete with foreign equipment manufacturers.

Let me give you an example of how we use foreign exchange derivatives to manage currency risk.

Australian farmers are important producers of agricultural commodities. Deere has sales and credit operations in Australia, but no manufacturing. The products we sell in Australia are manufactured mostly in the U.S. and Europe. Australian farmers place orders for equipment well in advance of the use season to ensure they will be ready for spring planting or fall harvest. There is a significant lead time to manufacture a tractor to the farmer's specifications and ship it to Australia. We set a price in Australian dollars well in advance of making the loan and collecting payments, and our manufacturing costs are primarily in U.S. dollars and Euros. This exposes the Company to Australian dollar exchange rate movements. Without hedging this exposure, we would not be able to lock in a reasonable price for the Australian farmer and we would lose the sale. We use foreign exchange forwards, options, and swaps to manage these sales and financing risks.

The discussion draft's exclusion of foreign exchange swaps and forwards from regulation, will enable exporting companies like Deere to continue to cost effectively manage foreign exchange using simple derivative instruments that pose minimal risk to the financial system.

Foreign exchange derivatives are essential to Deere & Company's ability to offer the products and services that our customers rely on, but these are not the only types of derivatives we use. Let me provide one more example – this time, of an interest rate swap – to give you a better sense of why derivatives are so important to Deere's day-to-day business.

We provide financing for our customers on a significant percentage of our sales in both good and bad economic times. Our credit operations have over $20 billion in assets. We offer fixed and variable rate financing to meet the various long and short-term financing needs of our customers. We issue debt in the commercial paper, medium term note, and asset-backed securitization markets to fund our loan and lease portfolios. Institutional debt investors purchase the majority of our debt securities, and the demand for these securities varies as economic conditions change. Derivatives enable us to match the interest rate characteristics of the funding available in the capital markets with the financing needs of our customers. This was especially critical during the credit crisis, as capital was scarce. John Deere's volume of new loans to customers and dealers increased during the credit crisis as we stepped in to replace other financial institutions that curtailed lending. During the crisis, we were able to issue long-term fixed rate notes in the capital markets and use interest rate swaps to match the fixed and floating rate loans and leases that we offered to our customers. We employ this strategy of issuing longer-termed debt even in good economic times to reduce our refunding risk.

For a swap to be effective, it must match the timing and amount of the cash flows of the hedged exposure. Therefore, the terms of our interest rate swaps are customized to match the terms of the debt we issue. They will match the currency, principal or notional amount, interest rates, and maturity dates. Standardized contracts with predetermined terms would be far less effective.

Investment grade companies like Deere and its finance subsidiary John Deere Capital Corporation are able to issue debt securities or borrow from banks on an unsecured basis, which is a flexible form of financing. Many investment grade companies, including John Deere Capital Corporation, also have debt covenants that prohibit the posting of collateral for derivatives or other borrowings. We have a number of swap contracts that extend well into the future. If these existing contracts are not permitted an exemption from clearing and collateral requirements, we would have to terminate the transactions at significant cost.

Deere's interest rate swaps are transacted with fifteen commercial and investment banks that underwrite our debt securities, extend loans to us around the world, and provide us with commercial banking services. These banks enter into derivatives trades with us without requiring margin or collateral; however, they do impose credit limits on our derivative trades that take into consideration Deere's overall credit risk and their total credit exposure to the Company.

Derivatives provide stability to our business. At the end of our most recent third quarter, Deere had over $18 billion notional amount of derivative transactions outstanding. That is a large number, but it corresponds directly to the $20 billion of credit we have extended to our customers and dealers to purchase the equipment they need to help drive the economy. The fair value of these derivatives, which represents the price to terminate or settle the positions, was approximately $600 million, and was a receivable for Deere - the banks would owe us that amount if we terminated the derivatives.

As Congress considers how to regulate the over-the-counter derivatives market, we ask that you bear in mind how what you do could affect the thousands of customers that rely on John Deere equipment to work the land on farms, construction sites, forests, and homes across the country.

The Administration released a proposal for derivatives regulation in August, and you, Chairman Frank, offered a proposal of your own this past Friday. Deere & Company welcomes derivatives reform legislation and commends both the

Administration and you, Chairman Frank, for advancing the debate on this important subject. The current regulatory structure has proved ill-suited to prevent the abuses that contributed to the financial markets crisis, and reform is needed. However, reform must not tie the hands of end-user companies that rely on derivatives to manage risk, and whose customers rely on us to provide the products and financing they need to do their jobs.

Chairman Frank, your bill appears to take key steps that positively acknowledge and accommodate the needs of derivative end-users like Deere. For example:

- Your bill recognizes that many companies use derivatives for prudent risk management purposes, independent of the accounting treatment for the derivatives;
- Your bill does not rely on clearinghouses to determine what transactions are excepted from central clearing;
- Your bill does not prohibit the use of non-cash assets to satisfy margin requirements on customized trades.

At the same time, we continue to have outstanding concerns about the derivatives legislation that the committee plans to consider next week. While I have not conducted an exhaustive review of your bill and the Administration's proposal, I would offer the following three observations:

- First, we are concerned that regulators will be ceded too much authority to determine what companies are subject to higher regulatory thresholds associated with being a major swap participant and higher margin requirements imposed on end-user companies like Deere;

- Second, we are concerned about the capital requirements for non-centrally cleared transactions with end-users. We believe that capital charges should be levied solely based on actual risk of loss and not as a means of forcing companies to centrally clear transactions;
- And third, while your bill does not rely on a hedge accounting definition to determine which end-users are major market participants, we are concerned by the bill's open ended definition of "substantial net position" which creates a high degree of uncertainty and again gives the regulators too much authority to determine which end-users are covered.

Deere & Company is committed to working with this Committee, the Administration, and other Congressional bodies to enact thoughtful derivatives regulation that facilitates – not hinders – well-functioning capital markets. At that same time, the regulations should not be a disincentive to Companies to enter into prudent hedging transactions.

You can count on us to stand shoulder-to-shoulder with you to achieve that goal. Thank you, and I am happy to respond to any questions you might have.