



**House Financial Services Subcommittee on Capital Markets,
Insurance, and Government-Sponsored Enterprises
Hearing on the Effective Regulation of the Over-the-Counter Derivatives Markets**

**Statement for the Record
June 9, 2009**

3M Company (“3M”) appreciates the opportunity to speak to you about the importance of the over-the-counter derivatives market. My name is Timothy Murphy and I am the Foreign Currency Risk Manager for 3M. In this role, I manage currency and commodity risk for the company, as well as the company’s share repurchase program. I have worked with over-the-counter derivatives for over 20 years, both as a dealer for a financial institution as well as in my current capacity.

As you may know, 3M is a large U.S.-based employer and manufacturer established more than a century ago in Minnesota. Today, 3M is one of the largest and most diversified technology and manufacturing companies in the world.

3M thanks the Committee for studying the critical details related to reforms to the U.S. financial system and for considering our perspective in this important debate. In examining the concepts outlined in the recent U.S. Treasury proposal on financial system reforms, 3M respectfully urges the Committee to carefully consider the distinct differences among various derivative products and how they are used, and encourages the Committee to preserve commercial users’ ability to continue using derivative products to manage various aspects of corporate risk while addressing concerns about stability of the financial system.

Background on 3M

In 1902, five northern Minnesota entrepreneurs created the Minnesota Mining & Manufacturing Company, now known today as 3M. 3M is one of the largest and most diversified technology companies in the world. 3M is home to such well-known brands as Scotch, Scotch-Brite, Post-it, Nexcare, Filtrete, Command, and Thinsulate. 3M designs, manufactures and sell products based on 45 technology platforms and serves its customers through six large businesses: Consumer and Office; Display and Graphics; Electro and Communications; Health Care; Industrial and Transportation; and Safety, Security and Protection Services. 3M achieved \$25.3 billion of worldwide sales in 2008.

Headquartered in St. Paul, Minnesota, 3M has operations in 27 U.S. states, including over 60% of 3M’s worldwide manufacturing operations, employing 34,000 people. 3M’s U.S. sales totaled approximately \$9.2 billion in 2008. While its U.S. presence is strong, being able to compete successfully in the global marketplace is critical to 3M. 3M operates in more than 60 countries and sells products into more than 200 countries. In 2008, 64% of 3M’s sales were outside the U.S., a percentage that is projected to rise to more than 70% by 2010.

Ahead of their peers, 3M's founders insisted on a robust investment in R&D. Looking back, it is this early and consistent commitment to R&D that has been the main component of 3M's success. Our diverse technology platforms allow 3M scientists to share and combine technologies from one business to another, creating unique, innovative solutions for our customers. 3M conducts over 60% of its worldwide R&D activities within the U.S.

Our commitment to R&D resulted in a \$1.4 billion investment of 3M's capital in 2008 and a total of \$6.8 billion during the past five years while producing high quality jobs for 3,700 researchers in the U.S. The success of these efforts is evidenced not only by 3M's revenue but also by the 561 U.S. patents awarded in 2008 alone, and over 40,000 global patents and patent applications in force.

Our success is also attributable to the people of 3M. Generations of imaginative and industrious employees in all of its business sectors throughout the world have built 3M into a successful global company. Our interest in speaking with you today is to preserve our ability to continue to invest and grow, creating substantive jobs and providing high quality products to a growing base of customers.

Treasury Proposal.

On May 13, 2009, Treasury Secretary Geithner proposed the establishment of a comprehensive regulatory framework for OTC derivatives that is designed to:

1. Prevent activities in those markets from posing risk to the financial system
2. Promote the efficiency and transparency of those markets
3. Prevent market manipulation, fraud and other market abuses
4. Ensure that OTC derivatives are not marketed inappropriately to unsophisticated parties.

OTC Derivatives: Helping U.S. Companies Manage Risk in a Competitive Marketplace.

While 3M unequivocally supports these objectives, we have strong concerns about the potential impact on OTC derivatives and 3M's ability to continue to use them to protect our operations from the risk of undue currency, commodity, and interest rate volatility.

Derivative products are essential risk management tools used by American companies in managing foreign exchange, commodity, interest rate and credit risks. The ability of commercial users to continue to use over-the-counter ("OTC") derivatives consistent with the requirements of hedge accounting rules is critical for mitigating risk and limiting damage to American businesses' financial results in volatile market conditions.

We urge policy makers to preserve commercial users' access to existing derivative products as you design new regulations. We share the following comments with you in the spirit of working together to address the concerns about the stability of the financial system:

1. Preventing Activities Within OTC Markets From Posing Risk To Financial System:

- We agree that the recent economic crisis has exposed some areas in our financial regulatory system that should be addressed. However, not all OTC derivatives have put the financial system at risk and they should not all be treated the same. The OTC foreign exchange, commodity, and interest rate markets have operated uninterrupted throughout the economy's financial difficulties. We urge policy makers to focus on the areas of highest concern, such as credit default swaps.
- We would like to work with policy makers to address oversight where warranted, but recommend that it be targeted and not applied to all segments and market participants.

2. Promoting Efficiency and Transparency within the OTC Markets:

- We understand the need for reporting and record keeping. Publicly held companies are currently required by the SEC and FASB to make significant disclosures about their use of derivative instruments and hedging activities, including disclosures in their 10Ks and 10Qs.
- We would like to work with policy makers on ways to efficiently collect information into a trade repository to further enhance transparency.
- **We oppose a mandate to move all derivatives into a clearing or exchange environment.** One key characteristic of OTC derivatives for commercial users is the ability to customize the instrument to meet a company's specific risk management needs. Provisions that would require the clearing of OTC derivatives would lead to standardization, thus impeding a company's ability to comply with the requirements of Financial Accounting Standard 133 (FAS 133). The inability to precisely hedge specific risks, whether currency, interest rates or commodities within the context of FAS 133, would expose corporate financial statements to unwanted volatility and uncertainty. Results could include lower valuations for companies as well as a reluctance to undertake as many growth investments because of the need to maintain some dry powder for adverse impacts from unhedged financial risks.
- While we are mindful of the reduction in credit risk inherent in a clearing or exchange environment, robust margin requirements would create substantial incremental liquidity and administrative burdens for commercial users, resulting in higher financing and operational costs. Capital currently deployed in growth opportunities would need to be maintained in a clearinghouse. This could result in slower job creation, lower capital expenditures, less R&D and/or higher costs to consumers.

Hedging in the OTC market is customized to fit the actual underlying business risks being hedged. The clearinghouse concept relies upon high volumes of standardized products, a characteristic that does not exist in the customized hedging environment of the OTC market.

By imposing initial and variation margin requirements, clearinghouses will add significant capital requirements for end users, adding significant costs, discouraging hedging, and diverting scarce capital that could otherwise be used in further growing American businesses.

3. Preventing Market Manipulation, Fraud, And Other Market Abuses.

- We support the appropriate regulatory agencies having the authority to police fraud, market manipulation and other market abuses. The CFTC is utilizing its existing statutory and regulatory authority to add significant transparency in the OTC market, receive a more complete picture of market information, and enforce position limits in related exchange-traded markets. The comment period remains open on the CFTC proposal and this work should be allowed to continue.

4. Ensuring That OTC Derivatives Are Not Marketed Inappropriately To Unsophisticated Parties.

- We support modifications to current law that would improve efforts to protect unsophisticated parties from entering into inappropriate derivatives transactions.

Responding to Specific Questions Raised by the Committee.

The Committee has requested that we address some specific questions in this statement. Our responses are provided below:

- **How will clearing affect the OTC market?** The obvious benefits of clearing are the elimination of counterparty risk and the facilitation of “data collection” for executed transactions. By requiring a greater swath of derivatives to be cleared, the “costs” of trading (for both dealers and end users) will rise. Increased costs will come in the form of trading fees, margin/capital requirements, and administrative burden associated with management of the margin requirements. This will likely result in 1) an increase in market concentration among dealers, as marginal players lose profitability, and 2) a decrease in hedging among end users, as margin requirements will pressure their capital/liquidity. The second impact will likely hasten the concentration effect mentioned above. Further, a clearing environment requires the use of standardized instruments. Standardized contracts are unusable to most end users, as they do not permit companies to precisely hedge the risks of their business. Any “mismatch” between business exposure and hedge instrument could result in the end user’s loss of hedge accounting treatment (FAS 133), thus creating additional income statement volatility.
- **Should clearing be mandated for all products or only some?** We believe that they should only apply to some of the products. The currency, interest rate, and most of the commodity markets operated well throughout the recent financial crisis. Clearing, however, may be appropriate in other areas where authorities believe there is a high degree of systemic risk present. Likewise, clearing may be appropriate in the case of

standardized instruments. Customized derivatives, however, need to be tailored to meet end users' business risk management needs, making clearing problematic.

It is also important to remember that, particularly with interest rate swaps and foreign exchange, these are global markets. According to the Bank for International Settlements Triennial Central Bank Survey (December, 2007), just 15% of daily FX turnover occurred in the United States, while 24% was the corresponding figure in the interest rate (single currency) market. U.S. based companies could be put at a disadvantage versus their foreign competitors should OTC trading regulations change dramatically in the U.S.

- **What are the pros and cons of exchange trading?** The primary benefits of trading on an exchange are price discovery and similar to clearing, elimination of counterparty risk and the ability to facilitate data collection for executed transactions. Again, for foreign exchange, interest rate, and much of the commodity market, price discovery is not an issue. These markets are much more liquid than their exchange-traded counterparts, and price transparency is excellent. The drawbacks of exchange trading include increased costs in the form of trading fees, margin/capital requirements, administrative burden associated with management of the margin requirements, and the inability to precisely hedge business risks (and risk violation of FAS 133) due to the standardized nature of exchange-traded instruments.
- **What are the potential benefits of increased electronic trading?** From the perspective of an end user, the primary benefits of electronic trading are speed of execution, creation of an immediate paper trail (accuracy), price discovery, and in the case of multi-dealer platforms, the ability to “create” competition among various counterparties. Electronic trading is already prevalent within the currency and interest rate markets. Greenwich Associates estimates (March, 2009) that 53% of FX activity during 2008 was executed on electronic platforms.
- **How is balance best achieved between price discovery and liquidity?** Price discovery is really not an issue in the markets in which most end users operate. From a trader's perspective, price discovery is useless if you cannot execute the trade because of poor liquidity. Putting an instrument on an exchange does not ensure that there will be adequate liquidity to trade that instrument.
- **Are books and records appropriate for all trades? Is warehousing appropriate for all trades?** Warehousing is not appropriate for all trades. For example, a large percentage of trades executed in the foreign exchange market (well over 50%) are of very short (1 week and under) duration. It would seem impractical to require warehousing for such transactions. Warehousing probably makes more sense for “term” transactions of longer maturity.

We thank the Committee for the opportunity to share our perspective as an employer interested in preserving and enhancing the global competitiveness of American businesses and workers. 3M looks forward to working with you as the Committee crafts legislation to strengthen the U.S. financial system.