



***Association for
Financial Professionals®***

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Commodity Futures Trading Commission and U.S. Securities and Exchange Commission
Joint Meetings on the Harmonization of Regulation

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On behalf of the membership of the Association for Financial Professionals, I welcome the opportunity to provide comments on the harmonization of regulation of the over-the-counter (OTC) derivatives market.

AFP represents over 16,000 finance and treasury professionals from over 5,000 corporations, including Fortune 1,000 and the largest of the middle market companies. Our membership includes a significant number of corporate finance officers who, like me, are responsible for the protection and management of corporate cash and cash flows, including hedging the risks to these cash flows from fluctuations in commodity prices, foreign exchange rates, and interest rates. Corporate finance officers are also responsible for managing both the short- and long-term investments of their companies and the market risk associated with these investments.

I am the Vice Chairman of the Board of Directors of the AFP and the Treasurer of Tiffany & Co. Founded in 1837 in New York City by Charles Lewis Tiffany and John B. Young, Tiffany & Co. is one of America's oldest business institutions and one of the world's premier jewelers. Tiffany & Co.'s American traditions include the establishment of the standards of purity adopted by the Congress for Sterling Silver and Platinum, the design of the Congressional Medal of Honor and the 1885 redesign of the Great Seal of the United States that is seen today on the one-dollar bill and other official federal documents.

Today, Tiffany & Co. has a presence in more than 50 countries with 211 owned stores and boutiques as well as wholesale distribution and independent retailers. Tiffany & Co. shares are publicly traded on the New York Stock Exchange and are included in the S&P 500 Index. In our own manufacturing facilities located in New York, Rhode Island and New Jersey, Tiffany & Co. manufactures approximately 55% to 60% of the product we sell globally.

Over the course of the past few months, Congress and the Administration have been actively pursuing regulation of the over-the-counter (OTC) derivatives market. CFTC Chairman Gary Gensler has called for a comprehensive framework governing OTC derivatives dealers and derivatives markets. Recent statements suggest that any regulation should promote market transparency, efficiency and integrity. As a practical matter, the members of AFP fully support the idea of improving the regulation of the OTC derivatives market and improving the ability to manage and minimize systemic risk. However, we are concerned that reform will be too singularly focused on the much publicized and more exotic and speculative uses of derivatives. As an unintended result, businesses that use derivatives responsibly to contain costs and manage risks associated with their ongoing business operations, as well as their shareholders, may lose the benefit of these risk management strategies.

AFP maintains that derivative products are essential risk management tools that financial professionals rely on to help mitigate volatility in the prices of the raw materials, goods and services they buy and sell. Derivatives are also used to minimize the risks to profitability from transacting business in foreign currencies. Companies also use derivatives to reduce the cost of capital that they must generate to sustain and grow their businesses. It is important to note that the vast majority of these activities are not speculative in nature, but are most often associated with an underlying transaction in order to minimize the volatility to earnings that results from the conduct of the business. Ultimately, the beneficiary of these activities is shareholders and other providers of capital, who typically seek predictable results that are consistent with management guidance and market expectations.

An AFP survey taken to assess risk management practices within organizations revealed that the vast majority of our members use some type of OTC derivative product to mitigate financial risk. Seventy seven (77) percent of companies report using foreign exchange swaps or forwards, while 28% use OTC options. Sixty eight (68) percent of companies surveyed use interest rate swaps or forwards, while 9% use OTC options. To manage the risks associated with buying and selling energy, 50% of respondents use energy forwards or swaps, and 23% use OTC options. Forty seven (47) percent of respondents use forwards or swaps for non-agricultural commodities such as metals, with 29% using OTC options. When asked more recently about the possible effects of reduced access to non-standardized derivatives contracts, AFP members indicated that any reduction in access to non-standardized OTC derivatives would steeply increase their costs and add unnecessary volatility and risk to their quarterly earnings and balance sheets.

Regardless of which instruments organizations use to manage the risks to which they are exposed, it is critical that they be able to understand the characteristics and mechanics of each instrument and have certainty about the legal and regulatory framework under which they operate. To that end, we fully support the goal of eliminating any jurisdictional uncertainty that exists regarding which agency regulates the various instruments used by corporate risk managers.

As a manufacturer and multinational distributor and retailer, Tiffany & Co. is exposed to market risk from fluctuations in foreign currency exchange rates, precious metals prices and interest rates, all of which could impact our earnings, cash flows and consolidated financial position. Tiffany & Co. manages its exposure to these market risks through its regular operating and financial activities and, when deemed appropriate, through the use of derivative financial instruments. Tiffany & Co. uses derivative financial instruments as prudent risk management tools with the objectives to provide stability and predictability to our cash flows and costs. Tiffany & Co. does not use derivative financial products for trading and speculative purposes. As an end-user of various types of derivatives contracts, it is

imperative to the companies represented by AFP membership that regulation is not only harmonious but practical in its approach.

In addition to harmonizing the regulation of OTC derivatives, a number of related proposals have been made. These proposals include required clearing of standardized OTC derivatives through central counter parties (CCP), imposing higher margin requirements on non-standardized OTC derivatives, and imposing recordkeeping and reporting requirements through either a CCP or regulated trade repository in the case of non-standardized OTC transactions.

Accounting Complexities and Unhedged Business Risks

The requirement to clear standardized OTC derivative transactions through a central counter party or impose higher margin requirements on non-standardized OTC transactions will likely lead to more standardization of derivative contracts. Many of AFP's practitioners who use custom contracts to match their contractual terms have voiced concern regarding their ability to continue to satisfy the strict hedge accounting rules imposed by the Financial Accounting Standard Board. Subtopic 815-20-25-104 of the *FASB Accounting Standards Codification* (formerly referenced in FAS 133) sets forth conditions that many of our practitioners use to obtain the short cut accounting treatment for their hedge relationships. The shortcut method allows practitioners to assume that no ineffectiveness exists in a hedging relationship, thereby qualifying for hedge accounting treatment and minimizing the impact on earnings. However, to obtain such accounting treatment, all of the rules must be met to demonstrate the effectiveness of a given hedge, including matching the terms of the derivative with the underlying business transaction. Should standardization be required or develop over time due to unfavorable treatment of non-standardized transactions, the ability to comply with the hedge accounting requirements for many hedge transactions would become difficult, if not impossible. The loss of hedge accounting treatment will introduce significant earnings volatility for all users. The unintended result of this inability to apply the short cut method is that many companies would be less inclined to hedge, thus taking on more risk in an environment already marked by significant volatility and investor aversion to risk.

If I may, I would like to walk through a brief example of the impact of the market risk of commodity prices at Tiffany & Co. and how we manage that risk in order to demonstrate a typical corporate's risk management strategy.

On an average monthly basis, Tiffany & Co. uses approximately 30,000 of ounces silver in the manufacture of silver jewelry and other merchandise. The volatility of silver prices in recent years has been at historic levels. Today, the price of silver is just over \$14.50 per ounce. In September 2008, it averaged \$12.30 per ounce.

Each month, we project the number of ounces of silver that we will we need 12 months hence. So, right now, we are looking to hedge for our anticipated September 2010 needs. We will enter into financial derivatives contracts to “lock in” a price band that we will tolerate in our product cost and retail price models.

If we did not hedge, we would be exposed if the market price for the silver would skyrocket – as it did in March 2008 when it went above \$20.00 per ounce. In that scenario, we would not be able to adjust prices of finished product to cover the cost increase and would have to make up for it from other sources. After the cost of the commodities that are used to make our products, our most significant cost is labor.

Maintaining hedge accounting for these financial derivatives is critical. In the absence of hedge accounting, the “mark-to-market” fluctuations of our hedging transactions would need to be reflected in our interim quarterly profit and loss statements, creating a distortion from actual operating performance in those periods.

Other organizations use OTC derivatives in very different but equally important and economically beneficial ways. Large consumers of energy use OTC derivatives to lock in the price of future energy purchases. American companies that have operations outside of the U.S. or that export goods or services use OTC derivatives to manage foreign exchange risk when signing long-term contracts or agreeing to future sales or purchases. There are many other examples of economically effective hedging transactions used by companies in all industries. If companies are unable to qualify for hedge accounting, or the process for doing so becomes overly onerous, companies and investors will, at best, be faced with significant earnings volatility from their risk management activities. At worst, some companies will choose to minimize short-term earnings volatility by leaving certain risks unmanaged, subjecting shareholders to far greater long-term volatility. Any reform of the OTC derivatives market must not create an environment that causes organizations to make economic decisions that are sub-optimal in the long term in order to avoid the complexities of regulations or meet the short-term earnings expectations of investors.

Mandatory Reporting of OTC Derivative Transactions

The Obama Administration has also proposed improving oversight and transparency of the OTC derivatives market by requiring the reporting of all derivatives trades to either a central counterparty in the case of standardized OTC derivatives, or to a regulated trade repository in the case of non-standardized OTC derivatives. AFP understands the benefits of and supports the mandatory reporting of OTC derivative transactions. However, it is our belief that the reporting should be done by the major market participant (MMP) involved in the transaction rather than any individual corporate user that may execute a derivatives trade only occasionally. Due to the nature of their business, the MMPs will likely have the people, processes and procedures already in place to report these transactions or, at the very

least, are better positioned to economically justify the establishment of the infrastructure. Corporate practitioners, on the other hand, will have to develop the entire infrastructure required to meet any future reporting, monitoring, and maintenance requirements while bearing the associated costs. These added costs would provide further disincentive to corporate users to effectively manage business risks.

Higher Margin Requirements on Non-Standardized Transactions

The Administration has also proposed imposing higher capital and margin requirements on non-standardized OTC derivatives. Currently, users do not typically have to post cash collateral with a bank counterparty to execute their derivatives transactions. Central clearing typically requires users to post cash or treasuries as collateral up front and potentially continue to post more collateral during the life of the transaction. The amount of capital this could tie up has the potential to be significant and would likely restrain other investments. Moreover, derivative users would be subject to margin calls as often as twice per day on derivatives, making it difficult to plan working capital requirements and ascertain the amount of capital available to support corporate initiatives. These capital commitments and uncertainties surrounding margin requirements on OTC derivative transactions would have a negative impact on companies' ability to invest in sustaining and growing their business, impacting current and future bottom line operating results.

No Systemic Risk

Risk is a natural phenomenon in business and it is the job of financial professionals to manage and mitigate that risk effectively. The vast majority of U.S. companies that use OTC derivatives do so as a prudent measure rather than for speculative reasons. Companies who are matching their risks with OTC derivatives do not pose a systemic risk and should be not subject to onerous regulation. In short, companies who use these products as bone fide hedges are not the problem. As financial professionals and experts on financial risk management for businesses across the United States, we believe it is critical to preserve the usage of certain OTC derivatives that companies have successfully used for prudent and economically sound risk management for many years. Despite all of the market disruptions in the past year, most corporate hedging transactions were unaffected and remained valuable risk mitigation tools.

Impact on U.S. Capital Markets

Capital is mobile. If the U.S. requirements for derivatives become too onerous, users may execute transactions offshore. Given the global marketplace for derivatives, AFP is concerned about the CFTC and the SEC's ability to effectively regulate this market if other countries do not participate. Just as companies are increasingly sourcing materials, generating sales, and establishing operations outside of the U.S., they are also able to execute capital

market transactions, including derivatives transactions, in other markets. If foreign regulations are viewed as less onerous or less costly, companies may elect to conduct their derivatives trades in those foreign markets. Any movement of derivatives activities from the U.S. to foreign markets will reduce the effectiveness of the Administration's reform efforts and harm the ability of U.S. regulators to manage the risks associated with OTC derivatives. We urge the SEC and the CFTC to consider this point as regulations are developed and implemented and attempt to harmonize the regulations globally to prevent a flight of capital from U.S. to foreign markets.

AFP applauds the efforts of the SEC and the CFTC to bring transparency and stability to the OTC derivatives market, prevent excessive speculation and allow for harmonious regulation. We urge you to ensure that harmonization of regulations and efforts to improve transparency, minimize abuses, and manage systemic risks posed by OTC derivatives do not come at the cost of proven risk management tools that are critical to the stability and competitiveness of American businesses.

Thank you for the opportunity to provide our comments on this important topic.