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U.S. House of Representatives
Hearing before the Committee on Agriculture
Defining the Market: Entity and Product Classifications under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act

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Chairman Lucas, Ranking Member Peterson and Members of the Committee, I appreciate the opportunity to testify today on the key definitions in Title VII of the Dodd-Frank Act. My name is Mark Cvrkel and I am the Chief Financial Officer of Susquehanna Bank ("Susquehanna").

Headquartered in Lititz, PA, Susquehanna is a commercial bank with assets of approximately $14 billion, deposits of more than $9 billion and more than 3,000 employees in 221 locations. At Susquehanna we are committed to building the economic strength of the communities we serve in Pennsylvania, New Jersey, Maryland and West Virginia.

As is the case with hundreds of community and regional banks, Susquehanna's risk management strategy involves using interest rate derivatives to prudently manage risks that are inherent to the business of commercial banking. We do not use credit default swaps or use derivatives for speculation. At Susquehanna, we use derivatives to add stability to our interest income and expense and to modify the duration of specific assets and liabilities. In short, we use derivatives to manage exposure to fluctuations in interest rates over which we have no control.

Additionally, we enter into a relatively small amount of interest rate and foreign exchange derivatives with commercial banking customers to facilitate their risk management needs. For example, we are able to offer a borrower a competitive long-term financing at a fixed rate by pairing a variable-rate loan with an interest rate swap – thereby providing the customer with the fixed rate they desire without taking on any incremental interest rate risk at the bank. As another example, we may have a middle-market customer that sells its products in Canada. We can offer to enter into an FX forward with the customer so that when they are paid in Canadian dollars, they can fix the exchange rate and know the exact amount they will receive in U.S. dollars.

Neither our use nor our customers' use of derivatives poses systemic risk. As was shown during the financial crisis, systemic risk in the derivatives market is concentrated among a few very large and interconnected financial institutions. According to the Office of the Comptroller of the Currency's Quarterly Report on Bank Trading and Derivatives Activities, while more than 1,000 banks in the U.S. use derivatives, 96% of the notional and 86% of the credit exposure is held at the top 5 banks in the U.S.[1]

My comments today stem from concerns that certain proposed rules released by the Commodity Futures Trading Commission ("CFTC") – including those relating to the key definitions in Title VII - could unnecessarily jeopardize our ability to manage risk, provide the services our clients demand and remain competitive against much larger financial institutions.

I would like to focus today on four issues: the swap dealer definition, the potential exemption from the financial entity definition for small banks, the eligible contract participant definition and the process and timing for rulemaking.

(1) Swap Dealer Definition

Several community and regional banks have expressed concern that the swap dealer definition in the CFTC's proposed rule could capture hundreds of community and regional banks that offer risk management products to commercial customers. This would hamper the ability for many smaller banks to compete with larger financial institutions without any appreciable benefit in terms of enhanced market oversight or reduction in systemic risk.

Congress provided an exemption from the swap dealer definition for any swap offered by a bank to a customer in connection with originating a loan with that customer; however, the CFTC's proposed rule interpreting this exemption is *very* narrow. While not required by Title VII, the CFTC is considering whether to limit the exemption to swaps offered *contemporaneously* with

[1] Please refer to page 1 of the report at: http://www.occ.treas.gov/topics/capital-markets/financial-markets/trading/derivatives/dq410.pdf

origination of the loan. As it is very common for a borrower to enter into an interest rate swap before or after origination of the corresponding loan, the exemption should not be limited to any swap entered into contemporaneously with a loan. In addition, we would urge the CFTC to consider excluding from the swap dealer definition swaps offered by a bank in connection with syndications, participations and bond issuances that are facilitated by the bank[2].

In addition we are concerned that the CFTC's proposed thresholds for the so-called "de minimis exception" from the swap dealer definition are *extremely* low. For example, if a bank were to offer just 21 FX hedges[3] to customers in one year, they would be required to register as a swap dealer. These low thresholds could have the effect of either subjecting many small banks to the substantial regulatory burden imposed on swap dealers, or causing them to cease offering certain risk management services to customers.

We urge regulators to compare the thresholds for the de minimis exception against the volume of dealing done by the large financial institutions that control the vast majority of the OTC derivatives market. For example, while executing more than 20 trades with customers in one year would require a bank to register as a swap dealer, it is known that Lehman Brothers had 900,000 trades in place at the time of its bankruptcy. Available data[4] suggests that the CFTC could substantially increase the thresholds without running afoul of congressional intent. We do not believe the benefit of regulatory oversight over smaller financial institutions engaged in a relatively infinitesimal level of dealing activity outweighs the cost associated with registration and compliance for such firms.

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[2] Please refer to pages 3-4 of the comment letter submitted by Susquehanna Bank and 18 other community and regional banks to the CFTC for examples.

[3] Note that the Secretary of the Department of the Treasury has the authority to make a written determination exempting certain FX derivatives from certain regulatory requirements. Such a determination has not been made as of the writing of this statement.

[4] Please refer to pages 5 and 6 of the comment letter submitted by Susquehanna Bank and 18 other community and regional banks to the CFTC for additional comparative data: http://www.chathamfinancial.com/wp-content/uploads/2011/02/Coalition-Comments-Small-Banks.pdf

(2) Potential Exemption for Small Financial Institutions

Congress provided the regulators with the authority to exempt small banks from the financial entity definition. If such an exemption were granted, these small banks *still* would have to meet the same conditions required for the end-user exception to the clearing requirement. Moreover, small banks already are subject to existing regulations, including rules that require adequate capital to be held against all assets, including derivatives. In addition, existing regulations allow examiners to take certain actions to prevent default, or to limit bank losses in the event of default. These protections adequately mitigate risks associated with an exception for small banks. We respectfully ask that the Committee urge the regulators to exercise the authority to exempt small banks from the financial entity definition.

(3) Eligible Contract Participant Definition

Section 723 of Title VII includes a Limitation of Participation provision prohibiting any firm that is not an "eligible contract participant" from entering into a hedge over-the-counter[5]. We appreciate Congress' efforts to ensure that OTC derivatives are not marketed to unsophisticated customers; however, many community and regional banks are concerned that certain customers - including small businesses and other firms that execute hedges out of pass-through entities - may not be able to use the customized, OTC derivatives that they require for risk management purposes. We would urge the regulators to clarify that smaller, sophisticated firms could continue to enter into hedges over-the-counter, providing that they meet specific criteria already established by the CFTC and observed by market participants for more than 20 years[6].

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[5] Firms that are not eligible contract participants will only be permitted to enter into derivatives on regulated exchanges. In addition to other criteria, corporations and partnerships that have at least $10 million in assets or are hedging and have $1 million in net worth qualify as eligible contract participants under the Commodity Exchange Act.

[6] Certain firms have been able to enter into over-the-counter hedges if they meet the criteria set forth in the CFTC's 1989 Policy Statement Concerning Swaps Transactions.

(4) Process and Timing

Finally, while the regulatory agencies are to be commended for running an open and transparent rulemaking process, community and regional banks are very concerned with the aggressive pace of rulemaking. We would urge Congress to extend the statutory effective date for Title VII and set a sequence for rulemaking that supports thorough cost-benefit analysis and productive public comment. We would recommend a sequence for rulemaking that defines entity and product definitions and other key terms first, duties and obligations second and then the specific regulatory requirements that apply based on these terms, duties and obligations. Additionally, we would recommend that the regulators permit market participants to consider the entirety of the proposed rules for all of Title VII, once they are available, and provide additional comment before finalizing any of the proposed rules.

Conclusion

Community and regional banks are essential to support the job creation at small and middle-market businesses that forms the foundation of any economic recovery. We applaud the work of the regulators to strengthen the OTC derivatives market, but we urge caution against finalizing rules that would place undue burdens on small banks that had nothing to do with the financial crisis, do not pose systemic risk and collectively engage in a fraction of the derivatives traded by the large dealers. It is critical to get these definitions right in order to ensure that regulation of the derivatives market is effective and unintended consequences are minimized. I thank you for the opportunity to testify today, and I am happy to answer any questions that you may have.