

**July 21, 2011**

**U.S. House of Representatives  
Hearing before the Committee on Agriculture  
Derivatives Reform: The View from Main Street**

**Statement of Denise B. Hall  
Senior Vice President  
Webster Bank**

Chairman Lucas, Ranking Member Peterson and Members of the Committee, I appreciate the opportunity to testify today on the implementation of Title VII of the Dodd-Frank Act. My name is Denise Hall and I am a Senior Vice President at Webster Bank (“Webster”). I have been employed by Webster for 15 years and manage the department that executes all interest rate and foreign exchange derivative products.

Webster Bank is an \$18 billion full-service commercial bank headquartered in Waterbury, Conn., with 176 branches stretching from Boston to Westchester County, NY. We are a major provider of banking products and services to middle market companies, small businesses and families in our region. For three consecutive years, Webster has written more SBA loans than any other bank in our home market of Connecticut. In our 76 years, we have only had two CEOs – our founder, Harold Webster Smith, and his son, Jim Smith, who has held that title since 1987. Throughout our history and growth, we have never lost sight of whom we serve and why we exist, something we call the Webster Way. To give the committee members a better idea of what this means, I want to share with you how we have conducted ourselves during the residential mortgage crisis. Since 2008, Webster has modified the payment terms of mortgages with balances totaling more than \$187 million. These modifications have saved homeowners an average of more than \$300 a month and kept more than 1,000 families in their homes. In that time, Webster has not had a single adversarial mortgage foreclosure where we were able to contact the borrower. What distinguishes Webster is that we have addressed head-on the issue of affordability for borrowers who have encountered difficulties through no fault of their own; we have not just postponed the day of reckoning. The proof of this is that our re-default rate on modified mortgages is about 13 percent, less than a third of the industry average. Our mortgage modification program was profiled in the Hartford Courant, and I’m leaving the committee with

a copy of that article. Although the topic of the hearing today is derivatives, not mortgages, Webster believes members of Congress need to know that there are community-minded banks that are trying to do the right thing by customers every day, whether it's an exporter that wants to hedge currency risk or a homeowner who has lost a job.

Webster, like many other community and regional banks, depends on interest rate derivatives to prudently manage risks inherent to the business of commercial banking. We do not use credit default swaps or use derivatives for speculative purposes. Rather, Webster uses derivatives to increase certainty with respect to its net interest margin and to reduce risks that naturally arise from making loans and taking in deposits.

Additionally, Webster provides a relatively small amount of interest rate and foreign exchange derivatives to our commercial banking customers to assist them in managing their own risks. By way of background, in 1999 Webster Bank loan officers approached me to request that we develop the ability to offer interest rate swaps in conjunction with loans that we would underwrite. In Connecticut, we face competition from many of the large New York banks and they found that we were losing deals to those banks that were able to offer borrowers the risk mitigation benefits associated with an interest rate swap. Interest rate swaps would allow us to offer borrowers competitive long-term financing in a manner that does not require Webster to take on unwanted interest rate exposure. In addition, we offer foreign exchange forwards to assist our customers in managing exposure from fluctuating currency rates that results from selling products or buying raw materials abroad. Again, we are helping our clients to mitigate risk.

We have offered these products responsibly to our customers for the past twelve years, and I am concerned that an unintended consequence of the legislation would be that it becomes cost prohibitive to continue to do so, borrowers would have fewer choices, and the lack of competition from small and mid sized banks drives their cost of credit higher.

Today I would like to address several concerns about the impact of certain rules the Commodity Futures Trading Commission ("CFTC") has proposed that affect smaller banks like Webster.

These proposed rules could unnecessarily jeopardize the ability of smaller banks to manage risk, meet our customers' risk management needs and compete with large dealer banks.

In particular, I will focus today on three issues: the potential exemption from central clearing for small banks, the swap dealer definition, and the eligible contract participant definition.

### **(1) Potential Exemption for Small Banks**

Congress recognized the low risk posed to the system by small banks when it granted regulators authority to exempt them from clearing requirements. It is important that the Commission exercise this authority. Subjecting small banks to such requirements will be costly and will offer little or no risk-reducing benefit to the financial system. The time and expense associated with clearing for small banks could serve to deter some community and regional banks from using swaps to hedge risk.

Small banks use derivatives to a much more limited degree than larger banks. As a result, Webster and its customers' derivatives use pose no risk to financial stability. Rather, such risk is concentrated among a few very large and interconnected financial institutions. In fact, while more than 1,000 banks in the U.S. utilize derivatives, 96% of the notional and 86% of the credit exposure is held at the top 5 banks in the U.S.<sup>1</sup> Importantly, the limited use of OTC derivatives by small banks means they are unable to meaningfully contribute to risks in the financial system. The derivatives losses that result from a small bank's failure could not cause a large bank to fail. And regulators would have little or no motivation to forestall the resolution of a major swap dealer on account of its swap positions with small banks.

Much of the limited risk posed by small banks is already addressed through bilateral margin arrangements, especially those customarily entered into with large dealer banks. Additionally, capital requirements also serve to ensure banks adequately protect against counterparty credit risks.

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

Relatively small derivative transaction volume can make clearing uneconomic for many banks. This is because lower transaction volumes make it difficult for small banks to absorb the fixed costs inherent in establishing and maintaining clearing arrangements. By contrast, large dealer banks can amortize the cost of establishing and maintaining clearing arrangements over hundreds of thousands of transactions. In preparation for the clearing requirements I have begun the process of evaluating different proposals, and will be faced with determining how the additional costs will be allocated.

In addition to exercising its authority to exempt small banks from clearing requirements, the Commission should also consider the parameters for identifying which banks are eligible to qualify for the exemption. Rather than focusing on a bank's asset size, the Commission should focus on the risk of a bank's derivatives portfolio. This risk could be defined by a bank's net uncollateralized derivatives exposure. We agree with recommendations that banks whose net uncollateralized exposure is less than \$1 billion be exempt from clearing requirements. If the Commission opts to focus solely on a bank's asset size, we believe it would be appropriate to allow banks with less than \$50 billion in assets to qualify for the exemption. Even so, we feel that it is conceivable that we could have \$55 billion in assets, and still have very little in uncollateralized risk due to our bilateral netting arrangements, and relatively few transactions. Uncollateralized exposure is a far better metric.

## **(2) Swap Dealer Definition**

Webster Bank shares concerns expressed by a wide range of community and regional banks that the swap dealer definition in the CFTC's proposed rule could inadvertently encompass hundreds of community and regional banks that offer risk management products to commercial customers. Such a broad swap dealer definition would result in many small banks ceasing to offer derivatives products to customers. This is because the volume of swaps many small banks offer would not justify the substantial compliance burden imposed on swap dealers. Such an outcome could significantly harm community and regional banks, by making it more difficult for them to compete with larger banks for loans. The diminished competition that would result from smaller banks' withdrawals from the swaps market would ultimately result in customers paying more.

Title VII included 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. This exemption reveals that customer hedging activity carried out by small banks does not pose the risks the Act is intended to address. However, the CFTC's proposed rule interpreting this exemption is unnecessarily narrow. While not required by Title VII, the CFTC is considering whether to limit the exemption to swaps offered *contemporaneously* with 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. Indeed, the flexibility to execute a swap after the loan closing is one of the features that borrowers employ to manage their risk. In addition, we 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<sup>2</sup>.

Additionally, the CFTC's proposed thresholds for the "de minimis exception" from the swap dealer definition are *extremely* low and should be increased. If a bank were to offer just 21 foreign exchange options<sup>3</sup> to customers in one year, they would be subject to the full panoply of regulation applicable to swap dealers. As noted, many small banks would simply cease offering certain risk management services to customers, rather than face such a regulatory burden.

In its economic analysis of the proposed margin rule<sup>4</sup>, the Office of the Comptroller of the Currency evaluated the impact of reducing the number of institutions that are classified as "swap entities" (e.g., OCC regulated swap dealers). The analysis considers the impact of increasing the notional test set forth in the de minimis exception from \$100 million to \$10 billion. Such an adjustment would reduce the number of OCC regulated swap entities from 74 to 22.

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<sup>2</sup> Please refer to pages 3-4 of the comment letter submitted by Webster Bank and 18 other community and regional banks to the CFTC for examples.

<sup>3</sup> 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.

<sup>4</sup> Office of the Comptroller of the Currency, Economics Department, Unfunded Mandates Reform Act Impact Analysis for Swaps Margin and Capital Rule (April 15, 2011)

Importantly, such an adjustment has virtually no impact on the notional amount of swaps covered by the proposed rule.<sup>5</sup>

Regulators have ample authority to address this concern while still faithfully interpreting Title VII<sup>6</sup>. We urge regulators to compare the thresholds for the de minimis exception against the volume of dealing done by the large financial institutions. 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. It would take Webster a century to generate that volume of transactions!

Expanding this exception will have little or no impact on the mitigation of systemic risk, while significantly reducing the regulatory burden on small banks.

### **(3) Eligible Contract Participant Definition**

Section 723 of Title VII prohibits a firm that is not an “eligible contract participant” from entering into an OTC derivative<sup>7</sup>. This provision creates uncertainty for certain small businesses that have previously been able to utilize uncleared OTC derivatives. Additionally, absent clarification from the CFTC, even large firms that make investments through smaller subsidiaries may be precluded from hedging the commercial risks associated with those subsidiaries. We urge the CFTC to clarify that such smaller firms can continue to utilize uncleared OTC derivatives, so long as they meet specific criteria already established by the CFTC more than two decades ago and relied upon ever since by numerous market participants<sup>8</sup>.

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<sup>5</sup> The notional amount at a swap entity threshold of \$100 million covers \$1.7949 trillion in notional for 74 banks. The notional amount at a swap entity threshold of \$10 billion covers \$1.74941 trillion in notional for 22 banks. The OCC notes, “*Because total swap amounts are concentrated in a relatively small number of institutions, varying this threshold has little impact on the dollar amount of swaps affected by the proposed rule.*”

<sup>6</sup> Please refer to pages 5 and 6 of the comment letter submitted by Webster 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>

<sup>7</sup> 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.

<sup>8</sup> 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.

**Conclusion**

Community and regional banks depend on customized OTC derivatives to mitigate risk and to help small and mid-sized businesses grow and prosper. Regulation intended to protect against systemic failures should not burden those who are incapable of causing such failures in the future. Broad-stroke regulatory approaches that fail to properly distinguish banks like Webster from major derivatives players like AIG could jeopardize the ability of small banks to efficiently mitigate risk, to compete for lending business against large-bank competitors, and to provide customers with competitively priced alternatives.

Thank you for the opportunity to testify today, and I am happy to answer any questions that you may have.

# Hartford Courant.

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## A BANK GUIDE THROUGH MORTGAGE TROUBLES: WEBSTER SPECIALISTS OFFER CONTINUITY, HOPE OF DEAL FORECLOSURE CRISIS

**A**fter years of complaints, state attorneys general are pressuring lenders to overhaul foreclosure practices and stop bouncing delinquent borrowers from department to department - but Natalie Silva is way ahead of the curve.

Silva, a loss mitigation specialist at Webster Bank, has worked under those rules ever since she began dissecting foreclosure cases at the bank two years ago.

Far from lawmakers in Hartford and Washington who are wrestling with the foreclosure mess, Silva's cubicle on the fourth floor of an office building in Cheshire is on the front lines of the crisis. Borrowers in danger of losing their homes jump from tidy statistics to real people in the biggest jam of their lives.

Here, day after day, come the calls: Borrowers - some crying, others screaming - initially make the bank their target. Some are angry about the banking industry in general in the wake of the financial services meltdown and the taxpayer-funded bailout that followed.

"If they are upset or screaming, I let them vent for a little while," Silva said. "I don't want to interrupt. If I try to say something,

even if it's good, they get mad about me interrupting."

Silva is one of the point people Waterbury-based Webster began assigning to delinquent borrowers in 2008, to provide a single contact with a road map through the complex and often confusing maze of foreclosure. The specialists may help reach a deal on a mortgage modification, although there is no guarantee that borrowers will keep their homes in the end.

"I talk to them through every step and am pretty much in contact with them every couple of days," Silva said. "I make sure they know how to call me."

The concept sounds deceptively simple. But housing advocates say that, industrywide, delinquent borrowers typically get a different person every time they call, are forced to resubmit paperwork repeatedly and often are left hanging for weeks.

In Connecticut, many borrowers in trouble have described that scenario, saying it adds to the nightmare.

The issue bubbled over last fall in the wake of the "robo-signing" scandal in which foreclosure documents were signed at some of the nation's largest loan servicers without verifying the accuracy of

the paperwork.

State attorneys general, including Connecticut's, now are pressing for sweeping changes in the way lenders and mortgage services deal with borrowers in foreclosure as part of a 27-page proposal that was released earlier this month.

But for Silva and her colleagues on the front lines, it comes down to a personal touch. She said she remains calm with borrowers on the phone. And while she must be realistic about whether a borrower can afford a loan modification, even with a lower monthly payment, she can't be totally detached from borrowers, either. "I do feel for them," Silva said. "I completely understand. We are them, they are everyday workers, working their jobs and trying to pay the bills."

### TOUGH PREDICAMENT

Joe Raad, a colleague of Silva's, said that once borrowers let off steam, a conversation can begin. Sometimes the person has lost a job or faces runaway credit card debt or mounting medical bills. Other times, borrowers simply have gotten in over their heads.

"The way it is set up here, you get to know the customer on a first-name basis," said Raad,



who has been in the department for two years. "It's not like we're bouncing around these accounts. Every time they call, they get the same person."

The foreclosure crisis has placed banks, including Webster, in a predicament. Modifying loans means banks must take steep losses; Webster has already logged \$17.5 million in writeoffs tied to mortgage modifications. And it's unclear whether foreclosures have even peaked in Connecticut and elsewhere in the bank's New England market.

Mounting stockpiles of repossessed homes, on the other hand, can further stymie a still-elusive recovery in the housing market. They pull down values of nearby properties and compete with owner-occupied properties that are on the market.

Webster doesn't offer temporary or trial modifications, which elsewhere in the industry sometimes left distressed borrowers with higher payments than they started with. Either borrowers can afford the permanent, lower payment or they can't, but the payment always has to be lower.

So far, the approach seems to be working.

Since 2008, Webster has worked with 1,881 distressed borrowers - about 56 percent of those, or 1,059, have had their mortgage payments lowered, each saving an average of \$333 a month.

Of the borrowers approved for modifications, 11 percent fell behind again, significantly lower than the 35 percent or more at some of the nation's largest servicers.

Of the 822 mortgages that weren't modified, 120 resulted in properties being repossessed by Webster.

Another 441 were put on the

market as short sales, in which Webster agreed to accept a sales price that was less than what was owed on the property. Some borrowers were able to get back on track, and some walked away and left the home keys to Webster. Through it all, Silva and Raad and six colleagues had to make tough telephone calls.

"I don't know if there is a way to prepare for that," Silva said. "It's almost like you don't want to deliver the bad news to someone. You have to. It's not the best feeling, but you have to."

Webster has more control over decision-making and has more leeway in modifying loans because 85 percent of the home mortgages Webster deals with are held on its books so the bank, in essence, owns those loans. That isn't the case with large servicers who collect monthly payments on behalf of investors who have bought bundles of loans.

Servicers often must broker modifications with multiple investors, complicating the process. Critics charge that those servicers benefit financially from stretching out the foreclosure process, generating additional fees along the way.

In some cases, Silva and Raad say, they have been caught off guard by the reaction of borrowers, even when a loan modification is offered.

More than once, Silva said, she has been particularly excited about making calls on modifications that have been particularly difficult to work out.

"The person said, 'That's it?'" Silva said. "Those are the ones that really shock me. Maybe their neighbor got a lower payment. No two people get the same type of modification."

## VOLUME RISING

Despite pressure from lawmakers and state attorneys general, housing advocates in Connecticut say little has changed since the foreclosure crisis first hit.

Jeff Gentes, a staff attorney and foreclosure expert at the Connecticut Fair Housing Center in Hartford, said that if change is coming in how lenders and servicers interact with borrowers, it is "very small scale if it is happening."

The majority of calls he receives are still from borrowers who are having trouble communicating with their lenders. And the volume of calls is up this year, he said.

"You still get people where they are in an endless cycle of sending documents and not making progress with their bank," Gentes said. "It's frustrating because there is little legally they can do about the non-responsiveness."

Back at Webster's operations center in Cheshire, Raad says his job carries a big responsibility because it involves a borrower's home. That, he says, obviously carries stress along with it.

His relief valve is going to the gym before arriving at work at about 8 a.m., but his workout schedule has been curtailed because he and his wife have a newborn baby.

Silva simply walks her dog every night.

"We all handle it a little differently," Raad said. "When it comes down to it, we're all individuals living in the same economy. We understand where they are coming from."

Follow Courant staff writer Kenneth R. Gosselin on Twitter at [kennethgosselin](https://twitter.com/kennethgosselin).

Committee on Agriculture  
U.S. House of Representatives  
Required Witness Disclosure Form

House Rules\* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2008.

Name: Denise B. Hall

Organization you represent: Webster Bank, NA

1. Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2008, as well as the source and the amount of each grant or contract. House Rules do **NOT** require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:

Not Applicable

2. If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2008, as well as the source and the amount of each grant or contract:

Webster Bank, N.A. participated in the Troubled Asset Relief Program – Capital Purchase Program (“TARP- CPP”) program between November 21, 2008 and December 29, 2010. Except as noted with respect to TARP-CPP and except in connection with the conduct of its business as a nationally chartered financial institution (including without limitation its participation in various federally subsidized lending programs), after due inquiry I have been unable to locate any indication that Webster Bank, N.A. has received any material federal grant or been a party to any material contract.

Please check here if this form is NOT applicable to you: \_\_\_\_\_

Signature: 

\* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

**PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.**

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**Summary** Background features 27 years of experience in banking and capital market environments, encompassing management, sales, compliance and operations. Demonstrated history of creating new business lines, having successfully established a money market, foreign exchange, and interest rate derivatives desk and a bank municipal securities dealership.

## **Experience**

2/96 to Present

### **Webster Bank, Waterbury, CT, Treasury Group**

#### Senior Vice President, Treasury Sales Manager

Established and currently manage a sales group that delivers money market and fixed income investments, foreign exchange spot and forward contracts, and interest rate derivative products to corporate, municipal, and high net worth investors. Price and manage over \$1.7 billion notional of loan level and balance sheet related derivatives and a portfolio of customer short term investments, including sweep repurchase agreements and Eurodollar deposits. Chair the Commercial and Institutional Liability Pricing Committee and serve as Secretary of the Loan Pricing Committee. Communicate pricing methodology to the Bank's lending officers on fixed and floating rate loans. Present customized interest rate risk hedge solutions to floating rate borrowers. Manage department's Sarbanes-Oxley process and internal and external audit requests. Conducted system search of bank investment accounting systems and implemented conversion to Paragon system.

9/89 to 12/95

### **Shawmut Bank Connecticut, N.A., Hartford CT**

#### Assistant Vice President and Manager, Money Center, Capital Markets Division

Supervised the sale of money market instruments, managing each product to reach specific bank funding requirements. Managed client communications regarding funding products and bank rating downgrades during New England's banking and real estate crisis. Conducted cash management presentations internally and externally. Marketed and sold hedge products to corporate customer base and priced all money market and commercial loans.

12/86 to 9/89

### Portfolio Analyst, Investment Operations (Connecticut National Bank)

Maintained Bank's \$10 billion investment portfolio by ensuring receipt and delivery of securities, income collection, reconciliation of asset and accrual accounts and overall accuracy of security portfolio.

12/85 to 12/86

### **Prudential-Bache Securities, Hartford, CT**

#### Sales Assistant, Direct Investments and Restricted Sales Coordinator

6/83 to 12/85

### **Advest, Inc. Hartford, CT**

#### Compliance Specialist

**Education** Bachelor of Arts, Psychology, University of Connecticut, Storrs, CT, May 1982  
MBA, Rensselaer Polytechnic Institute, Hartford, CT, August 1999

**Designations** General Securities Registered Representative (Series 7) February, 1990  
Municipal Securities Principal (Series 53) November 2001  
Notary Public  
Justice of the Peace

**Organizations** Minority Leader, West Hartford Town Council  
Former Member, Town of West Hartford Risk Management  
& Investment Advisory Committees  
Treasurer, West Hartford Veterans Memorial Committee  
Member, Mercy Housing and Shelter Finance Committee  
Past President, Mercy Housing & Shelter Board of Trustees  
Associate Member, Government Finance Officers Association of CT  
Member, Sarah Whitman Hooker Chapter, Daughters of the American Revolution  
Member, American Legion Auxiliary