July 21, 2011

U.S. House of Representatives
Hearing before the Committee on Agriculture
Derivatives Reform: The View from Main Street
Statement of Sam Peterson, Chatham Financial

Good afternoon Chairman Lucas, Ranking Member Peterson and Members of the Committee. Thank you for the opportunity to testify today regarding the impact of derivatives regulation on Main Street businesses. My name is Sam Peterson, and I am a Senior Advisor at Chatham Financial ("Chatham").

Chatham is a global consulting firm based in Pennsylvania that serves as an advisor to more than 1,000 end users of derivatives, including clients with operations in all 50 states. Our clients range from Fortune 100 companies to small businesses, and include manufacturers, community and regional banks, technology firms, health care companies, real estate companies and businesses from virtually every sector of the economy. What is common to all of our clients is that each uses over-the-counter ("OTC") derivatives to reduce business risk – not to take on risk through speculation.

Throughout the policy debate surrounding effective regulation of the derivatives market, Chatham supported the efforts of Congress to pass legislation that strikes a balance between reducing systemic risk and preserving safe and efficient access for thousands of firms that rely on over-the-counter derivatives for critical risk management. On the anniversary of the enactment of the Dodd-Frank Act, it is important to consider the current rulemaking efforts in light of the primary objective of Title VII.

The primary objective of Title VII was to reduce and contain systemic risk in the over-the-counter derivatives market in order to ensure that American taxpayers never again would have to step in and subsidize the reckless behavior of major players in the derivatives market. In pursuing this end, Congress appropriately distinguished between the major market players with derivatives exposures large enough to threaten the financial system and the firms that do not pose systemic risk and who use over-the-counter derivatives prudently to manage ordinary business risks. Now the regulators are tasked with implementing Title VII in a manner that is consistent with Congressional intent, and must craft the rules that will govern this important market for years to come. As the regulators work toward completing this monumental task, I would like to highlight a few key areas of concern for end users:

Margin

Despite the considerable efforts taken by the principal authors of Title VII to clarify that end users should be exempt from clearing and margin mandates, end users remain concerned that recently proposed rules could subject them to margin requirements for non-cleared trades.

Imposing margin requirements on end users is neither consistent with Congressional intent nor a holistic reading of Title VII; however, setting aside the question of whether regulators have the authority to impose margin requirements on end users, there are important differences with respect to the margin rules proposed by the CFTC and the prudential regulators.

The CFTC will finalize rules for trades done with non-bank swap dealers and the prudential regulators will finalize rules for trades done with bank swap dealers. The prudential regulators' proposed rule would require all end users – even non-financial end users - to have in place credit support arrangements with specific margin-posting thresholds. If exposure for their trades exceeded the thresholds, end users would be required to post margin. The CFTC's proposed rule would require all end users to have credit support arrangements in place, but specific margin-posting thresholds are not required, and we are hopeful that existing documentation would suffice. Chatham supports the CFTC's position that it is not required to impose margin requirements on non-financial end users. The majority of end users, however, enter into their hedges with *bank* swap dealers and, as such, would be subject to the prudential regulators' rule.

A precise estimate as to the aggregate impact of the regulators' decision to impose margin requirements on end users is not possible, since it will depend on how the rules are implemented; however, depending on implementation, it is clear that hundreds of billions of dollars in capital could be diverted from productive economic investment to sit idle as collateral.[1]

In a recent policy brief, the Progressive Policy Institute warned of unintended consequences associated with imposing margin requirements on end users, stating, "While margin requirements make sense in many contexts to reduce the threat of systemic risk, putting margin requirements on companies that use derivatives to manage risks in the ordinary course of business—i.e. end users—is both onerous and unnecessary."

Capital

Title VII requires regulators to set capital requirements for non-cleared derivatives at levels that are appropriate for the risk of the trades; however, end users are concerned that capital requirements could be set at punitive levels that are disproportionate to risk and appear aimed at re-shaping market structure. Punitive capital requirements could make non-cleared derivatives prohibitively expensive, potentially rendering the end-user exemption moot. Such an approach is not necessary to achieve the aims of Title VII and could work at cross-purposes to the objectives of the Act. Just as Title VII reflected Congress's view that end users do not meaningfully contribute to systemic risk, it is essential that capital requirements also reflect the lower risk posed to the system by end-user transactions.

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[1] The National Corn Growers Association and the National Gas Supply Association estimated the collateral requirements could run as high as $700 billion. (http://www.ngsa.org/Assets/docs/2010%20press%20releases/21-ngsa%20urges%20fix%20for%20derivs%20title%20in%20conference.pdfcorn%20growers%20join%20drumbeat%20against%20mandatory%20clearing.pdf); The Tabb Group estimated that $2.2 trillion in capital would be required globally to satisfy levels of margin required by clearinghouses (http://www.tabbgroup.com/PageDetail.aspx?PageID=16&ItemID=972); a study by ISDA estimated that collateral requirements under Title VII of Dodd-Frank could result in $1 trillion in capital being diverted to satisfy bilateral and clearinghouse margin calls in the U.S. (http://www.isda.org/media/press/2010/press062910.html); and, an analysis by Keybridge Research that was based on survey by the Business Roundtable estimated that the non-financial S&P 500 companies alone would have to post approximately $33 billion alone if subject to a fixed initial margin requirement of 3%. [http://businessroundtable.org/uploads/studies-reports/downloads/An_Analysis_of_the_Business_Roundtables_Survey_on_Over-the-Counter_Derivatives.pdf]

Taken together, the margin and capital requirements could have the effect of making customized, non-cleared derivatives prohibitively expensive, despite the fact that these are exactly the types of trades that end users require for sound risk management. Margin and capital requirements appear intended to create incentives for firms to use exchange-traded and cleared products. Any such incentives should be based on actual risk, and not on a regulatory predisposition in favor of a certain type of market structure.

It is unnecessary to force end users to choose between efficiently managing risks and investing in their businesses. With a sputtering economy, unprecedented uncertainty and unemployment above 9%, it is critical that we work to prevent such an outcome.

Implementation

Chatham appreciates the hard work of the CFTC, SEC and prudential regulators in proposing dozens of new rules. We have been impressed by the open and transparent process run by the agencies and by the skill and diligence of regulatory staff. However, as a firm that is working with hundreds of businesses that will be impacted by new rules, we have first-hand knowledge of the frustration felt by executives struggling to decide when to commit scarce resources toward preparing for compliance. Chatham supports the recommendation of Members of this Committee that the CFTC issue for public comment a proposed schedule for completion of final rules and a comprehensive plan for implementation of the rules.

Conclusion

As regulators go about the important work of finalizing rules intended to address problems revealed by the financial crisis, it is critical that well-functioning aspects of these markets not be harmed. It is essential to preserve Main Street businesses' efficient access to these important risk management tools. We appreciate your attention to these concerns and look forward to working with the Committee in order to ensure that derivatives regulations do not unnecessarily burden American businesses, harm job creation or jeopardize economic growth.

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

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	**2. Organization or organizations you are representing:**
Sam Peterson	Chatham Financial Corp.
3. Business Address and telephone number:	
Chatham Financial Corp., 235 Whitehorse Lane, Kennett Square, PA 19348 (610) 925-3136	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	**5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?**
☐ Yes ☑ No	☑ Yes ☐ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
See attached	
7. Signature:	

Please attach a copy of this form to your written testimony.

Supplement to "Truth in Testimony" Disclosure Form

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Question 6. Grants or contracts awarded: Chatham Financial Corp. was awarded a service contract by the FDIC in June 2009, which is still in effect. To date, Chatham Financial Corp. has received payment in the total amount of $539,500 in connection with that contract.

Biography of Sam Peterson
Senior Advisor, Chatham Financial

Sam is a Senior Advisor in Chatham's Derivatives Regulatory Advisory Group. Sam works closely with commercial and financial end users, and their representative trade associations, providing technical and public policy advice on the impact of regulation of the over-the-counter derivatives market. In this capacity, Sam has worked closely with the Coalition for Derivatives End Users and numerous financial and non-financial firms. Prior to joining the Derivatives Regulatory Advisory Services Group, Sam worked in Chatham's Hedge Advisory Services Group, helping community and regional banks, as well as public and private real estate companies, structure and execute hedges. Prior to joining Chatham, Sam worked at law firms in Philadelphia, Wilmington and New Orleans. Sam holds a BA from the University of Delaware and a Certificate in Finance and Accounting from the Wharton School of the University of Pennsylvania. Sam has passed Level I of the Chartered Financial Analyst examination.