**Testimony of Luke Zubrod**
**Chatham Financial**

**Hearing on Limiting the Extraterritorial Impact of Title VII of the Dodd-Frank Act**
**Before the Capital Markets and Government Sponsored Enterprises Subcommittee**
**of the House Committee on Financial Services**

**February 8, 2012**

Good afternoon Chairman Garrett, Ranking Member Waters, and members of the subcommittee. I thank you for the opportunity to testify today as the subcommittee considers legislation to limit the extraterritorial impact of Title VII of the Dodd-Frank Act. My name is Luke Zubrod and I am a Director at Chatham Financial ("Chatham"). Today, Chatham speaks on behalf of the Coalition for Derivatives End-Users ("Coalition"). The Coalition represents thousands of companies across the U.S. that utilize over-the-counter ("OTC") derivatives to manage day-to-day business risks. The companies represented by the Coalition use derivatives to reduce risks in their businesses – not to take on risk through speculation.

Chatham is an independent advisor and service provider to businesses that use derivatives to manage interest rate, foreign currency and commodity risks. A global firm based in Pennsylvania, Chatham serves as a trusted advisor to over 1,000 end-user clients, ranging from Fortune 100 companies to small businesses. Our clients are geographically diverse. In the U.S., we have clients in 46 states, including every state represented by Members of this subcommittee. Many of our clients invest and operate globally, and we serve them from offices in the U.S., Europe and Asia.

The Coalition has long supported the efforts of this subcommittee to mitigate systemic risk and increase transparency in the derivatives market. Additionally, we have appreciated the bipartisan efforts of this subcommittee to ensure that end users of derivatives are not unnecessarily burdened by new regulations. Throughout the legislative and regulatory debates, end users have expressed concerns to Congress and to regulators about a number of issues – most notably, the imposition of government-mandated margin requirements on end-user transactions and the regulation of an end user's inter-affiliate transactions. We appreciated the recent efforts of this subcommittee to pass legislation targeted at these concerns.

In addition to these regulatory requirements that would directly burden end users, the Coalition has raised concerns about regulatory actions that could indirectly burden end users by making risk management more expensive or effectively unavailable. We have, for example, expressed concerns that certain derivatives-related proposals by the Basel Committee on Banking Supervision could deter end users from managing their risks or could make it materially less efficient to do so. We have expressed concern about regulatory requirements that might adversely impact liquidity and make it more difficult to efficiently hedge risk.

Today, we add to these concerns by highlighting the ways in which an expansive extraterritorial application of Title VII could adversely impact end users. Global companies often manage risks arising from their foreign operations by executing hedges out of the foreign subsidiaries that are actually exposed to those risks. Such entities often have relationships with both foreign and U.S. banks, including the foreign divisions of U.S. banks. Having a robust pool of bank counterparties enables end users to enjoy numerous benefits, including achieving efficient market pricing and diversifying counterparty exposure. Importantly, the transactions end users execute abroad are not designed to evade U.S. law; they are so executed for important business, legal, and strategic reasons. For example, a foreign subsidiary of a US company may finance its operations with foreign-denominated debt. Financing its foreign operations in this way protects the company from currency risk that would otherwise arise from servicing US-denominated debt with foreign-denominated revenue. However, such debt may expose the subsidiary to the risk that rising interest rates threaten the subsidiary's financial health. In order to mitigate this risk, the foreign subsidiary may execute an interest rate swap, which effectively locks the subsidiary's interest expense and immunizes it from rising rates. In such a case, the end user executes the swap in the foreign subsidiary because that subsidiary is exposed to risk by virtue of its foreign borrowing.

Because it is practically infeasible to perfectly align U.S. and foreign rules, expansive extraterritorial application of Title VII could create structural disincentives for end users to transact with counterparties that are subject to U.S. law, including foreign branches of U.S. banks and foreign banks that centrally book swaps with U.S. persons. Such disincentives could

lead foreign end users or the foreign subsidiaries of U.S. end users to transact with a smaller potential pool of counterparties, thus reducing competition and liquidity, increasing pricing and concentrating counterparty exposure. Indeed, end users have experienced such consequences in recent years as a result of the dissolutions and/or acquisitions of Bear Stearns, Lehman Brothers, Merrill Lynch and Wachovia. Measures banks may take to limit competitive disadvantages that result from expansive extraterritorial application of Title VII would inevitably increase cost for end users, further exacerbating these adverse impacts.

Additionally, the expansive application of these same requirements to foreign banks operating in the U.S. could further impact U.S. end users operating domestically. U.S. end users presently transact with a wide array of banking partners, including both U.S. and foreign banks. In order to avoid the duplicative application of U.S. and home country law to transactions executed with non-U.S. end users, foreign banks may have incentives to spin off their U.S. operations into separately capitalized subsidiaries. This would adversely impact end users in several ways, including the following: (1) end-user transaction costs would increase in order to compensate foreign dealers for the additional capital likely needed for the U.S. subsidiary entities, (2) end users may be precluded from netting their exposures across global financial institution counterparties, and (3) end users may incur additional administrative and legal expenses associated with, for example, collateral management and documentation. Further, the spun-off U.S. subsidiaries of foreign banks may have lower credit quality than the global financial institutions that the end users previously faced. The accumulation of these adverse effects could serve to prevent certain investments from occurring.

In effect, expansive extraterritorial application of Title VII could undermine end users' ability to manage risk efficiently, both when they transact domestically and abroad.

We therefore appreciate this subcommittee's consideration of legislation that would clarify the territorial scope of U.S. law. Proposals such as H.R. 3283 will increase certainty for market participants and resolve inevitable conflicts that would result from overlapping regulations in foreign jurisdictions. We acknowledge the complexity of the task before policy makers in considering the appropriate boundaries of U.S. law, and believe H.R. 3283 thoughtfully

recognizes the need to defer entity-level regulations to home country regulators while clarifying US regulators' transaction-level requirements apply only in circumstances in which there is a US counterparty.

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 the derivatives markets not be harmed. It is essential to preserve end users' efficient access to these important risk management tools.

We appreciate your attention to these concerns and look forward to continuing to support the subcommittee's efforts to ensure that the derivatives markets are both safe and efficient. Thank you for the opportunity to testify today and I am happy to address 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: |
|---|---|
| Luke Zubrod | Please see attached. |

**3. Business Address and telephone number:**

[redacted]

| 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.**

Please see attached.

**7. Signature:**

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

**Supplement to "Truth in Testimony" Disclosure Form**
**Luke Zubrod**
**Wednesday, February 8, 2012**

**Question 2: Organizations you are representing:** Coalition for Derivatives End-Users, Chatham Financial Corp.

**Question 6: Grants or contracts awarded:** Chatham Financial Corp. provides services to the FDIC pursuant to a contract awarded in June 2009, which remains in effect. To date, Chatham Financial Corp. has received payment in the total amount of $627,500 in connection with that contract.