Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
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Dear Ms. Johnson,

BBA response to Interagency Statement on Sound Practices Concerning Complex Structured Finance Activities

The British Bankers Association is the principal banking association in the United Kingdom representing more than 250 banks from across the world including all the major UK banks.

Welcome for the Agencies' Initiative

The BBA and its members welcome the US regulatory agencies' policy initiative, setting out sound principles concerning complex structured finance activities, and the opportunity to comment on it. The exposure to legal, reputation and other transactional risks arising from structured finance activities presents risk management challenges for banks and supervisors alike. Accordingly we are very supportive of a statement aimed at improving risk management processes in banks.

We welcome much of the content of the interagency statement – which in most areas sets out practices and procedures which are already carried out by our members in relation to complex transactions and relevant new products.

Key Concern: Flawed Assumption about financial institution oversight of clients

Our members have one key concern about the proposed statement which, if addressed, would, in our members' view, better serve what we understand to be the objectives of the US regulatory agencies. We understand that the principal objective of the agencies is to ensure that banks (and other relevant financial sector participants) have good procedures in place to protect themselves against reputation, credit, legal and other risk arising from complex structured finance transaction – thus reducing their risk exposure to corporates and improving their safety and soundness.

Our members share the objective of improving the safety and soundness of banks but fear that that objective may be significantly impaired by one fundamental assumption which appears to underlie the approach adopted. This is a point of significant concern and relates to the

responsibility placed upon a financial institution (at pages 21 and 22 of the statement) to have oversight of the client's intentions and state of knowledge.

Our members believe that it is right and proper that a bank should carefully analyse the risks associated with entering into more complex transactions, especially in terms of potential reputation risk. In doing this the bank is making a judgement call about the transaction and its policies, procedures and internal controls should ensure that those involved in the transaction are aware that a judgement call is being made and are also aware of the risks of getting this wrong.

However, our members consider that where the guidelines go beyond giving guidance on ensuring a good environment for making such a judgement call and expect banks to engage in policing the knowledge and intentions of a customer they risk exposing banks to much legal uncertainty and the possibility of increased, rather than reduced, reputation and legal (i.e. litigation) risk. In particular, when coupled with the detailed obligations on banks to seek assurances from customers, their auditors and third party advisors, the approach risks inflicting upon institutions and their executives the danger of being characterised as "shadow directors" and becoming legally liable for the actions of the customer.

We would make specific points as follows::

- This approach requires a bank to reach an unrealistic degree of certainty about the intentions and state of knowledge of its clients. The focus should, instead, be on the importance of having proper procedures to make a judgement call, the importance of knowing when the judgement call is being made, the possible reputation risk of making the wrong judgement call – and the consequent need for caution.

- It is prescriptive without taking into account differing legal backgrounds even within the US. For example, there is an expectation that a bank will be able to contact a customer's auditor and rely upon information from it. It is our understanding that the relative significance of contractual privity on the one hand and "reasonable reliance" on the other is inconsistent even across US jurisdictions. In any case, it is questionable whether external auditors would see any incentive to respond, thus possibly accepting liability to a bank.

- It assumes that particular types of procedures are likely to be the most suitable ones and does not give sufficient flexibility for different types of procedural arrangements and control structures.

- It overemphasises specific procedures for complex structured finance transactions. We believe that the emphasis should be on having good quality general procedures and controls which will capture risky complex structured finance transactions – but also other types of transactions which should also be properly controlled. In the experience of our members a good general control culture is more effective than setting up a large number of separate controls and committees for particular types of transaction.

- It is insufficiently sensitive to the fact that banks coming to the US from elsewhere will have to implement the guidelines in banking structures and a legal framework which may be considerably different from typical US banking structures and legal frameworks. Our members foresee significant difficulty with regard to this legal consistency issue if the statement was to be applied to banks in different European jurisdictions. It may also bring them into procedural conflict with their home regulators. This issue is only one of

several which arise from the implication that this policy initiative can and will be applied with ease on an extra-territorial basis.

- It would be sensible to discuss the guidelines with European authorities such as the EU Commission and the Committee of European Banking Supervisors before finalising them - with a view to seeking to avoid potential divergences of regulatory approach between the US and the EU. In this regard we note the recent CESR/SEC initiative to try and work together to produce common regulatory solutions which can operate in both a US and a European environment.

- The process would also cut across different cultural assumptions: for instance, the greater emphasis in some jurisdictions on a "substance over form" approach to transactional evaluation would in some senses be undermined by greater emphasis on establishing technical legality.

Conclusion

We would welcome the opportunity to discuss these issues with you further. If you wish to do this please contact Michael McKee at **michael.mckee@bba.org.uk** or on 00 44 20 7216 8858.

Yours sincerely

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Wholesale Banking and Regulation