



Fédération Bancaire Européenne
European Banking Federation
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Ms. Jennifer J. JOHNSON
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.,
Washington D.C. 20551
United States of America

Brussels, 8 July 2004

Subject: Interagency statement on sound practices concerning complex structured finance activities

Dear Ms. Johnson,

The European Banking Federation (FBE) represents the interests of some 4,000 banks in 26 countries with 20 million employees and assets of 20,000 billion euro.

The FBE broadly agrees with the objectives of the US regulatory agencies' policy initiative. The exposure to legal, reputational and other transactional risks arising from structured finance activities presents risk management challenges for banks and supervisors alike.

We are encouraged to note that the majority of the practices and procedures in relation to complex transactions and relevant new products set out in the interagency statement have already been implemented by our members.

Our enclosed paper, therefore, addresses one element of the interagency statement in particular. Our members' key concern is with the legal uncertainty arising from the proposals which we feel will expose banks to increased, rather than decreased, reputational and legal risk. This concern relates to the prescriptive nature of the statement. We firmly believe that financial institutions must have

freedom to implement these systems in line with their individual profile. A principles-based, rather than rules-based, process would, therefore, be more appropriate in this context.

Furthermore, notions such as reputational risk are broad and are impossible to standardise across jurisdictions and cultures. We would, therefore, urge the agencies to place more emphasis on safety and soundness arguments in the statement.

The FBE would like to thank the agencies for the opportunity to comment on this paper.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Nikolaus Bömcke', with a long horizontal stroke extending to the right.

Nikolaus BÖMCKE



Fédération Bancaire Européenne
European Banking Federation

Interagency statement on sound practices concerning complex structured finance activities: *Flawed Assumption about financial institution oversight of clients*

The FBE understands that the principal objective of the agencies is to ensure that financial institutions 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. European banks share the objective of improving the safety and soundness of banks.

However, we fear that there is a fundamental assumption underlying the statement which places responsibility with financial institutions to oversee clients' intentions and state of knowledge (pages 21 and 22). This is a point of significant concern for our members. We feel that it detracts from the overarching objective of the statement.

In entering into more complex transactions the bank is making a judgement call about the transaction. 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.

Our members believe that it is right and proper that a bank should carefully analyse the risks associated with complex transactions, especially in terms of potential reputation risk. **However, where the guidelines 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, reputational and legal (i.e. litigation) risk.**

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 in place 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.
- The approach 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. For example the requirements on independent monitoring, analysis and compliance with internal policies (pages 24 and 25) are far-reaching and prescriptive without reflecting the overarching need for a risk-orientated control environment.
- 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.