

INSTITUTE OF INTERNATIONAL BANKERS

299 PARK AVENUE, 17TH FLOOR, NEW YORK, N.Y. 10171
TELEPHONE: (212) 421-1611 FACSIMILE: (212) 421-1119
HTTP://WWW.IIB.ORG

LAWRENCE R. UHLICK
EXECUTIVE DIRECTOR AND GENERAL COUNSEL
DIRECT E-MAIL: LUHLICK@IIB.ORG

June 15, 2006

Jennifer J. Johnson
Secretary
Board of Governors of the Federal
Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Public Reference Room
Mail Stop 1-5
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments/OES

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: Proposed Interagency Statement on Sound Practices Regarding Complex Structured Finance Activities (Federal Reserve Board Docket No. OP-1254; Office of the Comptroller of the Currency Docket No. 06-06; Office of Thrift Supervision File No. 2006-20; Securities and Exchange Commission File No. S7-08-06)

Ladies and Gentlemen:

We are submitting this letter in response to the request of the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission and the Office of Thrift Supervision (collectively, the "Agencies") for comment on the Agencies' proposed revised interagency statement (the "Revised Statement") regarding sound internal controls and risk management practices relating to complex structured finance transactions ("CSFTs").¹ The Institute of International Bankers represents internationally headquartered financial institutions from over 30 countries, and our members include international banks that operate branches and agencies, bank subsidiaries and broker-dealer subsidiaries in the United States.

¹ 71 Fed. Reg. 28326 (May 16, 2006).

The Institute's mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

INSTITUTE OF INTERNATIONAL BANKERS

General Support for the Proposed Revised Statement

The Institute strongly supports the revisions reflected in the Revised Statement, and we commend the Agencies for their careful consideration of the public comments submitted in response to the Agencies' previous proposed Interagency Statement (the "Initial Statement"), including the Institute's comment letter.² Specifically, the Institute supports the Agencies' changes to the Initial Statement to focus the guidance on those CSFTs that may pose heightened legal or reputational risks ("elevated risk CSFTs"), generally reflecting a more risk-focused approach to risk management practices in this area. The Institute also supports the Agencies' revisions to the wording of the Initial Statement to make it more principles-based. The Institute believes that the Revised Statement in this regard more clearly and accurately reflects the stated intent of the Initial Statement and the Revised Statement—assisting financial institutions that engage in elevated risk CSFTs in managing the legal and reputational risks involved in such activities. The Institute also supports the Agencies' addition of an explicit statement in the Revised Statement clarifying that the Revised Statement does not affect the legal duties or obligations that financial institutions owe to their customers.

Points of Clarification

In addition to expressing our strong support for the Agencies' revisions to the Initial Statement, this letter offers a number of points of clarification for the Agencies to consider in finalizing the Revised Statement, focusing on the unique issues presented for international banks that engage in elevated risk CSFTs.

Consistency of a U.S. Branch or Agency's Risk Management Procedures for Elevated Risk CSFTs with Global Risk Management Structures

The wording of footnote 6 to the Revised Statement has created some uncertainty regarding the ability of an international bank to implement a CSFT risk management structure that relies significantly on procedures managed in the bank's head office outside the United States or another non-U.S. branch of the international bank (e.g., the London branch of a continental European bank). For example, under existing guidance and practices, new product or transaction approval procedures for a U.S. branch of an international bank engaged in CSFTs may involve review by a head office risk management structure without any separate governance structure in the U.S. branch.³ The Institute believes that such an allocation of responsibility should be consistent with the Revised Statement.

² See Letter, dated July 19, 2004 from the Institute of International Bankers to the Agencies (the "Institute Initial Comment Letter").

³ Of course, some U.S. branches and agencies of international banks have adopted separate governance structures in the United States that are coordinated with head office risk management policies and procedures.

INSTITUTE OF INTERNATIONAL BANKERS

The first sentence of footnote 6, which appeared in the Initial Statement, is consistent with this practice.⁴ The second sentence, however, is less clear. It provides:

In addition, the U.S. branches and agencies of foreign banks should implement a control infrastructure for CSFTs, including management, review and approval requirements, that is consistent with the institution's overall corporate and management structure as well as its framework for risk management and controls.

The Institute understands this second sentence to contemplate implementation in a U.S. branch or agency of a global risk management structure, including that structure's review and approval requirements. Indeed, the sentence appears designed to recognize that the manner in which a global risk management structure is implemented in the United States, taking into account variance in global risk management practices in this area, may lead to differences between approaches used by a U.S. branch of an international bank and a U.S.-headquartered institution.⁵ Recognition of the need for consistency between implementation in a U.S. branch and the international bank's global risk management framework is a useful addition to the Revised Statement.

To that extent, the Institute believes the second sentence of footnote 6 can accommodate current risk management practices among international banks operating in the United States. U.S. branches that engage in CSFTs may implement a global risk management structure—managed by head office or a non-U.S. branch—by applying relevant risk management policies and procedures to its CSFTs, submitting its CSFTs to a head office risk management review and approval procedure, etc. We therefore do not understand the second sentence of footnote 6 to require that U.S. branches and agencies of international banks adopt separate risk management governance structures—either in addition to or in lieu of a head office governance structure. Indeed, we believe such a requirement would be unduly burdensome for some institutions and would be unnecessary to achieve the objectives of the Revised Statement. To avoid any doubt concerning the intended guidance in footnote 6, the Institute believes the second sentence could be clarified to recognize the need for consistency with global risk management structures and to make clear that a U.S. branch or agency is not required to adopt a separate U.S.-based risk management structure.

Board of Directors Reporting

The last section of the Revised Statement refers to policies and procedures to provide information and reports to “appropriate levels of management and the board of directors.” This phrase appears to have been drafted primarily with U.S.-headquartered financial institutions in mind, as U.S. branches and agencies of international banks are not separate legal entities and do not have boards of directors. Indeed, whether information relating to elevated risk CSFT activities is reported to an international bank's board of directors in its head office will be a function of the international bank's global risk management policies and procedures and home

⁴ See 71 Fed. Reg. at 28332 (“In the case of U.S. branches and agencies of foreign banks, the institution should coordinate these policies with the foreign bank's group-wide policies developed in accordance with the rules of the foreign bank's home country supervisor.”)

⁵ See Institute Initial Comment Letter at 4.

INSTITUTE OF INTERNATIONAL BANKERS

country corporate governance requirements. The Institute does not understand the Revised Statement to mandate a head office board of directors reporting requirement for international banks.

The Institute believes that the use of the word “appropriate” was intended to provide sufficient flexibility for an international bank to determine, in accordance with its global risk management policies and procedures, the types and extent of information that would be provided to its head office board of directors regarding the elevated risk CSFTs activities of a U.S. branch or agency. However, to make this point clearer, and to take into account the fact that U.S. branches and agencies do not have boards of directors, the Institute believes the Revised Statement could be further revised to add a footnote recognizing that a board of directors reporting requirement for international banks will be a function of their global risk management structures.

Other Points of Clarification

In addition to the Institute’s central points of clarification relating to the unique position of international banks, there are a number of additional areas in which the Institute shares the perspective of U.S. domestic financial institutions relating to the intended implications of the Revised Statement.

First, the Revised Statement recommends that new elevated risk CSFT products receive approval of all relevant control areas before the product is “offered” to customers. The Institute understands “offered” in this context to mean “offered” in the contractual sense—the point in time in which a transaction or product is formally offered to a customer in a way that the customer could accept the transaction or product and thereby bind the financial institution. From a risk management perspective, the Institute believes that obtaining approvals for a new product before it is formally offered to a customer represents an effective and efficient approach to new product approval procedures.

Indeed, requiring approvals at an earlier stage would not be practical in some cases and would not add any further protection to the financial institution from the legal and reputational risks associated with an elevated risk CSFT. The development by financial institutions of structured products frequently involves extensive discussions with potential customers regarding financial, legal, tax, accounting and other considerations. Financial institutions should have flexibility to define the point in time in the development of a new product when it requires approval as a new product, so long as approval is obtained before the product is formally “offered” to the customer.

Second, the Revised Statement cautions that “[i]nstitutions should not conclude that a transaction identified as being an elevated risk CSFT involves minimal or manageable risks solely because another financial institution will participate in the transaction or because of the size or sophistication of the customer or counterparty.” The Institute agrees with the basic content of this statement. At the same time, the Institute believes that it should be consistent with the Revised Statement for a financial institution’s policies and procedures for elevated risk

INSTITUTE OF INTERNATIONAL BANKERS

CSFT's to take into account as a relevant factor—albeit not a dispositive consideration—the status of a counterparty as, for example, a large, sophisticated financial institution.

Third, the Institute believes that the Revised Statement could usefully be clarified with respect to the role of independent reviews of an institution's elevated risk CSFT activities. As currently drafted, the Revised Statement discusses the importance of independent reviews of elevated risk CSFT activities in the context of "Monitoring Compliance with Internal Policies and Procedures" and in the context of "Audit." As in other risk management areas, the Institute believes that periodic independent reviews are a valuable component of a risk management framework. Institutions may take a number of approaches to these types of independent reviews, the most conventional being coverage by the institution's internal audit function.

In order to clarify that financial institutions are not required to implement two separate independent review procedures for elevated risk CSFT activities, the Institute would recommend that the Agencies consolidate within the "Audit" section of the Revised Statement their guidance regarding periodic independent reviews of elevated risk CSFT activities. To the extent that the Agencies intended to offer additional guidance regarding monitoring of evolving legal and reputational risks relating to elevated risk CSFT activities, the Institute believes that the section currently captioned "Monitoring Compliance with Internal Policies and Procedures" could be clarified to discuss such monitoring and could be re-titled "Monitoring Legal and Reputational Risks."

Fourth, the Revised Statement includes a statement to the effect that "[a]s in other areas of financial institution management, compensation and incentive plans should be structured, in the context of elevated risk CSFTs, so that they provide personnel with appropriate incentives to have due regard for the legal, ethical and reputational risk interests of the institution." The Institute understands this as a general statement of the Agencies' expectations regarding financial institutions' approach to compensation structures from a risk management perspective—i.e., not a recommendation that financial institutions adopt specific compensation practices tailored to elevated risk CSFTs. Many financial institutions take risk management factors into account in designing compensation structures for employees, and the Institute understands the Revised Statement to indicate the Agencies' view that elevated risk CSFT activities should not be an exception from this practice.

Fifth, as part of the documentation procedures described in the Revised Statement, the Agencies suggest that financial institutions collect sufficient documentation to "confirm that customers have received any required disclosures concerning the transaction."⁶ We understand this suggestion to refer to a financial institution's disclosures to its own customers—i.e., not disclosures by the financial institution's customers' to their customers. However, to clarify this point, we would suggest that this language be revised to read in relevant part: "... confirm that the financial institution's customers have received..."

* * *

⁶ 71 Fed. Reg. at 28334.

INSTITUTE OF INTERNATIONAL BANKERS

Please do not hesitate to contact the Institute if we can be of further assistance.

Sincerely,

A handwritten signature in black ink that reads "Lawrence R. Uhlick". The signature is written in a cursive style with a large, prominent initial "L".

Lawrence R. Uhlick
Executive Director and
General Counsel