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

Proposed Policy Statement:
Interagency Statement on Sound Practices Regarding
Complex Structured Finance Activities
Commission File No. S7-22-04

Dear Mr. Katz:

We are pleased to comment on the proposed interagency statement on sound practices regarding complex structured finance activities. Structured finance transactions serve an important role in both the U.S. and global economies, allowing entities to manage, assume, and mitigate various financial risks to meet their specific operating goals and objectives. Financial institutions play a critical role in these transactions, as well as in the broader capital markets where investor confidence is paramount. Given the importance of their role in these transactions and the markets, it is essential that financial institutions design and maintain internal control infrastructures to identify and appropriately address the risks inherent in complex structured finance transactions. Therefore, we support the Commission's and the Banking Agencies'[1] (collectively "the Agencies") objectives in providing this guidance and continuing to strengthen internal controls and investor confidence in these areas.

We are providing comments and suggested improvements for the Agencies' consideration. The primary focus of our comments is on the involvement of accounting professionals, and especially independent auditors, in the risk management and internal control process. Our comments and recommendations regarding the proposed policy statement are discussed in detail below.

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1 Proposal also made by the following Banking Agencies: the Office of the Comptroller of the Currency, Docket No. 04-12; the Office of Thrift Supervision, No. 2004-27; the Board of Governors of the Federal Reserve System, Docket No. OP-1189; and the Federal Deposit Insurance Corporation.

INVOLVEMENT OF THIRD-PARTY ACCOUNTING PROFESSIONALS

We support the inclusion of accounting professionals in the control process. It is an important step for a financial institution to seek accounting advice, both internally and externally (as deemed necessary), during the product development and/or review process to fully understand the accounting, tax, and regulatory implications of a complex structured finance transaction to its customer. This will further improve the institution's ability to evaluate the appropriateness of the transaction in addressing the customer's legitimate risk management needs. In addition, during the process leading to the consummation of a transaction, we believe that the customer's independent auditor should, along with the customer, have open communication with the financial institution to understand the transaction. Timely access to the complete and accurate facts of the transaction, as well as direct access to the financial institution's expertise, will help the customer's independent auditor determine that the relevant accounting principles are considered and applied by the customer.

Existing professional standards address the involvement of third-party accounting professionals in consulting on the application of accounting principles to transactions and products. Section AU 625, *Reports on Application of Accounting Principles*, of the American Institute of Certified Public Accountants' (AICPA) Codification of Auditing Standards (AU 625), which was adopted by the Public Company Accounting Oversight Board (PCAOB) as interim guidance in Rule 3200T, *Interim Auditing Standards*, provides the "reporting accountant" (the accountant providing advice on the application of accounting principles to a transaction) and the "continuing accountant" (in this case, the customer's independent auditor) with guidance on their roles and responsibilities. In addition, AU 625 discusses certain restrictions in consulting on specific transactions and "hypothetical transactions" (transactions not involving facts or circumstances of a specific entity). We believe the guidance in AU 625 should be considered by the Agencies as they finalize any policy statement to achieve consistency between their expectations for the involvement of a third-party accounting professional and the AICPA and PCAOB standards the accountant must follow.

At the same time, we believe care should be taken not to imply that the customer's accounting is the responsibility of the financial institution. A financial institution should not be required to make accounting determinations for its customer. A financial institution usually is not in a position to assess the myriad of facts and circumstances necessary to make the appropriate accounting and disclosure determinations for each individual customer. It is for similar reasons that AU 625 prohibits a reporting accountant from issuing written reports on hypothetical transactions. The customer and its independent auditor are in a unique position to assess the specific facts and circumstances of the complex structured transaction in the context of the customer's financial reporting. Therefore, it should be sufficient for the financial institution to determine that the customer and its independent auditor have been informed of the facts and have access to the information necessary to make appropriate decisions, as it is the responsibility of the customer's management to make the accounting assertions and the responsibility of the independent auditor to opine on those assertions in the context of the audited financial statements.

ADDITIONAL COMMENTS

Impact of "Supervisory Guidance" by the Banking Agencies on Consideration and Testing of Internal Control over Financial Reporting

The proposed policy statement states that it is intended to address several aspects of risk to financial institutions including market and credit risk (financial risk), operational risk, legal risk, and reputational risk. The proposed policy statement suggests controls in several of these areas that the financial institution should consider. The proposed policy statement further indicates that the Banking Agencies will consider the statement to represent supervisory guidance with regard to the financial institutions they regulate. Accordingly, for the most part, the suggested controls would represent elements of a financial institution's internal control related to compliance objectives, rather than internal control over financial reporting. We recommend that the policy statement clearly indicate that the suggested controls are not part of a financial institution's internal control over financial reporting, and therefore would not fall within the scope of the reports issued under Section 404 of the Sarbanes-Oxley Act of 2002 and related rules and standards adopted by the Commission and the PCAOB, or, when applicable, for reports issued under the Federal Deposit Insurance Corporation Improvement Act of 1991. Instead, in the audit of a financial institution's financial statements, the registered public accounting firm's consideration of compliance with such controls would be performed under AU Section 317, *Illegal Acts by Clients*.

New Product Policies and Emphasis on Consideration of Minor Changes

We suggest that additional emphasis be placed on the need to establish controls to identify when existing products should be evaluated as new products, even when only minor changes or modifications have been made. Under the complex accounting principles that are often involved in structured finance transactions, small changes may have a significant impact on the accounting conclusions that were reached on the original transaction. Both the transactors and the independent control staff at the financial institution should be mindful of the changes being made in a transaction that is seemingly similar to a previous transaction.

Customer's Ability to Understand the Transaction

We agree it is critical that the customer understand all of the risks and rewards associated with a complex structured finance transaction. As the sophistication of customers can vary significantly, the communication protocols and other policies and procedures employed by the financial institution may need to be adjusted depending on the nature of the customer. Some customers may have valid needs for structured transactions to manage risk, yet may not have sufficient expertise to appreciate the accounting nuances of a transaction and alternatives. In those cases, it would be important that the financial institution determine that the customer obtains competent assistance in evaluating and understanding the transaction.

Procedures to Address the Creation, Acquisition, and Use of Institution and Client-Sponsored Special Purpose Entities (SPEs)

Internal control at a financial institution is important to both the interaction with a customer and the preparation of the financial institution's own financial statements. In that regard, we completely agree with the Agencies' suggestion that maintaining adequate documentation of all SPEs involved in a complex (or any other) structured finance transaction is important. Maintaining accurate and complete records of all SPEs and their activities is necessary for the financial institution to correctly apply the provisions of the Financial Accounting Standards Board's Interpretation No. 46, *Consolidation of Variable Interest Entities*, to ensure that the financial institution's consolidated financial statements appropriately include or exclude those SPEs.

Involvement of Internal Auditors

The proposed policy statement discusses the involvement of the financial institution's internal auditors in the control process. Given the complexity of these transactions, the proposed policy statement notes that at times it may be appropriate to involve external auditors in the internal audit process, stating:

> For example, financial institutions may employ external auditors to test the structured transactions approval process and ensure compliance with its policies and procedures. The resulting reports and memoranda can provide valuable insight to the financial institution in improving its risk controls and oversight.

Although we agree that involvement of the independent auditor is beneficial to the process, we caution that both the independent auditor and the financial institution would need to consider any applicable guidance on the outsourcing of internal audit services, including any restrictions in the auditor independence rules of the Commission, the PCAOB, the Banking Agencies, the AICPA, or other applicable regulatory or professional bodies.

Conclusion

We support the Agencies' coordinated effort to continue to improve the control infrastructures of financial institutions for complex structured finance transactions. We believe that consultation with accounting professionals, including third-party accountants, in a manner consistent with standards adopted by the PCAOB and AICPA, would enhance the process. We encourage the Agencies to consider the appropriate nature and timing of the involvement of accounting professionals in a financial institution's controls over complex structured finance transactions.

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We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Very truly yours,

Ernst + Young LLP