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THE CLEARING HOUSE
Advancing Payment Solutions Worldwide

July 19, 2004

Office of the Comptroller of the Currency
250 E Street, SW
Public Reference Room
Mail Stop 1-5
Washington, DC 20219
Attention: Docket No. 04-12
regs.comments@occ.treas.gov

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Docket No. OP-1189
regs.comments@federalreserve.gov

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

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2004-27
regs.comments@ots.treas.gov

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609
Attention: File No. S7-22-04
rule-comments@sec.gov

Re: Proposed Interagency Statement on Sound Practices Concerning Complex Structured Finance Activities

Ladies and Gentlemen:

The member banks of The Clearing House Association L.L.C. ("The Clearing House")[1] appreciate the opportunity to comment on the proposed Interagency Statement on Sound Practices Concerning Complex Structured Finance Activities issued by the Office of the

[1] The member banks of The Clearing House are: Bank of America, National Association; The Bank of New York; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank; LaSalle Bank National Association; U.S Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

Comptroller of the Currency, the Office of Thrift Supervision, the Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation and the Securities and Exchange Commission (collectively, the "Agencies"). 69 Fed. Reg. 28980-28991 (2004) (the "Proposed Statement").[2]

We appreciate and support the Agencies' proposal to provide guidance to financial institutions in developing internal controls and risk management procedures to help identify and address the reputational, legal and other risks associated with complex structured finance transactions ("CSFTs"). We agree with the Agencies that financial institutions should have effective policies and procedures in place to identify CSFTs that may involve heightened reputational and legal risk, to provide for a level of review that is commensurate with those risks, and to protect the institution from participating in illegal or questionable transactions.

We are deeply concerned, however, about a number of aspects of the Proposed Statement. We have summarized immediately below our principal comments, which are discussed in greater detail in the sections that follow.

First, particularly given the current legal and political climate, the Proposed Statement could be improperly construed as creating new rights of action or theories of civil liability of financial institutions to third parties. We believe that it is crucial that the final Interagency Statement clarify that it is not intended to suggest any right of action or theory of liability that does not currently exist; rather, it is intended to help financial institutions conduct complex structured finance activities consistent with safe and sound banking practices and to help financial institutions protect themselves against unscrupulous customers. We also urge the Agencies to modify or delete certain specific language that exacerbates this concern.

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2 The Clearing House believes that the coordination among the Agencies in formulating guidance on this important issue is very constructive. We recommend that there also be coordination with financial supervisors in other countries because of the global nature of CSFTs.

Second, with respect to regulatory compliance, we believe it is essential that financial institutions not be required to police their customers' compliance with the federal securities laws or accounting, tax or regulatory requirements. Appropriate securities disclosure and proper accounting, tax and regulatory treatment are the obligations of the issuer, its accountants and its counsel, and securities disclosure is subject to review by the Securities and Exchange Commission. Financial institutions lack the information and the access to perform this role. This situation is different from the Bank Secrecy Act, where Congress has imposed due diligence and reporting responsibility on financial institutions with respect to their customers.

Third, it is essential that the final Interagency Statement recognize the differences among both institutions and transactions by utilizing a principles-based approach. The Interagency Statement should not become an examiner's checklist, with a prescribed list of requirements for all institutions and all transactions. The final Interagency Statement should explicitly acknowledge that financial institutions will need flexibility as they implement the Interagency Statement, and it should modify or delete certain specific suggestions and other language that could encourage a checklist approach.

Fourth, we believe that several key revisions should be made in the Proposed Statement to avoid creating unattainably high standards, unreasonable responsibilities and unwarranted exposure.

Fifth, we are concerned that certain statements in the Proposed Statement impose an unduly high standard on the board of directors of financial institutions and may discourage qualified individuals from serving as directors.

As the Proposed Statement recognizes, structured finance products "[i]n the vast majority of cases . . . have served the legitimate business purposes of customers" and are "an essential part of U.S. and international capital markets". Id. at 28981. Only in "a limited number" of cases have these transactions been used to circumvent regulatory or financial reporting requirements, evade tax liabilities or further illegal or improper behavior. Id. It is, therefore, essential that the final Interagency Statement both provide enough flexibility and avoid creating additional liability so that the vast majority of structured finance transactions that are legitimate are not rendered inefficient or even precluded, and that financial innovation is not discouraged.[3]

I. The Agencies Should Clarify that the Proposed Statement Is Not Intended to Create New Rights of Action or Theories of Liability of Financial Institutions to Third Parties

We are deeply concerned that the Proposed Statement could be improperly construed as creating new rights of action or theories of civil liability of financial institutions to third parties, particularly given the current legal and political climate. Absent a specific disclaimer to the contrary in the final Interagency Statement, there is a risk that third parties will use the Interagency Statement against financial institutions in support of a negligence claim or to attempt to establish the scienter element of an aiding and abetting claim. They will assert that a financial institution either failed to adopt policies and procedures as required by the Interagency Statement or failed to comply with those policies and procedures. The potential for third-party claims based on the alleged inadequacy of a financial institution's policies and procedures is increased by the inability to define precisely what transactions constitute CSFTs and which of those transactions require special scrutiny.

Although, as we stated at the outset, The Clearing House supports supervisory guidance on CSFTs, it is essential that this guidance not actually increase the risk to the safety and soundness of the banking system. Yet, that risk will be significantly increased if the Proposed Statement provides new causes of action for the plaintiffs' bar. Such a result would be inconsistent with the ultimate objective of the Proposed Statement of protecting financial institutions from legal and reputational risk.

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[3] As Board Governor Bies recently noted: "The improvements in technology, the quick pace of financial innovation, and the evolving risk-management techniques almost ensure that businesses will increasingly use almost limitless configurations of products and services and sophisticated financial structures." Remarks at the Financial Executives International 2004 Summit (San Diego, California), April 27, 2004.

We therefore respectfully request that the Agencies include an explicit statement, at the beginning of the final Interagency Statement, clarifying that the Interagency Statement is in no way intended to suggest any rights of action or theories of liability of financial institutions to third parties that do not currently exist. Rather, its purpose is to help financial institutions conduct complex structured finance activities consistent with safe and sound banking practices and to help financial institutions protect themselves against unscrupulous customers. Such a statement would be consistent with the Supreme Court's decision in Central Bank that there is no private right of action for aiding and abetting liability in civil cases under Rule 10b-5 under the Securities Exchange Act of 1934. (Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994)).[4]

We are not suggesting that financial institutions be absolved of any and all responsibility for transactions with their customers. It is important, however, to recognize, as acknowledged in the SEC Memorandum, that liability generally requires scienter – which is defined by the Supreme Court as "a mental state embracing intent to deceive, manipulate, or defraud". Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). It is also important to recognize that very few financial products are inherently deceptive. If there is deception, it is in their usage rather than their origin.

Our concerns in this regard are heightened by the SEC Memorandum. It refers repeatedly to "deceptive structured finance product", without distinguishing between a structured finance product that is inherently deceptive, which we believe is unusual, and a structured finance product that is used in a deceptive manner.

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4 Without commenting on any specific situation, we believe that various settlements of enforcement actions cited in the attachment to the Board's SR 04-7 (the Securities and Exchange Commission's memorandum of December 4, 2003 (the "SEC Memorandum")) do not constitute valid precedent on the question of liability under the federal securities laws. In none of the settlements did the settling parties admit the allegations of the complaint. Moreover, in today's environment, parties subject to proposed regulatory or law enforcement actions often have little option but to settle on the best possible terms.

There are two specific terms in the Proposed Statement that exacerbate the risk of third party liability, and we urge the Agencies to modify or eliminate them. The first is "ensure", which is frequently used in the Proposed Statement. See, e.g., 69 Fed. Reg. at 28982, 28983, 28985, 28986. We believe that the use of the word "ensure" – whether in connection with the policies and procedures themselves, the role of the board of directors[5] or the role of management – may incorrectly suggest that the financial institution, or its directors and officers, have strict liability as guarantors of legal and regulatory compliance by the financial institution or its counterparty. To avoid any confusion, we believe it is critical that the final Interagency Statement use a different term or consistently modify "ensure" with "strive to" (see id. at 28986).[6]

The second term that could increase the risk of liability is "conservatism", e.g., "financial institution personnel should err on the side of conservatism". Id. at 28987. With the benefit of hindsight, virtually every decision that ultimately proves to have been wrong could be regarded as not meeting this standard. We believe that this term should be deleted. A financial institution should be neither overly conservative nor overly aggressive in responding to the needs of its customers.

We support and appreciate the effort in the Proposed Statement to assist financial institutions in managing existing legal risk. The final Interagency Statement must, however, be revised so that this effort does not result in creating new legal risk.

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5 We address the role of the board of directors further in Part III below.

6 As one example of the need for this modification, the Proposed Statement provides that "the Board and senior management should ensure that incentive plans are not structured in a way that encourages transactors to cross ethical boundaries …." Id. Such a subjective determination cannot be "ensured".

II. The Agencies Should Clarify that the Proposed Statement Is Not Intended to Create a Policing Obligation for Securities Disclosure Violations or Improper Accounting, Tax or Regulatory Treatment

We strongly urge that the final Interagency Statement draw a clear distinction between a financial institution's obligation to deal with its own reputational and legal risks and an obligation to police its customers' compliance with the federal securities laws or accounting, tax or regulatory requirements. As the Sarbanes-Oxley Act of 2002 (Pub. L. No. 107-204) makes clear, proper disclosure is the responsibility of the issuer, its accountants and its counsel. The Securities and Exchange Commission has been given enhanced powers and resources to review, monitor and enforce disclosure requirements. Similarly, a company's compliance with applicable accounting, tax and regulatory requirements is the responsibility of the issuer, its accountants and its counsel.

Financial institutions lack both the information and the authority to assume an investigatory and policing obligation. In most cases, the proper disclosure of and accounting for a transaction cannot be determined from the "four corners" of the transaction itself. Rather, the appropriate accounting and disclosure depend on the customer's use of the transaction and a variety of other factors relating to the customer's specific circumstances. The financial institution does not have access to this information from the customer, and it has no ability to compel the customer's advisors to provide the information (even if they have it).

Our concern here is that a disclosure violation or a violation of an accounting, tax or regulatory requirement by the customer will create a presumption, or at least an inference, of a violation by the financial institution of a regulatory obligation. That should not be the result, but we believe that an explicit disclaimer in the final Interagency Statement is necessary to protect against such a result.

III. The Final Interagency Statement Should More Clearly Provide Financial Institutions with Flexibility in Implementing the Proposed Statement

We believe that the Proposed Statement provides useful supervisory guidance on the types of internal controls and risk management procedures that a financial institution should consider in managing the risks associated with CSFTs. Although the Proposed Statement asserts that it represents guidance rather than mandates, we are very concerned that bank examiners may use the more specific suggestions in the Proposed Statement as a compliance "checklist" in the examination process. We believe that the final Interagency Statement should eliminate a number of specific suggestions as not being consistent with a flexible, principles-based approach, explicitly disclaim a checklist approach and generally acknowledge that financial institutions will require flexibility as they implement the Interagency Statement. The following areas are of particular concern.

1. Definition of CSFT.

The Proposed Statement does not define what constitutes a "complex structured finance transaction", leaving it by implication to each institution to establish its own process for identifying CSFTs. See id. at 28986. We are concerned, however, that the four criteria listed in the Proposed Statement will become a mandatory "checklist". The Proposed Statement does suggest that the criteria are not exclusive, but this only reinforces the idea that they are mandatory. See id. at 28985.

We believe that the final Interagency Statement should state explicitly that the absence of a precise definition of "complex structured finance transaction" is designed to provide financial institutions with discretion in determining what transactions come within the scope of their special procedures for CSFTs. Specifically, we urge that the final Interagency Statement make clear that the presence of one or more of the listed criteria does not create a presumption of the existence of a CSFT.

Our concern is generated in large part because these criteria are so broad that they have the potential of capturing numerous routine and well-established transactions that incorporate some of these criteria, but do not raise the legal and reputational risks to which the Agencies' guidance is directed. By subjecting an unnecessarily large number of transactions to the recommended procedures, such a broad definition creates excessive burden. Moreover, it may have the unintended consequence of diverting an institution's efforts from those transactions that have the potential for the greatest risks.

Accordingly, we recommend that the first three criteria be modified by adding the phrase "and is purposefully designed in order to achieve a specific tax, accounting or regulatory goal of the customer". Otherwise, such criteria as "non-standard" and "specific financial objectives of a customer" are far too sweeping. See id. Many transactions have non-standard features because they are directed to the customers' specific objectives. Arguably, all transactions are designed to meet the customers' specific financial objectives.

We also note that the fourth CSFT criterion – that the transaction exposes the financial institution to elevated levels of market, credit, operational, legal or reputational risks – does not define a CSFT, but merely identifies the risks that may be associated with CSFTs. See id. To avoid any confusion on this point, we recommend that the fourth criterion be eliminated.

2. "Heightened Risk" CSFTs.

A similar concern arises with respect to the Proposed Statement's list of twelve types of transaction characteristics that should be considered in determining whether a CSFT requires additional scrutiny. See id. at 28988. Many of these characteristics are individually and collectively very broad and could describe a large number of ordinary course transactions at large financial institutions.

It should be recognized that the adverse consequences of an unduly broad concept of heightened risk CSFTs are not limited to the burden imposed on financial institutions, as substantial as that would be. Such a concept could actually increase risk because it would divert attention from those transactions on which the control processes should focus. It would also reduce the efficiency of structured finance products that create only limited risk. Finally, the categorization of a structured finance product as a "heightened risk" CSFT has implications beyond requiring heightened review and scrutiny. It would discourage use of that product without regard to its economic value or other merits.

Although a number of the twelve characteristics listed in the Proposed Statement clearly raise "red flags", others do not. Perhaps most troublesome is the suggestion that the "use of SPEs or limited partnerships" is suspect because they "involv[e] multiple obligors or otherwise lack[ ] transparency". Id. Another area of concern is the reference to transactions "with unusually short time horizons", particularly when combined with the reference to transactions that are "executed at year end or at the end of a reporting period". Id. It is very commonplace for customers to borrow on a short-term basis over a quarter-end or year-end date.

Accordingly, we urge that the final Interagency Statement include an explicit disclaimer to the effect that the existence of one or more of these twelve characteristics will not create a presumption of heightened risk or require heightened scrutiny by the financial institution.

3. Different Roles.

One important aspect of the flexibility that financial institutions need relates to the wide variety of relationships that a financial institution may have with respect to a CSFT.[7] We accept that special scrutiny is often appropriate where a financial institution originates and structures a CSFT, but a lesser degree of scrutiny may be appropriate where the financial institution plays a more limited role. For example, a financial institution's only involvement in a particular CSFT may be to act as a custodian or perform some other largely administrative

[7] Our concern about this issue is reinforced by the SEC Memorandum's repeated joinder of the "offer[ing]" of and the "participa[tion]" in a deceptive structured finance product, without distinction between the two or among various levels or types of participation.

function. In that instance, we would expect that a financial institution would normally not be required to conduct the same level of review of the transaction as would be required if the financial institution were actively involved in the development of the deal structure. Furthermore, we believe that a financial institution should be required to conduct a lesser level of review when it is providing the financing for a transaction that has been structured and developed by the customer or an independent third party.

In order to deal with this issue, we request that the final Interagency Statement explicitly acknowledge that the policies and procedures relating to CSFTs may incorporate different standards of review based on the financial institution's role or the degree of the financial institution's involvement in a particular CSFT. Likewise, the final Interagency Statement should permit a financial institution that is participating in a limited part of a transaction to conclude that the duty of investigation need not extend to the entire transaction, depending on the particular facts and circumstances.

4. Syndicated Loans.

A specific variant of the different roles issue is presented in the case of syndicated loans. Where the financing in connection with a CSFT is provided by a syndicate of financial institutions, it would be totally inefficient for each member of the syndicate to investigate the transaction. Indeed, only in the rare case would each lender have access to the information required for such investigation.

5. Document Retention.

The document retention requirements set forth in the Proposed Statement are very detailed. See id. at 28989. Although the Proposed Statement uses the phrase "as appropriate" in describing these requirements (id.), we are once again concerned that bank examiners may use the list of documents included in the Proposed Statement as a compliance "checklist". Certain types of documents may be relevant to one type of transaction, or to a financial institution's role in that transaction, but not to another type of a transaction or different role. In addition, some of these documents may not be material to a transaction, such that retention of the document would not serve any purpose.

We believe that the document retention policy should be limited to the generation, distribution and retention of those documents necessary to evaluate and control the legal and reputational risks associated with CSFTs. As the Proposed Statement recognizes, the guiding principle in documentation standards should be to "minimiz[e] legal and credit risks, as well as [to] reduc[e] unwarranted exposures to the financial institution's reputation". Id. As part of this process, the final Interagency Statement should explicitly acknowledge that the scope of the documentation standards will vary with the institution, the transaction, the institution's role in the transaction and the materiality of the document. In addition, institutions should be explicitly authorized to determine for themselves an appropriate document retention timeframe.

We also have two specific concerns about the Proposed Statement's discussion of document retention. First, the Proposed Statement would require retention of "comprehensive documentation" for "disapproved transactions with controversial elements". Id. If a transaction is "controversial", it may be disapproved at an early stage before there is comprehensive documentation. In addition, a transaction might be controversial for a number of reasons, including the credit of the customer or the efficacy of the product. We believe that the "controversial" predicate should be limited to controversy because of legal or reputational risk.

Second, we strongly urge that the references to minutes be deleted, particularly because of the view of some that minutes should approximate verbatim transcripts. See id. We believe that any direct or indirect requirements to maintain minutes will significantly increase the risk to financial institutions without offsetting benefits.

6. Transactions with Private Companies and Individuals.

We believe that the Proposed Statement should generally not apply to CSFTs that are undertaken with individuals and private companies, as they do not present the same legal and reputational risks as public companies, particularly with regard to disclosure. If the Proposed

Statement is to apply to CSFTs undertaken with individuals and private companies, however, we would request that the Agencies explicitly acknowledge that transactions with such counterparties need not be subject to all the same processes as CSFTs with public companies.

7. Significance of the Transaction.

We request that the Agencies explicitly acknowledge that CSFTs that are of minor significance to the counterparty do not present the level of legal and reputational risks that would require the enhanced scrutiny for which the policies and procedures are designed. In addition, we believe that the final Interagency Statement should utilize a "significance" standard for the type and nature of review by management of CSFTs and the retention of documents.

8. Minimization of Specific Suggestions.

As mentioned, The Clearing House strongly believes that the Proposed Statement should incorporate a flexible, principles-based approach. Such an approach is particularly appropriate here because most of the large financial institutions that conduct CSFTs already have policies and procedures in place regarding CSFTs that have been reviewed by the Agencies. We are concerned, however, that the numerous specific suggestions on policies and procedures in the Proposed Statement are inconsistent with this approach.

Accordingly, we recommend that the final Interagency Statement eliminate the following specific suggestions: (1) the description of "areas of legal review" of CSFTs that includes suitability, tax considerations, insurance considerations, and regulatory capital requirements (see id. at 28987)[8]; (2) the recommendations that policies "clearly define" or "articulate" when the retention of external legal, accounting or tax advisors or review by higher level management at the financial institution or at the customer is necessary (see, e.g., id. at

8 These matters are addressed primarily or solely at most financial institutions by functions other than the legal function.

28987, 28988)[9]; (3) the bullet-point list under the section entitled “Independent Monitoring, Analysis, and Compliance with Internal Policies”, which suggests, among other things, on-site compliance coverage for each traded product or business line and “compliance” review of CSFT documentation (see id. at 28990); and (4) the statement that SPEs, including those that are client-sponsored, should be subject to a separate approval process and that a database of all such SPEs should be maintained (see id. at 28989).

Further, we respectfully request that the Agencies consider whether additional specific suggestions in the Preliminary Statement with respect to policies and procedures may be eliminated, which would further encourage a more flexible, principles-based approach. The specific suggestions in the Preliminary Statement are likely to encourage a checklist approach by examiners, and are seemingly inconsistent with the Agencies’ acknowledgement that policies and procedures concerning CSFTs “should be tailored to, and appropriate in light of, the institution’s size and the nature, scope, and risk of its complex structured finance activities”. Id. at 28983.

9. Additional Observations.

We have not attempted, nor would it be possible, to identify every circumstance in which financial institutions will need to be given flexibility as they implement the Interagency Statement. We respectfully request that the final Interagency Statement contain explicit general acknowledgement of the need of financial institutions to implement the Interagency Statement in a practical and flexible way so as not to stifle legitimate structured finance activity.

The concept of flexibility needs to take into account that some of the guidance, although perhaps theoretically unobjectionable, may be impracticable in the current environment. For example, our member banks have found that their customers’ accountants and counsel, fearful about their own liability risks, are refusing to provide any written confirmation of their

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9 These decisions are inherently case-specific determinations that are best made by the independent participants in the review process.

advice regarding a particular transaction. Indeed, in some cases, they are refusing even to talk to the lending banks about the transaction, or are requiring indemnities.

We recognize that the need for flexibility versus the need for guidance creates tension regarding the breadth of the Interagency Statement. Resolution of this tension is highly dependent upon the potential level of liability resulting from the Interagency Statement (either from examiners or from third-party plaintiffs). If it were clear that the Interagency Statement represents supervisory guidance within the parameters of which financial institutions have flexibility to create their own policies and procedures, then the breadth of certain sections may be appropriate to encourage flexibility. However, if the guidance is to be a prescriptive "checklist" (or enforced as such by examiners or plaintiffs), then the breadth of the Interagency Statement needs to be curtailed significantly and the recommended procedures need to be tailored to only what is necessary.

In addition, in view of the ambiguity and uncertainty surrounding what transactions constitute CSFTs and which of those transactions require heightened scrutiny, there will unquestionably be some level of disagreement between the regulators and the financial institutions, at least initially. The supervisory staff of the Agencies should be prepared to confer with financial institutions in a meaningful way as they implement the Interagency Statement. Except in egregious cases, we urge the Agencies to allow one full examination cycle to pass before a financial institution is subject to any significant criticism as a result of its policies and procedures under the new guidance.

IV. Appropriate Standards

The Clearing House believes that a number of specific standards in the Proposed Statement are inappropriate in that they create unreasonable and even unachievable responsibilities and risk creating unwarranted liability.

1. "Appropriateness" of a Transaction.

The Proposed Statement establishes a broad new responsibility for financial institutions to evaluate the "appropriateness" of transactions. See id. at 28987. Not only is this standard vague and subjective, and a radical departure from current law, but it is not possible for a financial institution to determine what is appropriate for another organization. Such a requirement would impose upon a financial institution the responsibility for making difficult qualitative judgments as to whether a particular transaction is appropriate for a particular company. The appropriateness of a transaction is the responsibility of the counterparty's management and advisors based on a number of factors and considerations, many of which are unknown to the financial institution. We recommend that this obligation be deleted.

2. Legally Enforceable Contracts.

The Proposed Statement requires that each counterparty's obligations be "reduced to legally enforceable contracts". Id. A counterparty may assume various obligations upon which a financial institution relies even though they are not legally binding. We appreciate the specific exception for "traditional, non-binding 'comfort letters'" (id. at 28988, n.6), but are concerned that this exception furthers the idea that all other non-binding obligations are improper. We recommend that the "in writing" requirement be eliminated or limited to situations where the financial institution is aware that the failure to document the obligation is likely to alter the views of the counterparty's accountants.

3. "Complete and Accurate" Standard.

We accept that a financial institution should obtain and document information about a customer's proposed accounting treatment of a transaction subject to heightened scrutiny. See id. We do not believe, however, that the standard should be "complete and accurate". Id. This is a very high standard and would probably require financial institutions to call upon their own external accountants. Yet, the accountants may be unable to express a view because they do not have sufficient knowledge of the financial institution's customer. In addition, where the financial institution is acting as a counterparty, rather than as an independent advisor, in a CSFT, it may not have complete, unfettered access to a customer's auditors, to nonpublic customer information, or to analyses prepared by the customer's outside legal counsel or accountants. Accountants and other advisors to the customer may not be prepared to divulge information to the financial institution because of their own liability concerns, because they believe their advice is privileged or because they may have a conflict of interest in advising on both sides of the transaction. We believe that the final Interagency Statement should explicitly acknowledge that a financial institution need only obtain information on a customer's proposed accounting treatment of a transaction that is reasonably available given the nature of the counterparty relationship.

4. "Independent" Review.

There are frequent references to "independent" review in the Proposed Statement. See, e.g., id. at 28989. Although, in a number of cases, the Proposed Statement makes clear that the financial institution's own employees in a separate unit, such as compliance, can satisfy this independence requirement, that is not always clear. We are particularly concerned that the specific reference to use of "outside" professionals to review structured product use will be treated by examiners as a requirement. See id. at 28990.

We recommend that the final Interagency Statement explicitly reject such a position. The decision whether to use external advisors should be related to the novelty or uncertainty of the issues involved and should be highly dependent on the expertise of internal resources.

5. Assumption of Risk.

The Proposed Statement asserts that a financial institution "assumes" various risks when it "provides advice on, arranges or actively participates in" a CSFT. Id. at 28984. We agree that active participation in a CSFT creates greater exposure to risk, but we do not believe that the risk is "assumed" in the sense that the financial institution has automatic liability. We recommend that the Proposed Statement be modified to delete this term.

V. Certain Statements in the Proposed Statement Impose an Unduly High Standard on the Board of Directors and May Discourage Qualified Individuals From Serving as Directors of Financial Institutions

At a time when the demands for higher standards and greater accountability is discouraging many individuals from serving in director positions, it is essential that the role and responsibility of directors be carefully articulated. We agree with the statement in the Proposed Statement that the "board of directors . . . is the focal point of the corporate governance system". Id. at 28985. It is precisely because of this responsibility that it is essential for financial institutions to obtain and retain the most qualified directors.

We are concerned that certain statements in the Proposed Statement may discourage qualified individuals from serving as directors of financial institutions, particularly if they appear to impose a higher standard than exists for directors of other companies. The Proposed Statement states that the board of directors is "ultimately responsible for the financial well being of the institutions they oversee" and has "ultimate responsibility for establishing the institution's risk tolerances". Id. at 28985, 28982. To the extent that "ultimate responsibility" is intended to be synonymous with liability, we strongly disagree with this statement. Such a standard of liability is inconsistent with the state law standards that govern the duties and responsibilities of directors and cannot, we believe, be justified by federal statute.

In addition, as noted in Part I above, we are concerned with the repeated use of the word "ensure" in describing the board's responsibilities, particularly in connection with the identification, evaluation and control of risk, because this word can be read to suggest directors have strict liability as guarantors of a financial institution's legal and regulatory compliance. See id. at 28985-86. As the Proposed Statement recognizes, the board's responsibility is one of oversight, and not management, and oversight cannot legitimately be expected to provide a guarantee. As mentioned above, we recommend that the final Interagency Statement consistently modify “ensure” with “strive to”. Alternatively, the final Interagency Statement should clarify, as regulatory enforcement orders often do, that “ensure” in the context of the role of the board of directors means (i) authorizing necessary action by the institution, (ii) requiring timely reporting by the management, (iii) following up on non-compliance and (iv) requiring management to take corrective action.

VI. Summary

As the Agencies recognize, CSFTs play a productive role in diversifying and minimizing risks and creating more efficient financing opportunities. It is essential that the Proposed Statement’s valid effort to prevent abuse not be expanded by others – whether private litigants, other governmental authorities or the Agencies’ own examiners – into restrictions that reduce the value of CSFTs in our economy. We urge that the final Interagency Statement be modified, as discussed above, to minimize this risk.

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The Clearing House appreciates the opportunity to comment on the Proposed Statement and would be pleased to discuss any of the points raised in this letter in more detail. Should you have any questions, please contact Norman R. Nelson, General Counsel of The Clearing House, at (212) 612-9205.

Sincerely yours,