

**TESTIMONY OF DOMENICK DEGIORGIO
BEFORE THE SENATE PERMANENT
SUBCOMMITTEE ON INVESTIGATIONS
NOVEMBER 20, 2003**

Members of the Subcommittee:

My name is Domenick DeGiorgio, and I am Managing Director at the New York City office of Bayerische Hypo-und Vereinsbank A.G. ("HVB"). HVB is an international bank and financial services organization, headquartered in Munich, Germany, and with offices worldwide. Currently HVB employs over 400 people in its New York office, with a payroll approaching \$100 million.

From 1997 through 2002, I was an officer of HVB's subsidiary, HVB Structured Finance Inc. Our group specialized in advising customers who needed specially tailored financial products, and in assisting such clients in achieving their business or investment goals using HVB's global financial resources. This business necessarily involves very complex transactions and a wide range of specialized financial services on the part of the HVB. I would note that HVB disbanded the Structured Finance group earlier this year as we refocus on our core business activities in Europe.

I have been asked by the Subcommittee to describe HVB's participation in a number of transactions it describes as tax shelters. I am pleased to be able to appear before the Subcommittee today. I want to begin by stating that HVB is eager to respond to the Subcommittee's inquiries and that we have complied with applicable laws and regulations. Indeed, we have actively cooperated with both the IRS and this Subcommittee, because we

recognize the effects that abusive tax shelter transactions may have in undermining confidence in our tax system.

Simply put, with one exception, HVB did not participate in any of the transactions the Subcommittee has asked about, including the ones denominated by the abbreviations “FLIP,” “OPIS,” “COBRA,” or “LILOs.” As I will describe in a moment, we did provide financial services for a small number of clients who participated in the so-called “BLIPS” transactions. However, we never organized, promoted or marketed the BLIPS transactions, nor any transaction that was being entered strictly for tax purposes. Furthermore, we never gave, nor even offered, tax opinions or advice regarding the tax treatment of our transactions; for we are a bank, not tax advisors. We did consult with our own outside tax attorneys regarding the implications of the BLIPS transactions for HVB under the applicable provisions of the Internal Revenue Code of 1986. The specific details of such advice are of course privileged under the attorney-client privilege; however, it should suffice for present purposes to say that HVB satisfied itself that we met all of our legal and tax obligations with respect to these transactions.

The Subcommittee has asked me in particular to describe how HVB became involved in the BLIPS transactions that we funded for approximately thirty customers in 1999 and 2000. These customers were brought to HVB by Presidio Advisors, an investment advisory firm. I, and HVB, knew from prior business relationships some of the principals of Presidio Advisors, who were former employees of the international accounting firm KPMG. I was initially contacted by one of the Presidio partners in approximately early August, 1999. He advised me that Presidio had developed a structured investment program for a number of high net-worth

individuals, and he asked me if HVB would be interested in providing banking services, including loans, foreign currency transactions, and transactions involving interest rate derivative products. He stated that one of our principle competitors, DeutscheBank, had provided similar financial services for a number of clients who participated in the same investment program, and Presidio was trying to diversify the financial services providers for the investment program. I agreed that HVB might be interested in providing such banking services, and I requested additional information about what would be expected of us.

Over the course of approximately the next month, we received a considerable amount of information about the BLIPS investment program, including a draft set of the transaction documents that DeutscheBank had been using, and an unsigned draft of an opinion by KPMG regarding the tax consequences of the investment program for the investors. This information was provided to us in order for HVB to understand the transactions and to determine what banking services we would be required to provide.

We of course knew that the BLIPS investment program, like practically all investments, could have United States income tax consequences for the investors, including substantial losses if the program was terminated early. Not being tax professionals ourselves, we relied on the KPMG opinion to assure us that the transaction met all applicable tax laws for the investors, and we did not separately perform our own comprehensive evaluation of the tax consequences for those investors. Rather, as we generally do when asked to participate in transactions in the ordinary course of our business, we focused on our own potential for profit and risk of loss from the transaction. Likewise, we did not view it as our role to evaluate comprehensively the

investors' purposes for entering into the transactions or the potential tax consequences of the transactions for them. The investors were to be sophisticated, high-net worth individuals who presumably had considerable business and investment experience, and the tax and other legal consequences of the transactions were the subject of opinions by some of the nation's best law and accounting firms. Further, the transactions had previously been funded by a prominent competitor, and it was represented to us that the investors could and would meet our own, conservative internal lending criteria. At the time (the last half of 1999), the IRS had not made any adverse determination regarding these transactions, and we consulted with our own attorneys about whether our participation in the program created any legal issues for the bank. As a result of all of these factors, we concluded that the bank's expected role in the BLIPS transactions was appropriate and complied with applicable laws and regulations.

In approximately early September, 1999, I and other HVB employees met in our offices in New York with several principals from Presidio Advisors, who described the investment strategy for us. We also carefully reviewed the banking services that would be required of HVB, including the "premium" fee structure for the loan, how the customers would meet the bank's lending criteria and "know your customer" requirements, and what would happen if the investment strategy were terminated by the investors after 60 or 180 days rather than running the full 7 expected years. Again, the potential tax consequences of the transactions were discussed, but were by no means the sole, or even the central, focus of our discussions at our meeting.

Over the course of the subsequent weeks, the members of my group at HVB confirmed that the bank could provide the various kinds of services required of it for the investment

program. We also obtained, through our ordinary credit approval procedures, authorization to loan as much as \$1 billion in the last few months of 1999 to participants in the investment program, provided of course that they met our usual lending criteria. The credit approval memorandum, which went through several drafts, fully described the investment strategy, which could run as long as 7 years or could terminate as early as 60 days after the loans were made. It also discussed the ordinary risk analyses, credit protection procedures, collateral arrangements, and other routine matters as well as, to the extent we knew them, the business purposes and tax consequences of the entire series of transactions. I would reiterate, however, that we did not fully analyze all the possible tax ramifications that the transactions might have for investors, relying on KPMG to do that for its own clients.

After we obtained credit approval for a series of transactions, we began processing the particular loans for approval and preparing to provide the other banking services that would be demanded of HVB. Each of the borrowers was required to meet our lending criteria and “know your customer” requirements, and we requested a substantial amount of documentation and verifications from them. Personnel from Presidio, which was the investment advisor for the transactions, and from KPMG, the tax advisor on the transactions, assisted us in compiling this information. Assisted by our own attorneys, we also drafted the transaction documents to meet our requirements.

Ultimately, HVB funded approximately eleven of these transactions in 1999, and another tranche of eighteen of them in early 2000. The average size of these loans was approximately \$71 million and the bank extended credit totaling approximately \$2.2 billion in the entire series

of transactions. Ultimately all of the investment programs were terminated after Stage I, approximately 60 days after they were entered, and all the loans HVB made were fully repaid, with full interest, at that time.

In August, 2000, the IRS published Notice 2000-44, in which the IRS stated its position that the tax benefits that investors might claim from transaction like the BLIPS transactions would not be allowed. HVB immediately ceased its participation in the program in view of the IRS's announced position. The loans that were still outstanding at that time were subsequently fully repaid, and that was the end of our involvement with BLIPS.

The Subcommittee has asked me to address a number of specific questions regarding the BLIPS strategy. I want to preface this portion of my testimony by reiterating that HVB's role in the transactions was limited to traditional banking services, and that some of the Subcommittee's questions would be better addressed to other participants. Take, for example, the question whether HVB performed "any analysis of auditor independence issues in light of KPMG's role in auditing the Bank's financial statements filed with the U.S. Securities and Exchange Commission." This first of all assumes that the bank files financial statements with the SEC, which it does not. Further, while we recognize that auditor independence is a serious issue, we must point out that we were approached by Presidio, not KPMG, regarding these transactions and that KPMG was involved to the extent of serving its tax clients, who ultimately became HVB customers. We did not consult KPMG for tax advice regarding HVB's role in these transactions, we consulted an outside law firm for our own tax advice. Moreover, we did not market, either jointly with KPMG or on our own, the BLIPs product to any of our existing

customers. At the time that these transactions occurred (in 1999), the present restrictions on auditor independence that are embodied in the Sarbanes-Oxley Act and SEC regulations of course had not yet been enacted. But even under the present regulatory framework, these facts might present no auditor independence questions, and certainly under the rules that were then applicable in 1999 we did not perceive such an issue.

The Subcommittee has also asked about the “development and accuracy of the formal representations made by and to HVB in connection with the BLIPS transactions.” Most of the “representations” made in connection with these transactions were of an entirely routine nature for a lending transaction. For instance, the investors represented the they had their own independent advisors and were not relying on HVB for tax, accounting, or financial advice, and HVB acknowledged that the transactions were conducted under arms’ length terms and that our compensation was within the range of market rates for our services. Further, Presidio (the sponsor of the investment program) and KPMG (the tax advisor) specifically represented that they would comply with section 6111 of the Internal Revenue Code by either registering the transactions as tax shelters or determining that they were not required to so register. After obtaining legal advice on this issue, we again relied on these representations.

As I noted previously, HVB did consult its attorneys with respect to the U.S. tax implications of the BLIPS transactions for HVB, and we remain confident that they were properly and accurately reported by the bank. Independent of this Subcommittee’s investigation, we have already received over two dozen summonses from the IRS with respect to examinations of investors in these transactions, and we have provided to the IRS the same documentation that

we have provided to this Subcommittee. To date, the IRS has not questioned HVB's role in the transactions, and we remain certain that we have done everything properly.

The last question that the Subcommittee has asked me to address concerns HVB's "review and approval process related to financing or implementing transactions that appear to have tax avoidance as a significant purpose." Although we certainly were generally aware the investors could have tax consequences at various stages of the program, including tax losses if the investors terminated after Stage I, we relied on KPMG's opinion in this regard. Moreover, we followed our regular loan approval processes in entering the transactions in this program; we did nothing extraordinary or unusual here.

We recognize, of course, that the Subcommittee may recommend legislation that might change HVB's or any other financial institution's legal obligations with respect to structured financial products and services or the tax implications of such transactions. We would be happy to work with the Subcommittee with respect to such legislation, and we look forward to a productive exchange of views with the Subcommittee on this subject.