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P R O C E E D I N G S

MR. GUYNN: Let's have a brief introduction, but I think the analysts will all know the people in this room. I'm Randy Guynn, the head of Financial Institutions Group at Davis Polk. I'll be moderating.

To my immediate right is Jack Jennings who's currently a managing partner at Chain Bridge Partners. Formerly he was a senior associate director of the Division of Supervision and Regulation of the Federal Reserve.

And then to his right is Meredith Fuchs who's currently chief counsel. Did I pronounce that right?

MS. FUCHS: Yes.

MR. GUYNN: Good. Chief counsel, regulatory advisor at Capital One, and she's a former general counsel of the CFBB.

And to her right is Jennifer Burns who is the deputy director of the Division of Supervision and Regulation. And I'm also very happy to say that Jack, Jennifer and I all were all graduates of the University of Virginia, so that might be a (inaudible).

And then to Jennifer's left is Peggy Twohig, who is the Assistant Director for Supervision Policy at the Bureau of Consumer Financial Protection. We're going to call it the Bureau because I don't know if we'll see (inaudible) and anyway I'll veer off to the --

MS. TWOHIG: The Bureau is it.

MR. GUYNN: The Bureau is it, okay. Good.

So we're actually going to focus on two topics today. The first is going to be called the new supervisory process land the rule of law, including some information -- some discussion of the new qualified rating so it's (inaudible) and then the second one is reg check, including the role of artificial intelligence and machine learning. We will be -- at times there are a number of other topics we might cover, like guidance versus rules, supervisory information transfer and so forth. But I have a suspicion we won't get to it.

Let me just give a quick little framing the issue and then we're going to have interactive discussion on this issue. So after the 2008 financial crisis the Federal Reserve substantially strengthened its bank supervision program and focused special attention on the largest most systemic institutions. In particular LISC which centralized more of the supervisory authority of Washington and away from the serve banks. LISC has conducted horizontal reviews and provided more consistency across the banking system. These practices have undoubtedly improved the effectiveness and fairness of the supervisory process at the level of the largest and most systemic banking organizations.

The Federal Reserve has also proposed amendments to its process for appealing adverse supervisory findings. Despite concerns about whether the anti-retaliation provisions of the new procedures will be effective, the proposed amendments are clearly a step in the right direction. But, and here's going to be the -- but some critics have said that these improvements have been achieved at the expense of compromising fundamental principles of due process and the rule of law.

According to them, the horizontal review process has resulted in the regular discovery of new best practices in risk management, governance and controls in particular, which resulted in new and ever higher standards and expectations. The critics realize that the continual creation of new and ever higher standards and expectations is probably a sign of a healthy supervisory process.

But their criticism focuses on how those new standards have been applied. They say that the examination teams apply these new standards retroactively in the form of MRIAs and MRAs for failure to be in immediate compliance with the new standards. In addition, they say that failure to be in immediate compliance with these new standards has resulted in retroactive penalties in the form of rating downgrades, delays in rating upgrades or even enforcement actions.

They say that these penalties have been imposed without the providing the bank organizations an adequate opportunity to challenge or seek refinement of the new standards and that these penalties have also been imposed without giving bank organizations a reasonable period of time to bring their systems and programs into compliance before being penalized for failure to comply. In addition, examination teams allegedly imposed similar penalties on banking organizations for failure to comply with supposedly non-binding supervisory guidance and having discretionary subjective notions among staff (inaudible) sound conditions and poor practices. They're not tethered to any violation of a specific law or regulation.

Now, I have a suspicion you might expect Jennifer and Jack to say that the, and I agree, that the supervision by nature requires some amount of judgment and flexibility to adjust to new circumstances. Moreover, the law requires the supervisors to ensure that firms are not operating in an unsafe and unsound manner and the appropriate level of resources and risk management will depend on the firm's activities and risk profile. In addition, I understand that the Federal Reserve uses horizontal practices as a way of ensuring that the risk management and control practices of the firm are appropriate for its risk taking.

To the extent that horizontal reviews are used to identify and hold firms to new standards, however, they would seem to be inconsistent with the distinction between supervision and regulation made in the Fed's recent supervision and regulation report. In that report, the Fed described regulation as the process for establishing rules within which financial instructions must operate. It then describes the provision as the process by which the Federal Reserve monitors, inspects, and examines whether a banking organization is in compliance with the established rules and regulations.

These alleged practices, that is sort of discovering new standards and applying them retroactively, would also seem inconsistent with the recent attempts when the Vice Chairman for Supervision Quarles, before the house Financial Services Committee and the Senate Banking Committee. His written testimony to both he said, "The banking agencies recently clarified the supervisory guides as a tool to enhance the transparency of the supervisory expectations and should never be the basis of an enforcement action. Guidance is not legally enforceable, and federal reserve examiners will not treat it that way."

Then, in response to a question from Senator Crapo about whether federal reserve examiners were "verbally giving instructions that are not contained in the law," and what he was "doing to make sure that the supervisory staff is accountable to him," Vice Chairman Quarles stated, "Obviously if there were instances where examiners were communicating and requiring banks to take actions that were not required by regulation, and it was not transparent to those above them in the hierarchy, that would be extremely concerning. We have a rigorous training program in the Fed."

So let me start with Jennifer, if I could on the due process or rule of law questions. Could you just describe to me what you think are the most important changes that have been made in the supervisory program, supervision program since 2008? Whether you think it's been more effective and fair than the prior program and whether any of the criticism that I just outlined is fair?

MS. BURNS: Thank you. I just want to say that (inaudible) those of us involved in research and did spend a lot of time struggling with the (inaudible) practices and we believe that this is where an assertion could be made and should be made more effective. And in response to that we have made several changes and one of the first change that I would like to highlight is the change in our governance practices.

As Randy noted, we did, in 2010, implement the LICT program which potentially changed the governance of how we oversee the execution and supervision of the largest financial institutions in the US. Before the crisis, supervision of large (inaudible) reserve banks further organizing themselves institution by institutions and the structure currently which, as you can imagine, both for supervising firms based on their (inaudible) practices versus expectations, with the changes in the LICT program came out we have these multi-disciplinary committees to oversee supervision of firms both work that we decide to undertake at firms as well as the outcomes of our supervisory activity.

We think this approach does improve the consistency of supervision and hopefully the effectiveness of supervision, and guards against some of the criticisms that you articulated in your opening remarks. Specifically it ensures there we have better informed supervisory decisions. There are lots of sets of eyes, you know, very senior, very experienced individuals with expertise across a range of areas looking at results and working together to ensure that we are not establishing these units for firms.

It results in better outcomes than the centralized process. Again, because we're looking across a range of practices and bring the full range of knowledge of all the folks involved together to make sure that we have both the (inaudible) of the firm in perspective, as well as the risk management practices they have in place versus good risks.

So I think the governance changes is an important one and one of the cornerstones of the controls we have in place against some of the criticisms that you shared.

The second thing I'll take about as far as Uncle Sam's -- I would like to emphasize that the Federal Reserve's use of horizontal exams is not a new thing. It certainly wasn't invented as part of the LICT program. I will say what's different about our use of horizontal exams for those (inaudible) is that we sometimes (inaudible) more deliberately than we did before. Horizontal exams are very important again, it allows us to understand the range of risk in the industry and within individual firms and to put that risk into perspective. It also gives us a view into the range of risk management practices that firms are bringing to bear against those risks.

There is more than one way for firms to effectively control their risks and by seeing those (inaudible) that are in place across the firms and it gives us a better sense of that. We think this is very valuable to us, again in understanding risks and understanding the state of risk in the industry. Again, the industry itself is making better informed supervisory judgments.

You articulate some pretty strong critiques of the horizontal practice and I wouldn't say that personally believe that those reflect our practices. We don't use our exams to surprise firms. But the new standards, just like any exam, supervisory findings relate to a firm's specific practice -- (inaudible) practice in relation to their risk. Findings that are always (inaudible) are always firm specific.

But that is not to say that firms don't often, or don't at times suffer from the same failings in their practices. And when they do so the findings are going to be consistent and will give, you know, all the firms with similar findings similar opportunity to address those issues before they become more material.

We also want to emphasize in regard to horizontals that we're not grading on a curve. We're not saying Formax has (inaudible) practices and everybody has to have that. We do our best to hold firms to what we feel are absolute expectations about their risks.

We have, I think, long thought potentially that our outcomes are appropriate for individual firms. Do we always get the right answer? Probably not. Even when we (inaudible) firms always get the right -- you know, always make the right credit decision, but we make the best decisions we can using the full range of information we have, the full range of expertise of those involved in making decisions to make sure that we are doing our absolute best to get to the right answer.

I think these changes, again, relay the intent of ensuring that we have a consistent and effective supervisory process. And we take very seriously our responsibility here. It's critical to us. It's critical to the industry, it's critical to the taxpayer that we have an effective supervisory program. We think we all learned first-hand, a rather unpleasant reminder 10 or so years ago about what happens when supervisors aren't effective and when firms aren't effective and understanding and controlling their risks.

You also mentioned the distinction between regulation and supervision which I think is key. Regulation by nature is supervised and fairly (inaudible). We use regulation in roles and we know the outcome absolutely that we want to obtain, and we think there's one kind of right way to get there. For instance, we use and quite often have quantitative expectations and requirements. But there are other areas that are critical (inaudible) that don't lend themselves as well to regulation; things like risk management and controls where a one size-fits-all approach is maybe not the most appropriate.

In areas like (inaudible) we want to give firms freedom to design their risk management approach in the way that they thing best, accommodates their business model, accommodates their internal culture and practices. Supervision allows us to provide that level of flexibility, allows us to communicate and where it's appropriate with firms, allows us to ensure that they're responding to management without effectively taking over and mandating and approach their firms which we think is absolutely not right outcome.

MR. GUYNN: So let me ask one quick follow up question. So imagine you're an examiner, someone's an examiner and they do a horizontal review and they say, while we didn't realized this risk was handled, there's a new risk that's developed. There's a new sort of way and one firm in particular appears to sort have identified it and really found an effective way to address it and you look at sort of their approach you realize that they seem to have these risks as well. They haven't really identified these, or they haven't found a system and now you say, well, we need to be able to sort of create some kind of expectation of what they'll do.

How would you apply that? Would you, in fact -- because this is what I'm trying to find out. Have a real life example, or at least as close a one as we can about we've discovered something we think this is a standard (inaudible) focusing on. This is, I would say it's a new standard, how would you apply it if you actually said, yeah, this is a new standard. It doesn't really matter going through a rule-making process, but how would you apply it? Would you in fact say, well let's have a discussion about whether this is an appropriate standard, and would you give the firms a reasonable period of time or should the firms have a reasonable period of time to bring their systems in compliance with that?

MS. BURNS: So I would say that I can't honestly think of a time and I'm (inaudible) where we've gone into a firm and seen a new risk and we've kind of automatedly said, well here's something new that we need to address across the industry immediately. Usually when we come across something new we see -- it's usually not a new risk though, I would say it's an evolution in the safety in a firm and we'd love to see (inaudible) that firm and how they're controlling it.

We would begin to explore and to have conversations with the firms to understand how that risk may be manifest in other institutions; understand how they're controlling that risk and you begin talking about it. Typically when we're seeing risks evolving and we believe that there needs to be, where there's not existing risk management guidance that we have (inaudible) you'll see us start to message on that. You'll see our principals we introduce speeches on that.

I think in the area of reg tech there's a great example where you're seeing Governor (inaudible) speak periodically about it. You know how reg tech is influencing the banking industry, how it's creating new risks, how existing risk management expectations might be applied. Typically in places like that we're going to investigate. We even watch, counsel the industry about the practice (inaudible) and our understanding in defining that risk and determining the appropriate approach. And then, over time, when there is enough body of information then it may be time to create a policy or guidance or pass a rule.

So I actually -- maybe there's an example but there's not one that I'm familiar with.

MR. GUYNN: Thanks. Jack, so you were involved along with (inaudible) you were actually with the Fed. You've now been outside of the Fed for a period of time. What -- can you give us your thoughts in terms of the evolution of the Fed supervisory program and in particular how it interacts with the new (inaudible) ratings system; or how it is likely to interact?

MR. JENNINGS: I'll do my best. I suppose I'm on the panel because I have certain debts to pay. I guess I was part of the problem since the crisis and now that I'm out I have to atone for what was done. So Jennifer and her colleagues will carry on in a more enlightened way than I, and some of my previous colleagues.

Gosh, where to start here. A lot of what

Jennifer covered are things that I would have said, just to sort of give background as to what the current structure and the changes were. And I certainly agree with all of that. I mean I would say that this horizontal approach that Jennifer described -- I understand there are issues with it. I understand that the ability to get everyone who's involved and marching to the same tune and employing exactly the same procedure is a challenge, a huge management challenge for the organization.

And every organization -- this conversation about risk is interesting because I don't think that for any two organizations the risk affects them the same way. And there needs to be a certain amount of interpretation and analysis around that. So these are all, you now, a lot of moving targets that you're trying to manage. But, overall if you look at where we are today versus where we were prior to the crisis and immediately following it, I think it's hard to argue with the results in terms of the health of the industry and the way in which the Federal Reserve, and other regulators, I believe through their processes contributed to the improvements that we see today. So I think the evolution of course, is -- I think it's just natural and it should be expected.

This question about issuing rules for everything that supervisors are expected to ask banks to do, you know, that has limits or at least I think it should have limits. As Jennifer described in the absence of rules, that is to say of formal rules, using guides, using moral persuasion allows supervisors to tailor what banks are able to do to comply with -- sort of lessen litigation strategies.

So I think most would agree that it's almost impossible to write a rule that everyone would say well, that's exactly the way it should be written according to the way I see the risk and the way it affects me. So I think there are a lot of benefits to the flexibility both to bankers and to supervisors in applying guides in the more formal ways that it has done.

I would just make this observation, that is to say that I've seen supervisory regimes around the world through different responsibilities I had for my time there at the Fed. And supervisory regimes in countries where supervisors have very limited discretion in where they can only take action when there has been a financial loss or where there has been an event, a financial event which has caused these losses, the supervisors do not focus on the preventative risk management type of issues because they're preventative actions, and when taking action there are (inaudible) practices.

I'm not saying we're anywhere near that, but I think you could carry this to an extreme to say that you don't want your supervisory regime to be focused just on dealing with the mess that happens, you want them to focus with risk management practices, and that just requires a certain amount of flexibility and judgment as to what really is important and what is, perhaps may be less important. So that would be sort of my overall sense here; this question about whether or not we should go one way or a different way in terms of what the requirements are on banks. But I think the guides is important.

I might also add something to Jennifer's, sort of -- if I may, in telling the story, of what we did over the years of the crisis. Certainly there was the government changes, and I think that's very important. But we also did some evaluation as to how we got ourselves -- I'll just use plain language here. How we got ourselves distracted enough that these major problems went undiscovered, or at least not sufficiently identified. And really the answer to that was simply to say we need to narrow our focus. But within that narrow focus deep in what we do there, all right.

And this is reflected, of course, and this new rating system which really has been what the Fed has been focused on at least since 2012. And we should (inaudible) there capital, liquidity, governance and resolution and resiliency planning. And what we did was identify those key things we needed to work on.

So when examiners were working in those areas I think it's probably seen more frequently now, but I think it's probably fair to say that we absolutely dug deeper into those areas. And probably worked on those things, possibly at the expense of other areas, but those were the things that we thought were the main contributors, or the things that we needed to focus on to insure we didn't have this financial instability issue that we had happen again.

And I think when you do that, when you narrow your focus and decide that you're going to do it more thoroughly and more analytically that it's going to result in raising the bar, more dramatically than otherwise. And that was the focus of our work for a number of years there. So I just would say that we call it in 12/17, I guess, in retirement I've tried to forget those kinds of things. The letter we put out then and as this new rating system really focuses on that and I think that's -- well, it's sort of a key driver, if you will, of why we took steps to improve.

And I think there's a time element, you know, sort of a cycle element in all of this also that we just need to recognize. I mean we were in a bad state of affairs going back to 2010, and those years there. And if anyone in this room disagrees with the statement that you know that there was a very significant -- I'll use the word in enormous gap between what could have been done in terms of better practices versus what was actually being done, I mean I would challenge you on that. So the gap in terms of what needed to be done was very large, and not just in a few firms, but across the majority of firms in this larger category I'm referring to.

So, you know, that was the situation that we were dealing with and fair enough, I think, there was a mindset that we needed to take steps through the way the horizontals were conducted to make sure that we were bringing sort of a rising tide, if you will, trying to raise all the ships kind of thing.

And I bring that up because in a moment I would like to contrast to that with sort of where I imagine, and I use that word because I'm not there, but where I imagine the regulators are going now with conditions the way they are. But before I do that I did just want to comment on the governance process. I had notes which covered a lot of what Jennifer said about the quality assurance aspects of what was supposed to be happening, and I think it was happening a lot of those oversight groups and others that were described.

I think that for some firms who were, I'm going to say, or not as far along in some of their practices. When you say raise the bar substantially well, you know, the implication of that statement is well, where are you sitting at? Because for some folks that bar wasn't raised as far as it was for others.

And so I think that prior to changing the governance practices that Jennifer has spoken about I think there was variation in Reserve Bank supervision programs. Sufficient variation to say that some banks in some districts were -- banks were at different places in terms of what they thought supervisory expectations were. And so with its more centralized governance process was invoked. And Jennifer spoke about, I mean some firms said boy, you know all of a sudden the bar has gone from its substantially raised. And again, I don't think that was necessarily for all firms because supervisors in different districts, quite frankly, were able to handle things somewhat different. So I just make those observations.

So fast forwarding, if I could a bit, and I'll actually just get to today where we are and what the future probably looks like. Again I'm not privy to what's going on inside the agencies any longer. But clearly things are different in terms of the level and sophistication of risk management practices, and financial condition overall. So -- and there's a lot more going on that obviously that everyone in this room is aware of.

First, we have the Dodd-Frank changes which are raising the bar, or raising the thresholds under which allow these -- enhanced credential standards are required. I think going forward is going to be pretty clear, I'm putting myself in the agency, but supervisors and the managers from the agencies are going to have, I think, a challenge and they're going to try to temper what takes place on examinations to get -- you know I had my hands full in terms of tailoring what was done in smaller firms versus larger firms.

But I think now that sort of the tables have even changed in terms of what's required from different firms. Getting that message all the way down from the top to the bottom of the organization is a tremendous challenge. But I think it is one that is important, and I think that at least within the higher levels of management within each of the organizations, you know, they're going to be committed to getting this tailored and communicated out because the last thing they want to be seen as somehow circumventing or it's not being implemented in both the literal and the spirit of the changes that are required under the legislation.

The other thing I would note, Governor -- the Vice Chair for Supervision Randy Quarles, I think, has been pretty active, pretty outspoken about his views.

And certainly has put forth, I'm going to call it a moderated tone, with regard to supervision, a very balanced tone. If you had the opportunity to look at his remarks on stress testing recently he essentially says that there that where we are now is that we've got good practices, the (inaudible) that is looked at very closely in the CCAR process, he believes is at such a level now that he favors the elimination of the qualitative objection and putting that in the ongoing day-to-day supervision process.

I just -- I'm not passing judgment on that one way or another, but I think it reflects, at his level within the organization, a sense of what I spoke of earlier, that the majority of firms may have had significant weaknesses, it makes clear that he's communicated to the majority of firms who have those weaknesses and at least foundation only that these firms are at a (inaudible) place.

So I don't think, you know, we are at a place -- if that's your believe then I think the likelihood that you're going to be going out and looking for ways to increase standards, I think you're going to be looking more at, you know, as we're looking at the business climate along with the activity, obviously the economy weekends there could be problems., But I don't think that your intent is to say we've got to get out and foundation only overhaul the way banks are operating which was a part of the mindset that we had back in 2010.

MR. GUYNN: Okay. Thanks a lot. I appreciate that. That's very, very helpful. I think in the interest of time we will kind of skip to the reg tech discussion, which is topic 2. And we'll start with Peggy and Meredith. My guess -- obviously there's been a lot of talk recently about using artificial intelligence and machine learning to facilitate compliance and (inaudible) to facilitate supervision enforcement, which we typically refer to as reg tech. So Peggy, and then Meredith, can you talk about the benefits that you see from the use of technology by institutions to facilitate compliance? What are some of the challenges from relying on technology? Starting with Peggy, and then Meredith.

MS. TWOHIG: Sure. Good morning. I'd be happy to talk about reg tech. Of the two aspects we focused on our -- and we've been doing this for a while, we just didn't call it reg tech. But we went back in our supervisory highlights which came out (inaudible) that and took a look at some of our findings that had to do with use of technology to facilitate compliance to help with compliance, to help enable compliance. And we found a fair number of findings of law violations of various types that had some root cause in the technology.

So it was interesting in that we had been observing this but not calling it, not labeling it reg tech. Reg tech was found a new fancy term. We applied just to call it reg tech. And indeed in 2015 we did a special supervisory highlights summing up our observations after four years of work in (inaudible) servicing, and noticed that the more servicers that had evaluated an IT system had saw they were outdated and did something to try to improve that and modernize them. And that did, indeed, help their client's position. Conversely, others who didn't do that were struggling more and we encouraged more servicers to take a look at how technology could be a benefit in facilitating the client.

So we have seen lots of benefits. I think it can help reduce manual errors because the system takes care of it. Hopefully, at a lower cost because of that where there is manual processes can be eliminated. So I think there's many benefits. I think it's happening. Because of those benefits. That technology's increasingly being embedded in this will take compliance.

There are some things to keep in mind though. Because it's system-wide then if there is an error it can multiply very quickly across the whole system. So there's certainly oversight practices that need to be handled. Also, we observed you can't like kind of set it and forget it. Like assume the technology is going to take care of it. There still could be coding errors. There still could be implementation errors. There could be change in management errors. There could be design flaws. So there are certain special considerations that have to come in when especially there's an increasing reliance on technology. But we observed it can be a very beneficial thing. And that there's some special considerations to be (inaudible).

MR. GUYNN: Meredith, what is your -- you have two perspectives I think probably, both from when you were at the Bureau and now at Capital One. How do you see things? How do they differ, you know, from the two perspectives?

MS. FUCHS: Well, I that starting with sort of where I am today, I think that we see technology as offering tremendous value potentially for our customers. I mean the opportunity to be able to provide services faster, to be able to do compliance testing in real time, to be able to identify and analyze information in a more effective and a deeper way than we do with our kind of existing models and existing practices is really exciting and it is something that we think a lot about.

How can you use these opportunities to do things like better detection of wrongdoing at the bank? How do you protect your customers from something that's going wrong? As well as eventually, one day, you know, how do you open up access to credit to people who otherwise might not have credit? I think some of that's talked about in the last panel. The thing is, with those opportunities there is all sorts of questions that we have, and a lot of new ethical dilemmas and things we are thinking about.

You know, Peggy alluded to the sort of coding of technology and how it can cause a small mistake to become a big mistake. So how do we deal with that to make sure that we're not building a system that brings us far afield from where we want to be. But also there is just simply errors and equity questions. So for example, the banking industry has obligations to try to open up access to credit to bring people into the financial system so that they can participate in the economy.

But, you know, when the computer is trying to make assessments about individuals, it might determine there's a lot of people who are not great risks, and they get pushed further outside, even though it's a policy matter that might not be what we want.

And certainly we have the challenge of all sorts of third parties that we deal with who have their black box algorithms, and we don't know what they say and what's in them. And that raises compliance challenges for us. We want to try to reach people through whatever mediums are out there, but we don't know whether those marketing firms, et cetera, want to use factors that we would never consider when we were doing our own work directly.

I also think a big challenge, and this kind of crosses over into the having been at the Bureau (inaudible) really just the transparency and supervise ability of these new technologies that we are planning to use and hoping to use. I think that, you know, we were talking earlier really just the transparency and supervise ability of these new technologies that were planning to use and hoping to use. And think that we were talking earlier about some data challenges that the Bureau faces.

You know each institution that's here in the room has different systems. They maintain their data in a different way. What happens to your examiner when they need to try to look (inaudible) and see a sense of it? Do they have to build, you know, a hundred systems or have -- and they make it something they can that they can do effectively.

So I think that's a big issue. And I also think from the Agency's perspectives probably, you know, people with different talent are going to be needed in the future and that's a hard thing in the federal government at least two kind of move from one model of staffing to a different model of staffing, not only is it because people tend to stay in federal jobs but also, you know, attracting tech talent is probably no easier for the Fed agency than it is for, you know, capital one.

So I think those are some of the big challenges that are going to be face to going forward and yeah, we shouldn't let all that stop us. Because, you know, the banking industry are highly regulated. We have these challenges, but our customers are expecting us to meet these challenges because in every other aspect of their life those challenges are being met. So we need to be able to do it as well.

MR. GUYNN: Thanks a lot. Well, I have about five more hours of questions about I we don't have that much time for the panel I'm told. So why don't we open it up to questions from the audience, and if no one is asking any questions I'll start going down my list of five hours of questions.

So I'm not sure how -- is there a microphone or how does this work?

MR. JENNINGS: I (inaudible). Let's do that.

AUDIENCE: I have a question for the Federal Reserve reps. So could you talk a little bit about how horizontal reviews are factored into the rating system? Ratings are pretty important as to whether or not banks can conduct business the way they like to do in this marketplace. So do they factor in and if so how? And if so, how does that affect timing of final ratings being decided through each of the (inaudible) current cycle?

MS. BURNS: So findings from horizontal reviews come together with findings from institutions (inaudible) one firm. You know, when we're assigning ratings we look across the totality of the findings we have and use that and former supervisory ratings. So they don't get any special emphasis, but more they are just (inaudible) because the finding comes from a horizontal review. They all just kind of meld together in how we think about, you know, overall the firm's financial condition and its quality of its controls and risk management.

How does it affect the timing? It shouldn't affect the timing. We typically assign our supervisory ratings cycle no less than annually. Occasionally we'll do it in term of upgrade or downgrade if we're finding findings from our exams positive or negative that suggest a change is needed. But we wouldn't necessarily hold a rating cycle open based on an ongoing horizontal examination. But we, again, we do think horizontals provide us an opportunity to understand and put it into perspective the various specific issues of individual firms.

AUDIENCE: This is a question about -- Jack, you mentioned SR letters and a particularly famous one, and other famous ones as well. Are SRs, and this is for Jennifer, or for Jack, are SRs, are they rules? Are they policy, or are they guidance? And regardless of which they are, or if they're some fourth thing, why have they not been submitted for notice and comment review under the Administrator Procedure Act? Or Congressional scrutiny under Congressional (inaudible)?

MR. JENNINGS: Well, I'll -- so of course I'll simply communicate what a rule is and that's something a little different. But no, they're not rules. They are considered to be guidance, and check me on this Jennifer.

So as I was in my (inaudible) it was becoming more and more the practice that in fact we wouldn't offer comments, on things that would be considered guidance, and were not rule makings. That was done, I think, for some of the things that we've talked about here to make sure it was adequate in the sense of both communication and due process that we were working in a vacuum. I think that it also, quite frankly was viewed as it would be helpful if we went through that process if we were challenged on some of the things.

In fact, as we talked about here, it's not a rule but we have high expectation here that we unless, you know, we should have on mitigating controls or whatever the situation may be unless you can -- and then we are expecting, or it could initiate a process of downgrade in ratings. And ultimately this is all about deciding whether or not something was sufficiently problematic in trouble some that it has a likelihood of becoming whatever again -- a safety and soundness issue, right. I mean that's always a fallback here.

And so I think that when something is put out for comment -- I think the rating system was put out for comment. There was some -- I was involved in that before I left. Just whether that needed or -- did or did not need to be put out. But in any event, I think that the belief is that the more that we do put out and transparent we are that the more likely that we are challenged, that is we -- the Federal Reserve is challenged that there would be a higher probability of success.

AUDIENCE: One of the things from the (inaudible) due process and (inaudible) possibly to guide institutions (inaudible) an issue for (inaudible) and supervise the other (inaudible)?

MS. BURNS: So we use to provide just an exam for reports and supervisory letters to firms which I share with them, to communicate the results of our work, we provide MRAs and MRIAs. There's a growing attention, there's a growing media attention to convey with some of -- in some -- to convey the severity which we think the issue has. In many cases, I will say that MRAs and MRIAs don't -- there's not an automatic if you have one there's a ratings downgrade.

In essence we're telling the firm we think you have a need to improve your practices in this area and it's essentially giving them time to address those issues before there are ramifications to a rating which has broader consequences than an MRA or a MRIA may have. That's not to say that if there is a pattern or practice consistent shortcomings across a variety of areas that that wouldn't escalate or result in and influence a ratings change. It absolutely would.

But we consider our communication and findings to be -- you know, provide for us with an opportunity to understand there are concerns with their practices and an opportunity to remediate those. You know, in most cases we hope that they will do that before the risk manifests in a material enough way that we need to make a ratings change.

MS. TWOHIG: So for the Bureau, we got comments, all kinds of comments, thank you in response to the request for information. Which actually we quite seriously are very grateful for as a start-up organization. We feel -- you know we had to start from scratch figuring out how do we do (inaudible)? How do we prioritize our limited resources across this fairly large first issue we have with banks among banks? Do we do ratings?

We had to kind of figure everything out from scratch. So it's kind of, I think, in our DNA to keep evaluating what we're doing, why are we doing it? Is it effective? So the comments that were provided are very helpful as we continue to ensure to grow our processes. For a while now we have used what we call -- well, first of all an examiner should be providing an institution which thoughts about what they're seeing, what they are observing, at least preliminary findings. I think that does happen.

Again, it might not be perfect, or up to everyone's expectations all the time, but I think that it does happen (inaudible). The basis for UDAP findings or serious regulatory findings, we've had a process for a while now, a potential action request to a response, which is a letter that puts the institution on notice officially that there's preliminary findings. It's always used with potential UDAPs and it's often used with potential serious regulatory foundations.

It's got two purposes. One is to make sure there's a formal document laying out what the preliminary findings are, and we want to make sure we've got the facts right and that we hear any legal analysis. We want to hear any counter arguments about why that's not a violation of the law. We also, typically, at that time, if it's serious are considering whether supervision should refer the matter to our enforcement colleagues for follow-up and with an investigation.

And we want to hear any policy reasons why that should not happen. We did have a comments in the area of (inaudible) process that some entities would like more time to respond to those letters. They would like opportunity to talk to lawyers who have done the analysis. At headquarters my team is organized by product market and we have experts in every product market and the laws that apply to those product markets, and we're the ones that support the exam teams and doing the analysis.

We also have equitable processes to run those findings by legal and/or regs colleagues as appropriate. So we have quite a bit of centralized input and review for consistency purposes into all of our legal findings and exams. So we did get that input that we should be giving more time for that dialogue, and that's something we'll be considering over time. Do you think -- do you want to just respond for a little bit?

MS. FUCHS: I think that, you know, what you all are hearing from some of the questions is, and I think both Jennifer and Jack did a very good job at the beginning sort of talking about where we were 10 years ago and like the journey that we've come to get here. But where we were 10 years ago, and certainly the Bureau was, you know, a creation of the financial crisis, right? It wouldn't exist if that hadn't happened.

Where we were 10 years ago was where we didn't have the even playing fields on these different institutions and businesses in terms of regulation. Where we had some unevenness as we described (inaudible) because things were not centralized. And so the reaction was this like dramatic centralized, hard lines in the sand, you know, like strong expectations. And today we're in such a different place, where, like, all these institutions that you regulate, many of them, certainly the banks, have evolved.

And so today we look at kind of what's going on, and we're told well, we really want to be judged based on who we are, what our business model is, what our business profile is and not sort of be bucketed or, you know, put into a place because either is a kind of concern about that.

So I think some of these questions are really kind of getting at how do we move to that place where the dialogue between the regulated entity and the regulator is one that is kind of very ongoing and doesn't have to immediately lead to adversarial-ness. And where the sort of evolution of their institution is being considered by our regulators as they're supervising us.

MR. GUYNN: Yeah.

AUDIENCE: My comment or Tom's comment are an observation on what Jennifer commented. I've been very struck in the last three or four years that working through some things (inaudible) myself, the number of times I've encountered the criticism that (inaudible) described and he was being very respectful, but they're held very strongly. And I (inaudible) but that's not what the Fed (inaudible) at all.

And I've come to realize that I think 90 percent of the time those criticism originate from a scenario that I find myself being (inaudible) where a firm feels that the goal has been moved or there's been a lack of due process, or they haven't been given proper notice or some (inaudible) that really could be resolved with just a little more dialogue. But they know that they're going to have to deal with that DST again, or that FSOGAN, or that TCP, or that horizontal again, and again, and again. And they, in the long run, they're very wary about retaliation from that (inaudible). And the issue isn't serious enough to begin to warrant triggering an actual appeal process.

But it's almost like Groundhog Day for me trying to find a way for the two sides just to talk a little further to understand each other. And I'm wondering if you -- if I can elicit from anyone, just a little more about ways to escalate the conversations but the firms have a way to escalate the conversations in a way that doesn’t make them feel vulnerable to retaliation. Because a lot of this is just misunderstanding and it can be resolved.

MS. BURNS: So I mean, of course we want open lines of communication with the firms at many levels. You had mentioned all those firms have decades of (inaudible) in place where there's ongoing interaction with them. You know there's also opportunities to talk with the folks that lead the horizontal programs and the horizontals exams where institutions, we would hope, would feel comfortable raising their concerns, offering additional information if that's, you know, what is needed. Providing another perspective that can be factored into the practice, or into the process and evaluation of a particular issue.

We also meet fairly regularly in the (inaudible) program, and we call it (inaudible) making revisions in the (inaudible) I guess. You know, meeting with the leaders of those firms on an ongoing basis, with the individuals in Washington and then individuals in the (inaudible) as well. So there are actually a lot of opportunities for firms to raise or share their concerns.

I understand that there is a natural, I'm sure, hesitancy. Because you want an ongoing productive relationship with your regulator. Believe it or not, we also want a productive interaction and relationship with the firms we supervise as well. And we do what we can to create those relationships so that firms are able to become more comfortable. You know, providing them perspective. I'm not sure there's more that we can do. We are always open to suggestions about that, but we think that building the relationships perhaps.

You know certainly I've talked a lot about trying to put findings and issues into perspective, even we -- we do truly believe that the individuals -- the best place to understand and manage a firm's risk is the management of the firm itself and you should have insights that we may not have. And you know, we want to hear those in putting our (inaudible) into our -- to put our perspectives into context. That's all I (inaudible). I would say there are going to be times when we have differences of opinion, and I think that's why we're here. But hopefully, we are open and make ourselves available to (inaudible) from firms.

AUDIENCE: And that's absolutely (inaudible) why I attend and (inaudible) and also I think you would say if you (inaudible) extraordinarily respectful, but it is (inaudible) and have a dialogue respectfully on a selective basis and then understand that that may or may not go your way.

MS. BURNS: I think that's right, and I will also say that it's not my -- I'm sure firms hold back at times, but I've had plenty of experiences where that has not been the case. So that's all (laughter drowns out).

MR. GUYNN: I think we have time for one more question.

AUDIENCE: And this is probably for Jennifer. The main complaint -- I have heard the very same complaint that he discussed, and it really involves more of the non (inaudible) firm. That the apparent lack of (inaudible) and transparency over the examination process, the supervisory process (inaudible) and the very lack of consistency across an agency. And the broad discretion without much question given to the chief examiner in that situation.

And they don't have an effective appeal ability, et cetera. But it really impacts those organizations, not just that day, but going forward. And I think it's a -- you know we're not seeing any kind of issuances from the Agency saying what governance and transparencies. We really are being placed it the middle, just (inaudible) has been -- and probably rightly so at the larger institution level. But I would think now is the time, if it hasn't already (inaudible) to really exercise some sort of better oversight, and perhaps better centralization of the exam process for the small institutions. Is there anything that could be shared with us? Anything that's going on in that sector?

MS. BURNS: So I think we strive for consistency of application across the (inaudible) institutions, across the (inaudible) that we organize them into. And there are, you know, actions that we are taking and have been focused on for a while to improve consistency. So there is (inaudible) so I need to mention for the hundreds who (inaudible) in this case. You know there is also a central governance committee who doesn't have the same decisioning responsibilities that the LICT or that the LICT program, but there is an ongoing sharing of perspectives, a vetting of ratings. The continuous horizontal exams for key areas of supervision, like capital planning activities and liquidity including risk management.

AUDIENCE: What about the (inaudible)?

MS. BURNS: And so the many --

AUDIENCE: (inaudible)

MS. BURNS: Exactly. So when you get to the statement or bank portfolio in particular and the (inaudible) original portfolio we are just launching now, a revised oversight program at the board that will undertake more use of horizontals where there will be folks that look at specific issues or sampling exams across districts as an example to see are we bringing similar ratings decisions, similar issues for similar fact patterns to create additional consistency.

I'm sure because -- to support additional (inaudible) so this is what we need to do, more training, making expectations more explicit so there are efforts under way. But as you point out, there are a lot of institutions. There are a lot of folks who are involved in the process. We spend a lot time on training. We have a, you know, various (inaudible). We will have to continue to work on that.

MR. JENNINGS: I was going to say, and I won't say much, but it will probably astonish you to hear me say that one of the biggest management challenges I had when I had the job over that portfolio there, was how many of those CPC (inaudible) firms felt a loss of empowerment as a result of the way that we had -- at least when I left that there was more centralization than they were used to. So it's a pretty broad spectrum across which we operate in terms of --

MR. GUYNN: Well, let me end with an observation as opposed to a question. But it's a very interesting observation.

The CFBD, sorry the Bureau recently had a letter that (inaudible) distinction of MRAs and supervisory recommendations which I thought was interesting and I think was good. One of the things that I think was lost in the supervisory process for the Federal Reserve was the experience of observations in favor of just MRAs and MRIAs. I think what that had led to is some -- I think some people questioned whether some of the MRAs were really material to safety and soundness, or whether they really would be observations. But since there's no observation category to put anything in, you either don't say it or you put it in the MRA category. And so you might actually see usefulness in reintroducing the idea of an observation category

And anyway, thanks a lot to the panelists. I think this has been a really interesting session.

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