

WRITTEN STATEMENT

KONRAD ALT, MANAGING DIRECTOR, PROMONTORY FINANCIAL GROUP, LLC

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Mr. Chairman and members of the Subcommittee, my name is Konrad Alt. Since 2004, I have been a Managing Director of Promontory Financial Group, based in our San Francisco office. Prior to joining Promontory, I held senior executive positions in the financial services industry and at the OCC, and served as counsel to this Committee. I am pleased to appear before you. My colleagues and I are grateful for your leadership on the important topic of this morning's hearing.

My firm, Promontory Financial Group, has served as a formally-designated independent consultant dozens of times, in connection with the enforcement activities of over a dozen different regulatory and law enforcement authorities, domestic and foreign. We believe our firm is well-suited to this role, and we take pride in these assignments. We appreciate, however, that the use of private-sector resources to further public purposes can present special challenges. We are pleased to discuss our experience with those challenges with this Subcommittee today.

Your invitation letter raised nine specific questions. I will address each of them in turn.

Promontory's Business Framework

Your first question asked that we address Promontory Financial Group's business framework and how independent consulting fits into that framework.

Broadly speaking, Promontory Financial Group's business centers on helping financial institutions meet their business challenges in a manner consistent with regulatory requirements and expectations. Clients typically come to us for assistance in strengthening a particular aspect of their risk management or corporate governance, or because they want an independent assessment of whether some aspect of risk management or corporate governance

needs strengthening. Our clients range from large, complex broker-dealers and central banks to credit unions and community lenders, and our work takes many forms. For example, we may be enlisted to help test risk models, run stress tests, administer compliance reviews, review board performance, perform a mock examination, or recommend improvements in operational risk reporting. Depending on the assignment, we can recommend improvements to strengthen corporate governance or risk management, bolster capital and liquidity, or better protect consumers. And, when approved to serve in a formally independent capacity, we can support the efforts of regulators by providing additional subject matter expertise or simply additional arms and legs.

Our assignments are often challenging. They require us to synthesize many different types of information, to perform complex analyses, and to formulate and deliver actionable recommendations, often under short deadlines. Our work can have important consequences for the institutions we work with, for the individuals who work in them, and for their customers. We have a responsibility to take these assignments seriously, and we do.

We believe that expertise, experience, and integrity are fundamental to our success, and we work hard to build and maintain a team of senior professionals who can deliver those qualities to our engagements. Many of our senior professionals have decades of experience. They know the laws and regulations deeply, and believe that compliance with them is centrally important to the fair and efficient operation of our financial system. More than that, they understand the expectations of financial regulators and can draw on their long experience to see where regulatory issues may arise.

Notwithstanding that regulators have approved the Promontory Financial Group as an independent consultant many times, these assignments comprise only a small part of our caseload, less than five percent of the nearly 1,500 engagements we have undertaken during the twelve years of our firm's existence.

Promontory's Experience as an Independent Consultant

Your second question asked that we address Promontory Financial Group's experience as an independent consultant.

Promontory Financial Group's business model requires us to bring a high level of independent judgment to all of our engagements, not just when we are formally designated as independent consultants. . If we merely told our clients what they want to hear, we would lose credibility when the regulators show up and tell them something different, and our business would suffer accordingly. We have to have sufficient expertise to diagnose the issues and the solutions accurately. We have to have the integrity to take our diagnosis to the most senior levels of management and the board, even when our news and views are unwelcome. And we must have enough tact and diplomacy to communicate a tough message in a way that leads to constructive action.

Our independent consulting assignments have involved over a dozen different regulatory authorities, including securities regulators, banking regulators and other law enforcement authorities, both domestically and internationally. These assignments have been disparate in nature. Many have focused on review of a specific body of transactions, such as, for example, the recently concluded foreclosure review assignments. Others have entailed evaluations of management teams or boards of directors. The scale and complexity of these assignments has also varied considerably. Some have been large, complex, and extended projects, but many have been quite small and narrowly-focused.

Qualifications of Independent Consultants

Your third question asked about the qualifications of independent consultants. Let me first address our view of the necessary qualifications and then speak to our experience working with regulators as they attempt to evaluate our qualifications.

Given my preceding comments, it should not surprise you that we believe the most important qualifications for independent consultants are subject matter expertise and integrity. Expertise

is particularly important. A consultant without sufficient expertise cannot accurately identify issues or appreciate their significance, and may not notice when something seems a little off and know to dig deeper for an explanation. That consultant is at risk both generally of doing a poor job and specifically of being unduly influenced by management views. But expertise is not enough. A consultant who lacks the integrity to deliver a tough message will, if a tough message is in order, deny the institution an adequately clear understanding of both the problem and the solution.

In our experience, regulators look for essentially the same qualities. Characteristically, before approving our firm to serve as an independent consultant, a regulator will ask us to answer a number of questions that go to both our expertise and our independence. To judge by the questions they pose in evaluating our credentials, most regulators take similar approaches to evaluating expertise. Typically, they will want to know both about our firm's experience working in the subject matter under review, and about the qualifications of the individual or individuals proposed to lead and carry out the engagement. For example, if Promontory were proposed to perform an independent review of a consumer compliance issue, we would expect the regulator to inquire about our firm's experience in performing similar reviews, and about the specific qualifications and experience of the individual or individuals slated to conduct the review on behalf of our firm.

The questions we receive relating to independence, by contrast, are more varied, and tend to focus on the presence or absence of red flags suggesting a potential conflict. For example, in my own recent experience, one agency seemed particularly concerned with establishing that members of our team were free from past employment relationships or personal investments that could compromise their independence. Another focused on the nature and extent of past business relationships. A third wanted assurance that we would structure the working relationships with the institution to maintain our independence appropriately, for example, by memorializing all communications with the institution for potential regulatory review. Regardless of the specific concerns of the agency involved, we cooperate fully with all requests

for information and, of course, accept the regulator's judgment as to our fitness for service as an independent consultant.

Working Relationships with Regulators and Financial Institutions

Your fourth and fifth questions asked about the working relationship between independent consultants, regulators, and financial institutions and the nature of regulatory oversight we experience. As these questions are related, I will address them together.

In our experience, regulatory agencies all employ a range of oversight methods with regard to the independent consultants that work for them. Not surprisingly, the nature and extent of regulatory oversight we experience varies according to the nature and complexity of the review in question. In a small project – for example, a short, independent review of the management team at a community bank – regulatory oversight may consist simply of presenting our final report to a regulatory examination team and responding to any questions they may have about our findings and recommendations. In larger, more complex assignments, regulators will commonly deploy additional oversight methods, which can include review and signoff on our review methodology; receipt of regular status reports, usually in writing and often in combination with periodic in-person or telephonic meetings; sampling of our results; review of our workpapers; review and signoff on preliminary findings and recommendations; and deployment of field examiners to monitor the conduct of our review teams. We welcome all of these oversight methods and cooperate fully with them.

Recognizing that the goal of an independent review is to satisfy the regulator's requirement and that, in performing an independent review, we are working for the regulator, we generally try to structure a working relationship with the regulator that is as transparent as we can make it. Transparency helps to ensure that any questions or concerns the regulator may have about our work surface proactively, and allows the regulator to have confidence that we are pursuing our responsibilities thoroughly and professionally. To facilitate transparency, we will often incorporate into our working relationship with the regulator some of the same practices I have just mentioned. For example, we may on our own initiative solicit regulatory feedback on a

proposed methodology or initiate periodic written or in-person status updates to the regulators.

Our practices in regard to the financial institutions involved are similar. In general, we strive to be transparent, to avoid surprises, and to build confidence that we are approaching the review in a manner well-suited to identify and address the issues that have triggered regulatory concern. And, as with the regulators, we pursue this objective primarily through regular communication.

Unless regulatory direction or some special characteristic of the assignment dictates otherwise, we commonly will provide the financial institution with our preliminary results, either as we develop them or in the form of a preliminary report. We do this primarily for purposes of fact checking. The institution has a strong incentive to highlight any information we may have missed or misunderstood, and we want our work to be as factually accurate and as complete as possible. Not incidentally, this practice is also helpful in enabling management to begin to understand and accept the results of our review. To help ensure that management pushback in this process doesn't compromise the independence of our review, we make it clear to management that we are soliciting factual corrections only, and often provide the same preliminary results simultaneously to the regulators. We carefully track both the responses we receive from the institution and the changes, if any, we make in response to them, so that regulatory personnel will have a complete audit trail in case they wish to evaluate whether we have maintained appropriate independence.

Potential for Compromised Quality

Your sixth question concerns the potential for preexisting contractual or business relationships to compromise the quality of consultant services.

In some circumstances, prior work with a particular institution will constitute an absolute bar to taking on an independent review assignment. We could not, for example, undertake to review

as an independent consultant issues or programs we had previously reviewed, and we have declined work in such circumstances.

More commonly, however, our prior work will not be related to the subject matter of the independent review. In those circumstances, prior to applying for the independent consulting assignment, we will try to make a judgment taking into account the nature of the prior work, the extent of past dealings, how long ago they occurred, and whether we have the ability to establish appropriate ethical safeguards to ensure that past relationships do not compromise our independence. We typically make these judgments in consultation with both the regulator and the institution involved. The regulator always has the final say.

The challenges we face in this area are not unique to our firm or to the work we do as a formally-designated independent consultant. All professional services firms, if they stay in business for any length of time, develop a history of past assignments and past clients, and must develop techniques for recognizing and mitigating the conflicts that such a history can present.

Promontory Financial Group seeks to safeguard its independence and the quality of its reviews in three ways.

First, we pay attention. We know that conflicts could compromise the quality of our work, or undermine confidence in our work, and we try to adopt and maintain reasonable safeguards to mitigate these risks. Depending on the issues presented, these safeguards have included the establishment of ethical walls, the prohibition of individuals with personal relationships or past employment histories with the client from serving on an engagement team, and prohibitions on soliciting other business from institutions where we have ongoing independent consulting responsibilities. In the recently concluded foreclosure review, for example, we established toll-free hotlines to allow all project team members to raise anonymously any concerns they might have about breaches of independence, and we supplemented those hotlines with recurring internal communications efforts, underscoring our commitment to independence, integrity,

and professionalism. When such safeguards are not sufficient, we can decline and have declined assignments.

Second, we can often structure the engagement in such a way as to enhance our independence, for example, by establishing that, in our dealings with the institution, we will report to an independent unit of management, such as the internal audit or risk function, or to an independent committee of the board of directors. Regulatory enforcement actions requiring the use of an independent consultant not infrequently require the establishment of a committee of independent directors to oversee the consultant's work. We have found such arrangements a useful safeguard in many engagements.

Finally, and most importantly, we maintain a senior team of professionals with strong personal stakes in their individual reputations, and the firm's collective reputation, for integrity and professionalism. We constantly impress upon that team the importance of maintaining those reputations by executing our engagement responsibilities with uncompromising professionalism. We have turned down and will continue to turn down business when we feel we cannot pursue it at a level of professionalism consistent with our standards.

Legal Obligations to Institutions and Regulators

Your seventh question asked what legal obligations Promontory Financial Group has to both the regulated financial institution and the financial regulator during an independent review.

Promontory Financial Group is not a regulated entity and we rarely contract directly with regulatory authorities. As a general matter, our legal obligations are set forth in detailed engagement letters that we enter into with the financial institutions that are the subject of our reviews. In situations where we serve as formally designated independent consultants, these engagement letters will often incorporate portions of the relevant enforcement action by reference. Although executed by Promontory Financial Group and the financial institution, these letters are commonly subject to regulatory review and, at regulatory direction, often include express language describing our obligations to regulatory authorities while serving as an

independent consultant. Although the financial institution may be our contractual counterparty in these engagements, the regulator is effectively our client and we serve at the regulator's pleasure.

Regulatory Activities that Independent Consultants Cannot Perform

The eighth question in your invitation letter asked that we address regulatory activities that independent consultants cannot perform, and inquired how we might report compliance issues we identify that are outside the scope of a particular assignment.

We believe the answer to the first part of this question is simple: consultants cannot perform regulatory activities. Regulation is the domain of public officials, accountable to Congress and the American people. Private consultants, independent or otherwise, are advisors, nothing more. We don't make regulations. We don't issue guidance. We don't assign examination ratings. And we don't bring enforcement actions. We can make recommendations to regulators but we cannot and do not perform regulatory activities. Even when we act as a formal independent consultant pursuant to a regulatory enforcement action, our findings and recommendations have no effect until and unless the regulators adopt them. In our experience, regulators all over the world take that review and approval responsibility seriously.

As to the second part of your question, our engagements always have a defined scope. We do not actively look for issues outside of that scope. How we would proceed if we nonetheless found such an issue would depend on the facts and circumstances of the situation. Whether we would escalate it to the attention of regulatory authorities might depend, for example, on whether the institution had already escalated the issue on its own initiative.

Other Relevant Policies and Practices

Your invitation letter's final question asks us to describe other practices that Promontory Financial Group has established to ensure high quality and consistent oversight of financial institutions.

In general, Promontory Financial Group is not in the business of providing oversight. As I have noted, we are consultants, not regulators. We may assist an institution in self-monitoring, a form of internal oversight, or we may, pursuant to a regulatory enforcement action, assist the oversight efforts of an agency at a particular institution.

In these activities, and in all of our activities, quality and consistency matter to us. Both domestically and internationally, my Promontory Financial Group colleagues and I have worked to build what we believe is the world's leading consultancy in our area of practice. We seek to promote quality principally by hiring the most experienced and expert talent we can find to lead our engagements, and then by giving those leaders the support they need to do their very best work. That support includes an outstanding pool of mid-level and junior talent to staff their engagements, as well as systems resources and education, training, and quality assurance programs to help them recognize and address consistency issues.

Concluding Observations

The use of private sector resources to support the activities of federal regulators raises a number of legitimate public policy questions. My colleagues and I applaud this Subcommittee's interest in seeking assurance that the firms enlisted in such roles are qualified, and can be depended upon to support the public interest without compromise. I hope my responses to the questions your invitation letter posed have been helpful. I will be pleased to address any additional questions you may have for me this morning.