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June 18, 2003

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## RISK MANAGEMENT CHALLENGES REMAIN FOR BANKS AMID RECORD EARNINGS

### FOR IMMEDIATE RELEASE

U.S. banks and savings institutions continue to face risk-management challenges in a number of key areas even as bottom-line earnings of insured institutions set new records, the FDIC said today. According to the Summer 2003 *FDIC Outlook*, the banking and thrift industries' combined net income topped \$105 billion in 2002, marking the first time that annual earnings have exceeded the \$100 billion benchmark.

Today's report is an update on how banks have been addressing their credit, market, and operational risks. Credit risks specifically discussed in the report include those associated with commercial loans, commercial real estate loans, and subprime consumer loans, while market and operational risks relate to how banks are responding to the unusually low interest-rate environment, as well as bank activities in financial markets and their internal controls and procedures.

"Despite the industry's strong financial performance during 2002 and in the first quarter of this year, we continue to monitor trends that could undermine earnings growth down the road," said FDIC Chairman Don Powell. "This is an opportune time for institutions of all sizes to review the effectiveness of their risk management processes."

Some of the concerns discussed in today's report relate to the narrow underpinnings of economic growth in recent quarters, which has resulted from low interest rates, home building and consumer spending, even as business investment and hiring have remained weak.

One area where future problems could develop, according to the report, is in bank commercial real estate portfolios. Weakening conditions in commercial real estate (CRE) markets have yet to translate into significantly higher losses for FDIC-insured



Congress created the Federal Deposit Insurance Corporation in 1933 to restore public confidence in the nation's banking system. It promotes the safety and soundness of these institutions by identifying, monitoring and addressing risks to which they are exposed. The FDIC receives no federal tax dollars — insured financial institutions fund its operations.

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institutions because of low interest rates, better market information, and increased funding from outside the banking industry. However, analysts warn that it is unclear how long these factors will continue to shield bank CRE portfolios from credit problems. In contrast, signs point to a long-awaited improvement in corporate credit quality, where large institutions have taken steps to reduce exposures, recognize losses and manage problem credits.

FDIC analysts report that subprime consumer lending remains a priority, given increased indebtedness on the part of household borrowers as well as the expansion of unsecured lending to less creditworthy borrowers. In addition, FDIC analysts and examiners continue to monitor net interest margin compression; interest rate and funding risks related to the unusually low interest rate environment; exposure to market-sensitive, non-interest income sources; and the adequacy of internal audit and other fraud controls.

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Today's *FDIC Outlook* also addresses a variety of regional developments including:

**Atlanta Region.** Revenue shortfalls and rising expenditures have contributed to weakening fiscal conditions among states in the region. These developments may challenge the regional economy and pressure credit quality at insured institutions.

**Chicago Region.** Concentrations in commercial real estate lending continued to rise at the region's insured institutions as market fundamentals in the larger MSAs weakened.

**Dallas Region.** Despite a sluggish economy, insured institutions based in the region report favorable conditions; however, some deterioration has occurred in the consumer loan portfolio. Rising debt levels may contribute to additional credit quality weakening.

**Kansas City Region.** The number of newly-chartered institutions has increased significantly in certain metropolitan areas during the past five years. These institutions performed well during the recent recession; however, continued economic weakness could pressure earnings and credit quality.

**New York Region.** Many of the region's states face budget shortfalls, which may worsen in the coming fiscal year. Job losses in the financial sector have disproportionately hurt New York City and Boston.

**San Francisco Region.** The region's travel sector remains vulnerable to a sluggish economic recovery and events abroad. Asset quality and earnings at insured institutions based in travel-dependent markets could deteriorate if weakness in this sector continues.

The Summer 2003 *FDIC Outlook* can be found on the FDIC website at [www.fdic.gov](http://www.fdic.gov).