Remarks
By
Donald E. Powell
Chairman
Federal Deposit Insurance Corporation
Before
The
Risk Management Planning Seminar
Of
The
Federal Financial Institutions Examination Council
San Francisco, CA.
October 11, 2001

Good afternoon. I'm Don Powell, Chairman of the FDIC. I'm glad so many of you could participate in this excellent conference on effective risk management. During the past thirty years, I've been involved in just about every aspect of banking. Now I'm wearing a different hat, but experience has taught me that one thing remains constant in our business, whether that business is banking or whether it is deposit insurance. In both businesses, effective risk management is the key to long-term success and survival.

So I want to thank Tuck Ackerman and his colleagues at the FFIEC for arranging this conference, and I also want to thank them for inviting me to talk to you to let you know a little of what's on my mind these days regarding risk management.

A small aside to Tuck: I'm flattered that you arranged for meeting space on a street named "Powell," but it really wasn't necessary. I would have been delighted to accept the invitation no matter where the meeting was held.

The conference agenda this year is focused on technology risk. However, I am not going to limit my remarks to that issue. Because of the tragic events of September 11, I think it is important that we also talk about the effect those events have had on us as a nation, on our economy, and on the banking industry.

So I want to talk a little bit today about America. I want to talk about how great this country is and the amazing way we have come together to respond to this crisis. Business and banking, regulating and being regulated. They are all important. But being an American is important too and I want to take a moment to reflect on the atrocity that took place on September 11 and what it means for our great country.

I've heard it said that there are four or five defining moments in each of our lives. They differ from person to person. A defining moment might be when you bury your mother or daddy, or when you fall in love and marry, or when you receive your hard-earned diploma or achieve success in your chosen profession. Holding your first child, or your first grandchild - that sure was a defining moment for me. Going off to war, and coming back again in one piece. They all can be defining moments.

Nations have defining moments, too. A week after the terrorist attacks, I was in the reception room of CNBC in Washington, waiting to go on TV to reassure people that their money was safe in FDIC-insured institutions. On the wall were framed front pages from newspapers of some of the most dramatic crises in this country's history. First, there was October 1929, the Great Stock Market Crash. A defining economic moment.

Then: December 1941 - the infamy of Pearl Harbor that sent an entire generation of young American men to war and changed the world.

Next: August 1945: The atom bomb. Defining moment. It helped bring an end to that terrible war, yes, but it ushered in a period of fear and uncertainty that hung over the entire world for decades. Many of you will remember so clearly, as I do, growing up with air raid drills and home made bomb shelters in back yards.

Next on the wall: November 1963. People will always remember where they were when they heard the news of Kennedy's assassination. How ashamed I was as a Texan that that terrible event took place in Dallas.

Defining moment.

The last picture on the wall in the reception room was the Gulf War: January 1991.

Now, we all know what the next picture to be put on the wall is sure to be: the horrible atrocity of September 11 of this year --- exactly one month ago today.

And if every one of us in this room lives to be 100, I am willing to bet that each of us will still remember exactly where we were when, thanks to technology, we were eyewitnesses to the unfolding of that terrible day.

September 11 was a defining moment for each of us individually, and it was a defining moment for our nation.

I am not ashamed to say straight out how much I love this country.

But I have never loved it more than now.

For the first time that I can remember, all differences and disagreements have been put aside and we have come together as one people. We came together as Americans before anything else. I have been profoundly moved, as you no doubt have, by the spontaneous expressions of unity and patriotism that have sprung up in the most unexpected places in the wake of 9-11.

No doubt about it, we got sucker-punched that day.

But you know what? The great thing was, our infrastructure held. Our system continued to function.

Think about it.

Of course we all felt fearful, hurt, and overtaken by a tremendous sense of grief. The markets were disrupted for awhile. So was transportation.

But the day after the attack, the needs of most people in this country were being met. Things we always take for granted, like electricity. Water. Food. There was basically no interruption in services to most people in the United States.

We were knocked down, but we were far from being knocked out.

America's infrastructure held.

Now, I would be lying to you if I told you that I knew exactly what the future holds. No one does, for sure. And it's okay to say we don't know. We've never experienced anything like this before, and, God willing, we never will again.

But I was reminded when I saw those front pages on the wall a couple of weeks ago that we have been through many ups and downs in our history, and we've not only survived, we have learned and grown.

Take the stock market crash of 1929.

We all know it was bad, but how many people here know that the amount of money lost IN THAT ONE DAY ALONE -- October 24, 1929 - exceeded the nation's annual budget by more than a third.

Imagine that. That would be equivalent of the markets taking a hit of more than $2.7 trillion in a single day today.

But we survived; we learned; and we moved ahead.

Now, the crisis of the banking panic in the wake of the Great Depression was what led to the creation of the FDIC.

In the past month, I've talked to reporters around the country whose readers are worried about the safety of their bank deposits in the wake of September 11.

I tell all of them the same thing: since the creation of the FDIC in 1933, no depositor has lost a single penny that was insured in a bank failure.

Not one single insured penny. And think of all we have gone through since 1933: World War II, Korea, Vietnam, other stock market crashes, the banking crisis in the late 80s and early 90s.

But FDIC-insured deposits have remained safe through every one of these times of peril and uncertainty. And they will continue to remain safe.

The fact is, the banking industry has successfully met every challenge I've mentioned so far, and more I haven't even touched on. In the wake of 9-11, we have been analyzing how the banking industry has responded to adversity and crisis in the past century. In every case, the banking industry provided a source of recovery and operated as an engine of real economic growth.

The banking industry is going to be that engine again this time. Our data show that by key measures, the industry is currently stronger than it has been over the past 50 years. In fact, it may be as strong or stronger than it has been at any time in history, despite the recent softening of the economy. This makes banks well-positioned to be engines of recovery from last month's terrorist attacks.

Now, you are all probably wondering when I am going to get around to talking about risk management, seeing as this is a conference about risk management. The answer is: right now.

I said at the outset of this talk that experience has taught me that effective risk management is the key to long-term success and survival.

The atrocity of September 11 was a dramatic illustration that no one can predict every possible disaster that might befall an insured bank. Rough estimates are that 26 banks and 52 other financial services firms maintained offices in the World Trade Center. Those offices, as well as the books, records, and computers they contained have vanished and are gone forever. And that does not even take into account the loss of irreplacable human capital - the thousands of employees whose lives were lost.

But financial institutions can survive tragedies like this if they do comprehensive planning and preparation for a full range of disasters. By "comprehensive," I mean planning risk management in the immediate, intermediate, and long terms - all three.

For example, many of those banks and other financial services firms that were located in the World Trade Center continue to function because they had comprehensive, up-to-date backup and contingency plans that have been implemented.

God forbid that any bank or business will ever have to face another terrorist attack. But banks and services have always been subject to both natural and man-made disasters -- such as hurricanes, floods, snowstorms, fire, chemical spills, riots, and more - that could potentially interrupt normal business operations.

Our experience has been that financial institutions that survive with a minimum of damage have done comprehensive planning and preparations. They have well-tested contingency plans that address a full range of different kinds of disasters.

An effective contingency plan should be based on the assumption that the bank cannot continue operations at its physical location due to natural disaster or some other unforeseen event.

And that plan should be tested annually, at least. Some large firms that had offices in the World Trade Center found their computer systems disrupted nationwide for days. That's because their servers were in one of the towers and their backup systems wouldn't come on line.

They had a plan --- but no one made sure it worked.

Of course, no contingency plan on earth can replace the people who deal with your customers and operate your systems. The tragic loss of life suffered by many companies at Ground Zero on September 11 underscores the need for all employees to be familiar with the bank's contingency plan.

I'd like to stress that I am talking about contingency plans for the entire bank, not just IT operations. And those plans should be updated as systems and circumstances change. That's the best way to manage immediate risk.

In the intermediate term, all of us are going to need to keep a close eye on economic risk factors, though I will stress again that overall the industry is perhaps stronger than it has ever been. However, some deterioration in the financial services industry was evident even before September 11th. Credit risk is rising in both the commercial and the consumer loan sectors and the number of problem banks is increasing. The results of the 2001 Shared National Credit review, which were recently released, indicate continued deterioration in the quality of syndicated credits. Criticized assets represent 9.4% of total commitments, up from 5.1% a year earlier.

And because of the events of September 11, we are concerned about some vulnerable industry sectors such as airlines, insurance, lodging, gaming, and securities brokers/dealers. Rising unemployment may also adversely affect the relatively small number of banks with subprime lending programs. Even before the economy slowed, these banks represented a disproportionate share of the industry's problem and failing banks.

Because of these economic risk factors, the FDIC will continue to heighten our risk monitoring efforts through risk-focused examinations and offsite risk identification tools.

That was the bad news. Here is the good news.

First, I firmly believe that bank management will always provide the first line of defense against loss.

Second, despite the negatives I mentioned a moment ago, the past years of solid profitability means that both capital and loan loss reserves - the bank's cushion, if you will -- are at high levels. The industry's Tier I capital "leverage" ratio increased from 7.68 percent to 7.73 percent during the first quarter of 2001. Loan Loss Reserves also increased by $1 billion, as loan-loss provisions exceeded net charge-offs by $911 million.

As a banker, I used to always say you can never have enough capital. As the FDIC Chairman, you had better believe I still feel that way. Good capital policy has put the industry in a strong position to support a recovery. And as the deposit insurer that makes us sleep better at night.

Third, as a general rule, bank asset portfolios are much more diverse than they have been in the past. Since I am a former banker with 30 years of experience in the industry, I can't stress too strongly the importance of a diversified portfolio. We all saw what happened during the last recession, when much of the credit risk growth was concentrated in real estate construction and development lending and leveraged financing. None of us wants to see that again.

There is still more good news. Inflation remains low, which has enabled the Fed to cut interest rates repeatedly. And even though the cuts have exacerbated earnings problems at many community banks in the short term, in the long term they should eventually stimulate overall economic growth. In addition, the government has shown its willingness to assist those ailing industries that were damaged most severely by the terrorist attacks, which will have a stabilizing effect.

What about risk management in the longer term?

Well, the transformation to a digital world is altering both the nature of risk and its impact. Our growing reliance on technologies, particularly Internet technologies, exposes banks to the ultimate risks - that the technologies are disrupted and criminals misuse them.

We've always understood that these networks are one of the battlegrounds on which terrorists will engage us. But now we understand just how much damage these terrorists are prepared to do.

So we need to do whatever it takes to stay on top of security and our vendor relationships. We must protect our part of the infrastructure, because as banks increase their dependence on new technologies, the consequences of an interruption of these services can become quite severe.

Also, as new products become available, banks should carefully plan the implementation of new technologies and fully understand the risks they present.

Fortunately, sound policies and controls, strong risk management techniques, and common sense - in other words, the basic principles of good banking - will allow us to handle the challenges we face. This is just as true for technology-driven activities as it is for traditional ones.

I'd like to close by coming full-circle. The defining moment of September 11 has been seared forever in our national consciousness. It was one of the bloodiest days in American history. We're going to be dealing with the consequences for years, on a variety of different levels. But America has never failed yet to rise to any new challenge, grapple with it, and emerge stronger than ever.

This is the great strength of America. I'm proud of our country as we rise to yet another new challenge, and I will work hard - along with all of you - to see that we meet it.

As a nation, we've been wounded.
But we have learned through hard experiences that wounds heal.
Ours will.
We must have faith.
Faith in ourselves.
And faith in each other.

Faith has gotten us through so much before, and through faith, we will prevail.

Thank you.

Last Updated 10/11/2001