A PRACTICAL VIEW OF RISK MANAGEMENT PLANNING
Opening Remarks by Robert P. Forrestal, President
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for the Federal Financial Institutions Examination Council
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Good morning! I am pleased to welcome you to this program on risk management planning, which has been organized by the Federal Financial Institutions Examination Council. In the banking atmosphere of today, bank and thrift executives need to focus on managing risk more than ever before. As we all know, managing a bank or thrift is no longer the staid and sheltered profession it used to be. I will not dwell on the numerous and profound changes that have taken place in the financial services industry, because each of you is as conversant as I am on this topic. It is clear, though, that those who run banks and thrifts are faced with an array of risks that are much more complicated than those faced by bankers in the 1950s and the 1960s.

The main risk that banks and thrifts have always faced is credit risk. To ensure that loans have a better-than-average chance of being repaid, loan officers carefully screen applicants to determine their creditworthiness. Indeed, most community banks and thrifts have a keen awareness of credit risk as part of their corporate culture. However, other areas of risk have become increasingly important, and these may not be commanding sufficient attention. These include interest rate risk, which can lead to considerable variation in earnings as interest rates fluctuate more than in the past. There are also risks associated with technology, given the rapid pace of change and the challenges of choosing and timing investment in new systems and equipment to maximize operational efficiency.

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So, financial executives confront many risks that were less significant 15 years ago. That is exactly why we are here today at this event mandated by the Financial Institutions Reform, Recovery, and Enforcement Act--popularly known as FIRREA--and why programs similar to this one are being held around the country. The sessions that follow will provide you with a good deal of technical information and specific advice on how to identify, analyze, and control these risks. My role this morning is one of a regulator, and in that vein I would like to outline briefly some of the current issues of concern to Bank supervisory agencies, particularly the Federal Reserve.

Current Issues of Supervisory Concern

Before I describe these concerns, I would like to reiterate a point I recently made to a meeting of the Community Bankers Association of Georgia. That is, in the broadest sense of risk management, many institutions can protect themselves by doing what they know best and by concentrating on doing it better. This principle is important to bear in mind because, in times of adjustment and transition such as these, it is very tempting to try to escape problems by leading an organization into areas different from traditional strengths.

More specifically, there are four areas to which institutions must pay particular heed: (1) developing a risk management plan; (2) communicating it to employees; (3) keeping directors informed; and (4) establishing an ongoing dialogue with their regulator. On the first point, your attendance at this seminar should help each of you to create a plan if you do not already have one or to refine the plan that you do have. The process of formalizing a risk management plan

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will help you to articulate your tolerance range for various kinds of risk.

Once you define how tolerant you are of each category of risk, it can become a value system for your employees--if you succeed in communicating it to them. While the Federal Reserve is a different kind of financial institution from banks and thrifts, the Atlanta Fed has gone through a similar process by establishing and communicating a set of core values. About six years ago senior management, with considerable input from employees, developed a corporate philosophy and set of values. Simply stated, these are integrity, quality service, and cost effectiveness. Since then we have worked hard to communicate them to the staff. Our main effort is now aimed at inculcating our new employees with these values during their orientation and first few months at the Bank. As I see it, such measures are necessary, because employees are becoming more professional. We must give today's workforce clear but broad guidelines--not 200-page procedures manuals--that they can use to make daily decisions based on their best judgment. Obviously, if employees know what the institution expects--for example, in terms of what is acceptable risk--will be able to do their jobs better.

However, again from a regulator's point of view, it is not enough merely to develop these guidelines and disseminate them to employees. It is vitally important that each bank and thrift also have a monitoring system in place to make sure that employees are following the stated guidelines. For instance, once a loan is made, an independent party should periodically review the status of the loan to see if it conforms to the guidelines in the risk management plan. Only then can management be sure that its policies are being followed correctly. This is essentially

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what examiners will also be evaluating. Federal Reserve and other examiners review many banks in the course of a year. They know that the successful ones do not rely on a memo posted near the door of the chief executive officer to convince employees to follow the guidelines. As the Atlanta Fed's pamphlet for new bank directors says, "Policies that are not followed are useless."

In addition to developing a risk management plan, communicating it to employees, and monitoring its effectiveness, it is crucial to keep directors informed. About 10 percent of the members of this audience are directors, I am told. It is very gratifying to have you here, because directors are equally responsible with managers for the safety and soundness of their institutions. Since regulators now share more information about examinations with directors, it behooves bank and thrift executives to involve directors in their risk management planning and to use the general business expertise that directors offer. I just mentioned a primer for new bank directors that the Atlanta Fed's Division of Supervision and Regulation recently sent out to the institutions it examines. This effort reflects just how important we believe the role of directors to be.

Finally, I would say that the communication between financial executives and regulators has become much better, if only because of the recent difficult times. Nonetheless, there is still room for improvement. In some senses, regulators see themselves as partners of banks and thrifts, providing advice about ways to work through problems. Naturally, we believe that the better the communication between bankers and examiners, the better able we will be to help to

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prevent a bank or thrift failure. I spoke earlier of the necessity to determine your tolerance for risk. As regulators, we have become somewhat concerned that bankers and thrift executives have perhaps interpreted our words in a way that we did not intend, as evidenced by the deceleration in loan growth. This situation is being called a credit crunch by some and a lack of credit demand by others. To clarify our intent, the Fed has recently sent out a letter to its state-chartered members. The purpose of the letter is to emphasize that we would like to hear the views of senior management on developments that are affecting the availability of credit to bank customers. Similar actions are being taken by other federal regulators. These efforts, I think, are proof that regulators want to work with you during this challenging time in the financial services industry.

Conclusion

In conclusion, I commend to you the many expert speakers on the schedule today and tomorrow morning. I believe this seminar on risk management is an important opportunity for financial institutions to strengthen themselves, and I am glad that you are here.

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