Letter from the Director

Supervisory Insights has now entered its third year of publication. As indicated in our first issue in June 2004, our goal is to provide a discussion forum on how regulatory policy is put into practice in the field, to share best practices, and to communicate information about emerging issues bank supervisors are facing. While we are witnessing the longest period in FDIC history without a bank failure, we continue to face new challenges. In this issue of *Supervisory Insights*, we address a number of those challenges.

Increasing risks in institutions' operational environments have contributed to an evolution in operational risk management practices. While traditional internal processes, audit programs, and insurance protection to address operational risk remain of paramount importance, recent operational risk management practices have included a significant trend toward more quantitative measurement. "Operational Risk Management — An Evolving Discipline" explores the various views on operational risk management, as well as the inclusion of a charge for operational risk management as part of the risk-weighted assets calculation under the Basel II framework.

The ability to respond to, and recover from, business disruptions is critical to the survival of institutions and to the customers and communities they serve. The past two hurricane seasons tested Gulf Coast institutions' business continuity plans. In 2005, 280 financial institutions, with approximately $270 billion in total assets, were operating in the areas affected by Hurricanes Katrina and Rita. The vast majority of these institutions were well run, had strong management teams, implemented sound backup contingency plans, and were well capitalized. Even so, six months after the storms, 214 institutions were still reporting some lingering effects, including closed branches and the need for temporary locations. "Banks and Hurricanes: A Look Back" discusses some of the challenges faced by institutions along the Gulf Coast, how they met those challenges, and the prominent role of their business continuity plans. We hope that this article will provide some context as banks prepare for the 2006 hurricane season.

This issue of *Supervisory Insights* also contains the third and final article in a series on fraud, the resultant losses to institutions, and the enforcement actions taken by the FDIC. The first article focused on a review of the enforcement action process and the increase in enforcement action activity since 2002. The second article discussed two cases of insider misconduct and highlighted internal control weaknesses that facilitated the misconduct. This final article, "Enforcement Actions Against Individuals: 2005 — A Year in Review," presents information on a year's worth of enforcement actions, including information on the extent to which these enforcement actions addressed fraud committed by senior bank management. While there were no bank failures in 2005, fraud, specifically fraud perpetrated by insiders, has been a contributing factor in many bank failures. We hope this series of articles will be of interest to banks' boards of directors and the executive officers responsible for implementing the boards' policies, as they review their systems of internal controls and reporting to ensure that they are adequate to identify and deter wrongdoing.

This issue's "From the Examiner's Desk" discusses how the new pricing information reported by mortgage lenders with the Home Mortgage Disclosure Act data has changed the fair lending supervisory and examination processes. The "Accounting News" feature highlights the key provisions of Statement of Financial Accounting Standards No. 123 (Revised) (FAS 123(R)) and its effect on banks' reported earnings and capital levels. The article also provides examples illustrating the basics of accounting for employee stock options awarded after FAS 123(R)'s effective date.

We encourage our readers to continue to provide comments on articles, to ask follow-up questions, and to suggest topics for future issues. All comments, questions, and suggestions should be sent to **SupervisoryJournal@fdic.gov.**

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