Federal Deposit Insurance Corporation
Annual Report Highlights 2006

FDIC

In its unique role as deposit insurer of banks and savings associations, and in cooperation with the other state and federal regulatory agencies, the **Federal Deposit Insurance Corporation (FDIC)** promotes the safety and soundness of the U.S. financial system and insured depository institutions by identifying, monitoring and addressing risks to the deposit insurance fund.

The FDIC promotes public understanding and the development of sound public policy by providing timely and accurate financial and economic information and analyses. The Corporation strives to minimize disruptive effects from the failure of banks and savings associations. In addition, the FDIC assures fairness in the provision of financial services and the sale of financial products.

The FDIC's long and continuing tradition of excellence in public service is supported and sustained by a highly skilled and diverse workforce that continuously monitors and responds rapidly and successfully to changes in the financial environment.

Annual Report Highlights 2006

Mission

The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress that maintains the stability and public confidence in the nation's financial system by insuring deposits, examining and supervising financial institutions, and managing receiverships.

Vision

The FDIC is a leader in developing and implementing sound public policies, identifying and addressing new and existing risks in the nation's financial system, and effectively and efficiently carrying out its insurance, supervisory, and receivership management responsibilities.

Values

Six core values guide FDIC employees as they strive to fulfill the Corporation's mission and vision:

Integrity

FDIC employees adhere to the highest ethical standards in the performance of their duties and responsibilities.

Competence

The FDIC maintains a highly skilled, dedicated, and diverse workforce.

Teamwork

FDIC employees work cooperatively with one another and with employees in other regulatory agencies to accomplish the Corporation's mission.

Effectiveness

The FDIC responds quickly and successfully to identified risks in insured financial institutions and in the broader financial system.

Financial Stewardship

The FDIC acts as a responsible fiduciary, consistently operating in an efficient and cost-effective manner on behalf of insured financial institutions and other stakeholders.

Fairness

The FDIC treats all employees, insured financial institutions, and other stakeholders with impartiality and mutual respect.

Message from the Chairman • Sheila C. Bair

I am pleased to present the Federal Deposit Insurance Corporation's (FDIC) 2006 Annual Report (also referred to as the Performance and Accountability Report). The condition of the banking and thrift industry continues to be healthy and profitable and 2006 saw continuation of the longest period in the Corporation's 73-year history without a failure of an FDIC-insured institution — a record 31 months. Nevertheless, we continued in 2006 to actively pursue our mission of ensuring the stability of and public confidence in the nation's financial system.

The past year was a particularly significant one for the FDIC. On February 8, 2006, President Bush signed into law the Federal Deposit Insurance Reform Act of 2005, culminating a lengthy, multi-year effort by the FDIC, the Administration, and the Congress to make sweeping improvements to the federal deposit insurance system. The law requires the FDIC to make fundamental changes in its deposit insurance policies and business processes in 2006 and 2007, and we are well on our way toward full compliance with the provisions of that Act.

We focused much of our attention during 2006 on three high priority areas of activity: (1) addressing significant policy issues, (2) maintaining a strong supervisory program, and (3) concentrating our efforts on promoting economic inclusion. I would like to share with you some of our major successes during 2006 and some of our challenges for 2007 and beyond.

Policy Challenges

In accordance with the requirements of the deposit insurance reform statute, the FDIC in early 2006 merged the Bank Insurance Fund and the Savings Association Insurance Fund into the new Deposit Insurance Fund, and adopted new regulations increasing coverage for certain retirement plan deposits from $100,000 to $250,000. This was the first major change in deposit insurance coverage since 1980. The reform statute also provided the FDIC Board of Directors (Board) with greater flexibility to manage the Deposit Insurance Fund. The Board adopted final rules on a new assessment system that will make assessments more risk-sensitive and distribute the assessment burden more fairly across insured institutions, and it established new premium rates effective for deposit insurance beginning January 1, 2007. In addition, the Board adopted final rules on the distribution and use of $4.7 billion in one-time assessment credits, a temporary plan for the allocation of future dividends, and a designated reserve ratio. In 2007, the FDIC will complete and issue guidance on how limited adjustments may be made in the pricing of deposit insurance for large banks and publish an advance notice of proposed rulemaking seeking comment about how to implement a permanent dividend system.

Capital reform was a major area of focus in 2006. The FDIC continued to work with the other federal regulators and to participate actively on the Basel Committee on Banking Supervision, and many of its subgroups, in planning for the implementation of the new Basel II capital framework. The Board approved in September 2006 the publication of a notice of proposed rulemaking (NPR), jointly with the Federal Reserve Board, the Office of the Comptroller of the Currency and the Office of Thrift Supervision, seeking comment on draft regulations to implement the advanced approaches of the Basel II Accord. As a result of the findings in the fourth quantitative impact study (QIS-4), which examined the potential impact that the Basel II capital framework might have on the minimum risk-based capital requirements of a select group of financial institutions, safeguards were incorporated into the Basel II NPR to protect against an unacceptable decline in minimum risk-based capital requirements.

On December 5, 2006, the Board also approved the publication of a second NPR seeking comment on draft regulations to implement a new capital framework, referred to as Basel IA, which banks that do not use the Basel II capital framework may opt to apply. The Basel IA NPR was also issued jointly with the Federal Reserve Board, the Office of the Comptroller of the Currency and the Office of Thrift Supervision.

Both draft regulations represent an effort to enhance the risk sensitivity of the existing risk-based capital framework while maintaining safety and soundness within the banking and thrift industry. Throughout the interagency deliberations on both Basel II and Basel IA, the FDIC has maintained an unwavering commitment to the maintenance of strong capital requirements and to the principle that any changes to these requirements should have a minimal impact on competitive equity among banks of all sizes. In 2007, the FDIC will continue to provide leadership in this effort. It will explore the potential of using simplified approaches as an alternative to the advanced approaches in the Basel II Accord and, with the other banking agencies, work to achieve consensus on the overall package of regulatory capital changes for final publication.

Another significant policy challenge is presented by the continuing consolidation in the banking industry. While this presents challenges for all federal banking regulators, it poses unique issues for the FDIC because of its multiple roles as regulator, deposit insurer, and receiver. Fortunately, the banking industry and our largest banks are strong and have made many improvements to their risk management processes in recent years. Even so, the FDIC must be prepared to respond to instability in any size insured institution. To meet these challenges, the FDIC continues to enhance its capabilities to protect insured depositors and maintain stability in our banking system. Some of the initiatives involved in this ongoing process are contingency planning exercises, system and process improvements for determination of deposit insurance claims and management of failing bank assets, consultations with domestic and international regulators, improvements to the FDIC's supervisory program for larger banks, and the designation of internal and external expertise to focus on larger bank issues. This effort will continue and evolve as the challenges change in the future.

Matters that received significant public interest in 2006 included applications to the FDIC for deposit insurance filed by commercial companies for proposed industrial loan companies (ILCs). To obtain the public's insight on the issues, on July 28, 2006, the FDIC placed a six-month moratorium, ending on January 31, 2007, on ILC deposit insurance applications and change in control notices to give the FDIC time to assess developments in the ILC industry; to determine whether any emerging safety and soundness or policy issues exist; and to evaluate whether statutory, regulatory or policy changes need to be made in the oversight of these institutions. The moratorium also allowed FDIC time to further evaluate the various issues, facts and arguments raised in connection with the ILC industry, and to assess whether statutory or regulatory changes or revised standards and procedures for ILC applications and supervision are needed to protect the Deposit Insurance Fund or important Congressional objectives. In August, the FDIC Board requested public comment on a broad range of ILC-related issues. During the 45-day comment period that ended on October 10, 2006, we received more than 12,600 comments which were carefully and thoroughly evaluated.

Supervisory Program

In addition to managing an unusually large policy agenda, the FDIC also continued to administer strong and effective supervisory programs in 2006 in both the risk management and compliance areas. The FDIC performed 2,388 safety and soundness examinations, 1,959 compliance and Community Reinvestment Act exams and 3,052 specialty exams.

During the year, the FDIC enhanced the quality of fair lending examinations through the use of residential mortgage pricing data. This year represented the first opportunity for the FDIC to use pricing data collected by financial institutions pursuant to the 2004 changes to the Home Mortgage Disclosure Act. Also in 2006, the FDIC established the Large Bank Program to address challenges associated with supervising and insuring the deposits of large and complex institutions. In addition, the FDIC completed and issued guidance on concentrations in commercial real estate. This guidance provides supervisory criteria to assist in identifying institutions with significant concentrations of commercial real estate.

Further, the FDIC became increasingly concerned with the expansion of nontraditional mortgage products and the potential risk posed by these products to the DIF. To address these concerns, the FDIC implemented certain enhancements to the supervisory oversight of nontraditional mortgage banking activities and, with the other financial institution regulatory agencies, developed and issued guidance to address the growing risks in these loan products.

During the year, the FDIC conducted a comprehensive review of the compliance examination program's workload and resources. Based on workload projections, we identified the need for additional staffing in this area. In December, the Board authorized 72 new examiner positions to be phased in over a three-year period with the majority added in 2007. This will result in an increase of human resources dedicated to the compliance and CRA examination areas.

Reflecting our commitment to provide current and consistent guidance for examiners and banking organizations to comply with the Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) requirements, we worked closely with the other federal banking regulators to revise the Federal Financial Institutions Examination Council (FFIEC) BSA/AML Examination Manual. The FFIEC BSA/AML Working Group, which the FDIC chairs, collaborated with other federal banking agencies and the Financial Crimes Enforcement Network (FinCEN) on the revision project.

Promoting Economic Inclusion

The FDIC has long been committed to bringing all segments of society into the financial mainstream. This year, the Board approved the establishment of the FDIC Advisory Committee on Economic Inclusion to provide the FDIC with advice and recommendations on important initiatives focused on expanding access to banking services by underserved populations. The Committee members represent a broad cross section of interests from the banking industry, state regulatory authorities, government, academia, consumer and public advocacy organizations, community-based groups and others impacted by banking-related practices.

This year, the FDIC took two important steps to focus attention on the need for affordable small-dollar loan products. First, the FDIC released *Affordable Small-Dollar Loan Guidelines* for public comment. The guidelines explore several aspects of product development, including affordability, streamlined underwriting and savings. Second, the FDIC hosted a conference in December on meeting the needs of military personnel and their families, who are frequently turning to high-cost providers for short-term loans and other financial services. The banks that attended the conference developed a template for an affordable, small denomination loan product with a savings component. We will continue to work with the industry to find ways to promote both affordable short-term loan products and creative ways to encourage savings.

To reach an even wider audience of unbanked and underbanked with our successful *Money Smart* financial education program, this year the curriculum was released in Russian, large print and Braille. Release of the Braille and large-print versions was the first time that a financial education program has been specifically targeted for individuals with visual impairments. The FDIC also completed development of a Spanish-language version of our online Electronic Deposit Insurance Estimator and a Spanish-language video on federal deposit insurance coverage.

As part of our ongoing effort to help combat identity theft, we continued to take a leadership role in consumer education initiatives and released an online training tool called *Don't Be an Online Victim: How to Guard Against Internet Thieves and Electronic Scams*. The training tool is available through the FDIC's Web site and via disc.

In 2006, we continued to analyze the economies adversely affected by Gulf Coast hurricanes and worked closely with banks and consumers to address issues of concern. We also worked closely with other federal and state regulatory agencies to issue guidance outlining examination procedures for assessing the financial condition of institutions adversely affected by the hurricanes. The FDIC, working jointly with NeighborWorks® America, released a homeownership and financial counseling guide called *Navigating the Road to Housing Recovery in the Gulf Coast*. This guide was a focal point of an FDIC/NeighborWorks® Gulf Coast Housing Summit held in New Orleans in October that was attended by bankers, housing experts, homeownership counselors and others.

Conclusion

Finally, I am pleased to note that we were able to enhance our efforts in each of our major business lines during 2006 while maintaining strong fiscal discipline. As detailed elsewhere in the report, the FDIC has had an extraordinary record of controlling its operating expenses over the past five years. Spending against the FDIC's operating budget in 2006 was 18 percent lower than it was in 2002, due primarily to a 27 percent reduction in the Corporation's staffing and limited resolution and receivership management activities during that period. These staff reductions completed more than a decade of downsizing that followed the Corporation's rapid workforce buildup to address the banking crisis of the late 1980s and early 1990s. I am indebted to my predecessor, Donald Powell, for his efforts to move the FDIC past the difficult era of downsizing, and for leaving me with a revitalized workforce that is eager and willing to address the new and emerging challenges to the safety and stability of our banking system.

Our agenda for 2007 will be full of challenges. Along with continuing to implement the changes brought about by deposit insurance reform, we will focus our energies on continuing to ensure the safety and soundness of our banking system, the effectiveness of our consumer protection efforts and the efficiency of our internal operations.

On a personal note, I would like to say that I am honored to serve as the 19th Chairman of the FDIC. Having been sworn in as Chairman on June 26, 2006, I clearly joined the FDIC at a critical – but exciting – time for the agency and the industry. I look forward to working alongside our outstanding Board and the dedicated employees of the FDIC as we face the challenges of the future together.

Sincerely,

Sheila C Bair

Sheila C. Bair

Message from the Chief Financial Officer • Steven O. App

I am pleased to join Chairman Bair in presenting our 2006 Annual Report. The report covers financial and program performance information and summarizes our successes for the year. The FDIC takes pride in providing timely, reliable and meaningful information to its many stakeholders.

As a result of the passage of deposit insurance reform legislation, the Bank Insurance Fund and the Savings Association Insurance Fund were merged on March 31, 2006, to create the Deposit Insurance Fund (DIF). Overall, the combined fund remained financially sound throughout the year and I can proudly report that the U.S. Government Accountability Office (GAO), for the fifteenth consecutive year, issued unqualified audit opinions on the annual financial statements for both funds administered by the FDIC – the DIF and the Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund. These unqualified audit opinions validate our efforts to ensure that the financial statements of the funds for which we are stewards are fairly presented. This achievement also exemplifies the hard work and dedication of the FDIC staff.

FDIC's financial highlights during 2006 include:

In 2006, DIF's comprehensive income totaled $1.6 billion compared to $1.1 billion in 2005, a year-over-year increase of 44 percent. Excluding the recognition of exit fees earned of $345 million (a one-time adjustment), comprehensive income rose by $133 million from a year ago. This year-over-year increase is primarily due to a decrease in the unrealized loss on available-for-sale (AFS) securities of $348 million, which was offset by decreases in both interest earned on U.S.Treasury obligations of $101 million and the negative provision for insurance losses of $108 million.

The significantly lower unrealized loss on AFS securities primarily resulted from: 1) a smaller total market value of AFS securities, 2) a lower average duration for the AFS securities, and 3) a smaller increase in the market yields of the AFS securities. However, the lower unrealized loss was partially offset by a decrease in interest revenue on U.S.Treasury obligations that resulted from lower inflation compensation on Treasury Inflation-Protected Securities.

During 2006, we continued our efforts to control costs and to prudently manage the funds administered by the FDIC. Annual budgeted operating expenditures in 2006 totaled approximately $973 million, which represents a decline of $17 million (1.7 percent) from 2005. As Chairman Bair indicates in her message, the FDIC has an exceptional record of controlling its budgeted operational spending, which declined by $216 million (18 percent) from 2002 to 2006. The FDIC Board of Directors, on December 5, 2006, approved a 2007 Corporate Operating Budget totaling $1.1 billion, a modest 4.6 percent increase over the 2006 budget, largely due to the cost of employee pay increases negotiated for 2007.

Capital investment spending also declined substantially in 2006 to $25 million. In 2006, we completed two major investment projects, the Virginia Square Phase II building and the New Financial Environment (NFE) (an integrated state-of-the-art financial system), reducing to three the inventory of active investment projects. This is down from a high of ten active projects in 2003 and 2004. In late 2006, the FDIC Board approved a new investment project, an insurance claims determination system. It is the first new investment project approved since 2003. Investment spending is projected to total between $19 million and $23 million in 2007.

We are especially proud of our staff for the successful completion of Virginia Square Phase II – an outstanding facility that should serve the Corporation well for years to come. The project was completed on time and under budget, and has begun to yield substantial cost savings for the FDIC. We are also beginning to explore how to leverage the enhanced capabilities of the NFE to continue to improve our financial and cost management.

In accordance with the requirements of the Federal Managers' Financial Integrity Act of 1982, the FDIC's management conducted its annual assessment and concluded that the system of internal controls, taken as a whole, complies with internal control standards prescribed by the GAO and provides reasonable assurance that the related objectives are being met.

Looking ahead to 2007, the FDIC will continue to work toward sound management of the Corporation's financial and other resources.

Sincerely,

Steven O. App

Steven O. App

I. Management's Discussion and Analysis

The Year in Review

During 2006, the FDIC faced many high-profile policy issues, ranging from deposit insurance reform, to capital reform, to the appropriate role of industrial loan companies. In addressing these issues the Corporation published numerous notices of proposed rulemaking throughout the year, seeking comment from the public, and issued final rules to implement most of the components of deposit insurance reform legislation enacted early in the year. The Corporation also maintained its emphasis on a strong supervisory program, and pursued financial education and outreach initiatives focusing primarily on those adversely affected by Hurricanes Katrina and Rita and those not participating in the banking system. For the second year in a row, there were no insured institution failures, reflecting the continued strong health of the banking and thrift industry.

Highlighted in this section are the Corporation's 2006 accomplishments in each of its three major business lines – Insurance; Supervision and Consumer Protection; and Receivership Management – as well as its program support areas.

Insurance

The FDIC insures bank and savings association deposits. As insurer, the FDIC must continually evaluate and effectively manage how changes in the economy, the financial markets and the banking system affect the adequacy and the viability of the deposit insurance fund.

Deposit Insurance Reform

In February 2006, the President signed into law the Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005. These new statutes instituted most of the key changes in the deposit insurance system that the FDIC had been pursuing for the previous five years:

- Merges the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into the new Deposit Insurance Fund (DIF).
- Permits the FDIC's Board of Directors to price deposit insurance according to risk for all insured institutions, regardless of the level of the reserve ratio.
- Grants a one-time initial assessment credit of approximately $4.7 billion to recognize institutions' past contributions to the combined fund.

- Establishes a range for the Designated Reserve Ratio (DRR) of 1.15 percent to 1.50 percent, and allows the FDIC to manage the reserve ratio within this range. Also requires that, if the reserve ratio falls below 1.15 percent or is expected to do so within six months, the FDIC must adopt a restoration plan that provides that the DIF will return the reserve ratio to 1.15 percent within five years.
- Generally mandates dividends to the industry of one-half of any amount above the 1.35 percent level and of all amounts in the fund above the 1.50 percent level.
- Increases the coverage limit for certain retirement accounts to $250,000 but leaves the basic insurance limit for other deposits at $100,000.
- Indexes both coverage limits for inflation, and allows the FDIC (in conjunction with the National Credit Union Administration) to increase the limits every five years beginning January 1, 2011, if warranted.

Implementation of deposit insurance reform was a major initiative for the FDIC in 2006. On March 14, 2006, the Board adopted an interim final rule implementing the substantive changes to the FDIC's insurance coverage rules, effective April 1, 2006. (The final rule was adopted on September 5, 2006.) In addition, the FDIC merged the BIF and SAIF into the newly-created DIF, effective March 31, 2006, and adopted all of the required implementing regulations prior to the statutory deadline effective date of July 1, 2006.

On October 10, 2006, after considering comments on a notice of proposed rulemaking (NPR) published in May 2006, the Board adopted a final rule governing the distribution and use of the $4.7 billion one-time assessment credit. After considering comments on another NPR published in May 2006, the FDIC Board also adopted on October 10, 2006, a temporary final rule governing dividends from the DIF. Under this temporary rule, any dividend will be distributed based upon an institution's portion of the December 31, 1996, assessment base. In 2007, the FDIC will undertake a more comprehensive rulemaking on dividends to replace the temporary rule.

On November 2, 2006, after considering comments on an NPR published in July 2006, the Board adopted a final rule setting the DRR at 1.25 percent. The Board also adopted two final rules governing assessments after considering comments on NPRs published in

May and July 2006. One of these rules makes operational changes to the assessment system. Under that rule, assessments will be determined and collected after the end of each quarter, which will permit consideration of more current supervisory information and capital data. Among its other provisions, the rule requires larger institutions to use average daily deposit balances as the basis for assessments.

The other rule establishes new assessment rates based on four new risk categories. Effective January 1, 2007, assessment rates will range from 5 to 7 basis points for Risk Category I institutions and will be 10 basis points for Risk Category II institutions, 28 basis points for Risk Category III institutions and 43 basis points for Risk Category IV institutions. Base assessment rates range from 2 to 4 basis points for Risk Category I institutions and are 7 basis points for Risk Category II institutions, 25 basis points for Risk Category III institutions and 40 basis points for Risk Category IV institutions. The Board retains the flexibility to adjust rates in the future, within limits, without further notice-and-comment rulemaking.

Capital Standards

The FDIC, as insurer, has a substantial interest in ensuring that bank capital regulation effectively serves its function of safeguarding the federal bank safety net against excessive loss. During 2006, the FDIC participated on the Basel Committee on Banking Supervision and many of its subgroups. The FDIC also participated in various U.S. regulatory efforts aimed at interpreting international standards and establishing sound policy and procedures for implementing these standards.

One of the FDIC's key objectives has been to ensure the adequacy of insured institutions' capital under Basel II. In 2006, the FDIC devoted substantial resources to domestic and international efforts to ensure that the new capital rules are designed and implemented appropriately. These efforts included the publication in September 2006 of an NPR seeking comment on draft rules for Basel II and revisions to the Market Risk Rule and the continued development of examination guidance, which is intended to provide the industry with regulatory perspectives on implementation.

The findings of the fourth quantitative impact study (QIS-4), which were completed in 2005, suggested that, without modification, the Basel II framework could result in a significant decline in minimum risk-based capital requirements. As a result, several safeguards were incorporated into the Basel II NPR to protect against a significant decline in minimum risk-based capital requirements. These safeguards included a one-year delay in the targeted effective date of the regulation, a longer transition period, limitations on the amount that risk-based capital at individual banks could decline during the transition period, the retention of the U.S. leverage ratio and Prompt Corrective Action requirements, and a 10 percent downward limit on the aggregate reduction in minimum risk-based capital that could result from the implementation of Basel II.

The FDIC is actively involved in efforts to revise the existing risk-based capital standards for those banks that will not be subject to Basel II. These efforts, referred to as Basel IA, are intended to modernize the risk-based capital rules for non-Basel II banks to ensure that the framework remains a relevant and reliable measure of the risks present in the banking system and to minimize potential competitive inequities that may arise between banks that adopt Basel II and those banks that remain under the existing capital rules. The revisions proposed in the Basel IA NPR are anticipated to be finalized by domestic bank and thrift regulatory authorities in 2007 for implementation in January 2008. The Basel IA NPR was published in the Federal Register for public comment in December 2006.

Center for Financial Research

The FDIC's Center for Financial Research (CFR) co-sponsored two research conferences during 2006. The 16th annual Derivatives Securities and Risk Management Conference, which the FDIC co-sponsored with Cornell University's Johnson Graduate School of Management and the University of Houston's Bauer College of Business, was held in April 2006. In addition, the CFR and the *Journal for Financial Services Research* (JFSR) sponsored their sixth annual research conference in September 2006. The conference attracted academics from U.S. and foreign universities, U.S. and foreign bank supervisors, congressional staff, consultants and bankers. As a part of the conference, the CFR sponsored a symposium entitled "U.S. Implementation of Basel II," at which academics and U.S. and foreign bank regulators presented 12 research papers analyzing the potential effects of the new capital standards.

Thirteen CFR working papers were completed and published in 2006 on topics dealing with risk measurement, capital allocation, deposit insurance, community development or regulations related to these topics. The CFR Senior Fellows met in January 2006 to discuss ongoing CFR research on Basel II, deposit insurance reform, developments in the area of consumer finance and CFR activities for the coming year.

Central Data Repository

The FDIC continued to leverage its investment in the Federal Financial Institutions Examination Council's (FFIEC) Central Data Repository (CDR). The CDR streamlines the collection, validation and publication of financial institutions' Call Report data. The CDR was used to successfully collect

Call Report data from approximately 8,000 reporting institutions for each quarter of 2006. The FFIEC also began work during 2006 on enhancing the CDR to publish data to the public and produce bank performance reports, and an interagency team began work on modifications that will increase the flexibility of the CDR to process additional data series.

Risk Analysis Center

The Risk Analysis Center (RAC) was established in 2003 to provide information about current and emerging risk issues. It is staffed with employees on detail from each of the FDIC's three business lines. The RAC uses interdivisional teams to analyze selected risk areas and carry out special projects which culminate in presentations and reports regarding these risk issues. The activities of the RAC are guided by the National Risk Committee, which is chaired by the Chief Operating Officer. In 2006, major projects of the RAC focused on collateralized debt obligations, operational risk, and the housing sector/alternative mortgage products. The RAC also reported to the National Risk Committee on a variety of other topics, including economic conditions, industry risk exposure, credit underwriting practices, and consumer protection issues.

Supervision and Consumer Protection

Supervision and consumer protection are cornerstones of the FDIC's efforts to ensure the stability of and public confidence in the nation's financial system. The FDIC's supervision program promotes the safety and soundness of FDIC-supervised insured depository institutions, protects consumers' rights, and promotes community investment initiatives. In addition to carrying out its established examination program and other supervisory activities, the FDIC initiated in 2006 a substantial expansion of its programs to promote economic inclusion and confronted difficult policy issues regarding industrial loan companies.

Examination Program

The FDIC's strong bank examination program is the core component of its supervisory program. At year-end 2006, the Corporation was the primary federal regulator for 5,237 FDIC-insured state-chartered institutions that are not members of the Federal Reserve System (generally referred to as "state nonmember" institutions). Through safety and soundness, consumer compliance and the Community Reinvestment Act (CRA), and various specialty examinations, the FDIC assesses their operating condition, management practices and policies, and compliance with applicable laws and regulations. The FDIC also educates bankers and consumers on matters of interest and addresses consumers' questions and concerns.

In 2006, the Corporation conducted 2,388 statutorily-required safety and soundness examinations, including a review of Bank Secrecy Act compliance, and all required follow-up examinations for FDIC-supervised problem institutions within prescribed timeframes. The FDIC also conducted 1,959 CRA/Compliance examinations (777 joint compliance-CRA examinations, 1,177 compliance-only examinations,[1] and five CRA-only examinations) and 3,052 specialty examinations. All compliance/CRA examinations were also conducted within the time frames established by FDIC policy, including required follow-up examinations of problem institutions. The accompanying table compares the number of examinations conducted in 2004, 2005 and 2006 by type.

FDIC Examinations 2004-2006

	2006	2005	2004
Safety and Soundness:			
State Nonmember Banks	**2,184**	2,198	2,276
Savings Banks	**201**	199	236
Savings Associations	**2**	1	0
National Banks	**0**	0	0
State Member Banks	**1**	1	3
Subtotal - Safety and Soundness Examinations	**2,388**	2,399	2,515
CRA/Compliance Examinations:			
Compliance-Community Reinvestment Act	**777**	815	1,459
Compliance-only	**1,177**	1,198	673
CRA-only	**5**	7	4
Subtotal CRA/Compliance Examinations	**1,959**	2,020	2,136
Specialty Examinations:			
Trust Departments	**468**	450	534
Data Processing Facilities	**2,584**	2,708	2,570
Subtotal-Specialty Examinations	**3,052**	3,158	3,104
Total	**7,399**	7,577	7,755

[1] Compliance-only examinations are conducted for most institutions at or near the mid-point between joint compliance-CRA examinations under the Community Reinvestment Act of 1977, as amended by the Gramm-Leach-Bliley Act of 1999. CRA examinations of financial institutions with aggregate assets of $250 million or less are subject to a CRA examination no more than once every five years if they receive a CRA rating of "Outstanding" and no more than once every four years if they receive a CRA rating of "Satisfactory" on their most recent examination.

As of December 31, 2006, there were 51 insured institutions with total assets of $8.5 billion designated as problem institutions for safety and soundness purposes (defined as those institutions having a composite CAMELS[2] rating of "4" or "5"), compared to the same number of problem institutions with total assets of $6.6 billion on December 31, 2005. This constituted a 28.7 percent year-over-year increase in the total assets in problem institutions. During 2006, 38 institutions with aggregate assets of $4.7 billion were removed from the list of problem financial institutions, while 38 institutions with aggregate assets of $7.8 billion were added to the list of problem financial institutions. The FDIC is the primary federal regulator for 27 of the 51 problem institutions.

During 2006, the Corporation issued the following formal and informal corrective actions to address safety and soundness concerns: 29 Cease and Desist Orders; one Written Agreement; and 146 Memoranda of Understanding. Of these actions issued, eight Cease and Desist Orders, one Written Agreement and 21 Memoranda of Understanding were issued based on apparent violations of the Bank Secrecy Act.

As of December 31, 2006, four FDIC-supervised institutions were assigned a "4" rating for compliance; no institutions were assigned a "5" rating. All of the "4"-rated institutions were examined in 2006, and Memoranda of Understanding are currently being finalized to address the FDIC's examination findings. In addition, the FDIC developed and began using new screening tools in 2006 to identify those FDIC-supervised institutions with mortgage lending disparities, based upon "higher rate" pricing information supplied by these institutions under the Home Mortgage Disclosure Act (HMDA), and to assess whether the disparities in loan pricing and denial rates resulted from discriminatory lending or reflected other factors, such as creditworthiness, underwriting or other non-discriminatory criteria.[3] Compliance examinations were scheduled for all of the institutions with identified lending disparities to determine whether those disparities were the result of discriminatory lending.

Large Complex Financial Institution Program

The FDIC's Large Bank Program was established to address the unique challenges associated with supervising and insuring the deposits of large and complex institutions. A significant share of the assets and insured deposits of the banking industry are today held in a small number of large institutions. The Program ensures a consistent approach to large

2 The CAMELS composite rating represents the adequacy of **C**apital, the quality of **A**ssets, the capability of **M**anagement, the quality and level of **E**arnings, the adequacy of **L**iquidity, and the **S**ensitivity to market risk, and ranges from "1" (strongest) to "5" (weakest).

3 The Federal Reserve Board began requiring covered institutions to report "higher rate" pricing information in their HMDA reports in 2004.

bank supervision and risk analysis on a national basis by compiling key data and performing analyses of large-bank operations for use by various FDIC divisions and offices and by providing specialists to support supervisory activities for large banks. In 2006, guidelines were developed to enhance the FDIC's risk-monitoring program for large banks with assets greater than $50 billion. Monitoring and assessment activities also continued in 2006 to ensure internal and industry preparedness for the implementation of Basel II. Training on credit and operational risk was conducted for regional and interagency personnel, and numerous "supervisory working group" meetings were held with foreign regulatory authorities to address Basel II home-host and cross-border issues.

Industrial Loan Companies

In 2006, an application for deposit insurance filed by a very large retailer on behalf of a proposed Utah industrial loan company (ILC) generated significant public interest. In April, the FDIC held three days of public hearings on the application. Nearly 70 representatives of financial institutions, trade associations, advocacy groups, the retailer, and others made presentations at the hearing. In addition, the FDIC received written statements from 16 parties who did not request an opportunity to present during the hearings.

As a result of that interest as well as congressional interest and reviews by the GAO and OIG, the FDIC initiated a comprehensive policy review of ILCs. On July 28, 2006, the Board imposed a moratorium extending through January 31, 2007, on the acceptance, approval, or denial of deposit insurance applications and change in control notices submitted by, or on behalf of, any ILC. The purpose of the moratorium was to permit the Corporation to evaluate industry developments; the various issues, facts and arguments raised regarding the ILC charter; whether there are emerging safety and soundness issues or policy issues involving ILCs or other risks to the insurance fund; and whether statutory, regulatory or policy changes should be made in the FDIC's oversight of ILCs in order to protect the Deposit Insurance Fund or important congressional objectives.

The FDIC believes that public participation provides valuable insight into the issues presented by the recent trends and changes in the ILC industry. Accordingly, in order to obtain the public's insights, the FDIC invited comments on the ILC industry during a 45-day period that ended on October 10, 2006. In its Request for Public Comment, the FDIC posed 12 questions that sought public input on various topics, including the current legal framework of ILCs as well as the possible benefits, risks and supervisory issues associated with ILCs. At year-end 2006, eight ILC-related applications for deposit insurance and two change in control notices were pending.

Promoting Economic Inclusion

The FDIC pursued a number of new initiatives in 2006 to promote broader access to banking services by traditionally underserved populations and to ensure adequate consumer protection in the provision of these services.

Advisory Committee on Economic Inclusion

This Committee was created to provide the FDIC with advice and recommendations on important initiatives focused on expanding access to banking services by underserved populations and also explore ways to encourage the banking industry to adopt suitable products and marketing strategies to compete with alternative high-cost providers.

Alliance for Economic Inclusion (AEI)

The AEI was created to work with financial institutions and other partners to bring those currently unbanked and underserved into the financial mainstream. The AEI will focus on expanding banking services in all underserved markets, including low- and moderate-income neighborhoods, minority communities and rural areas.

Affordable Small-Dollar Loan Guidelines

A draft of the guidelines, targeted to the banking industry, was issued for public comment on December 4, 2006. The draft guidelines suggest ways the banking industry can make affordable short-term loan products more accessible to customers, helping to build long-term, profitable multiple-account relationships. The guidelines focus on product development and underwriting, and include information on tools such as consumer financial education and savings that may address longer term financial issues. The FDIC expects to finalize the guidelines in early 2007.

Military Bank Initiative

In late 2006, the FDIC began working closely with the banking industry to explore ways to make affordable short-term loan products more accessible to military personnel who frequently turn to high-cost providers for their financial services needs and to encourage individual and household savings by these borrowers. The FDIC established contact with the Association of Military Banks of America (AMBA) and more than 125 banks located near military bases.

Nontraditional Mortgage Products

In 2006, the FDIC became increasingly concerned with the expansion of nontraditional mortgage products and the potential risk posed by these products to the DIF. While these products, which are also referred to as "alternative" or "exotic" mortgage loans, have been available for many years, the number of institutions offering them has expanded rapidly in recent years. To address these concerns, the FDIC implemented certain enhancements to the supervisory oversight of nontraditional mortgage banking activities and, with the other financial institution regulatory agencies, developed and issued guidance to address the growing risks associated with these loan products. The guidance covers three primary areas: loan terms and underwriting standards, portfolio and risk management practices, and consumer protection issues.

Hurricane Recovery Assistance

Since the Gulf Coast hurricanes of 2005, the FDIC has worked with other federal and state regulatory agencies to address policy issues that arose due to the severity and scale of those events. In 2006, the agencies issued examiner guidance that outlines examination procedures for assessing the financial condition of institutions adversely affected by the hurricanes. Working through the Federal Financial Institutions Examination Council (FFIEC), the agencies also published and distributed to insured financial institutions a booklet entitled *Lessons Learned from Hurricane Katrina: Preparing Your Institution for a Catastrophic Event*. This booklet compiles the experiences of bank officials in the aftermath of these hurricanes and offers insights to those who are responsible for devising and implementing an institution's disaster recovery and business continuity plans.

In October 2006, the FDIC and NeighborWorks® America jointly released a new homeownership and financial counseling guide called *Navigating the Road to Housing Recovery in the Gulf Coast*. The guide is designed for evacuees who are now beginning to receive federal and state financial assistance to rebuild or relocate. It was a focal point of two conferences held in late 2006, the "Gulf Coast Housing Summit – Strategies for Redeveloping Communities and Rebuilding Lives," jointly sponsored by the FDIC and NeighborWorks® America in New Orleans, LA, and another housing conference sponsored by Back Bay Mission in Biloxi, MS. The FDIC, in cooperation with NeighborWorks® and an array of local partners, will schedule train-the-trainer sessions through early 2007 to develop 300 potential homeownership counselors.

Minority Depository Institutions

The FDIC has long recognized the importance of minority depository institutions in promoting the economic viability of minority and underserved communities. In August 2006, the FDIC hosted the first "National Minority Depository Institution Conference" in Miami, FL, with attendance from more than 100 bankers; representatives from the Office of the Comptroller of the Currency, the Federal Reserve and the Office of Thrift Supervision; and several private-sector and industry trade group representatives. The conference addressed topics of interest to the minority banking community, with particular emphasis on a shared commitment to expanding financial services available to minority and underserved communities; developing coalitions to improve minority community infrastructures by partnering with organizations such as NeighborWorks® America; and fostering a better understanding by the regulatory community of the unique challenges minority depository institutions face. A second national conference is planned for 2007.

During 2006, an FDIC task force also assisted three minority institutions headquartered in New Orleans, LA, and severely impacted by Hurricane Katrina in improving their liquidity by securing $22 million in deposit pledges from Utah-based ILCs. The ILCs also provided $123,000 in direct cash donations to assist these institutions in meeting the housing and other needs of their employees.

Homeland Security

The FDIC has taken a leadership role in ensuring that the financial sector – a critical part of the infrastructure of the United States – is prepared for a financial emergency. As a member of the Financial and Banking Information Infrastructure Committee (FBIIC), the FDIC has sponsored a series of outreach meetings titled "Protecting the Financial Sector: A Public and Private Partnership." During 2006, these Homeland Security meetings were held in 22 cities across the United States. These meetings provided members of the financial sector with the opportunity to communicate with senior government officials, law enforcement personnel, emergency management personnel and private sector leaders about emergency preparedness. Homeland Security meetings are planned for 11 cities in 2007.

Bank Secrecy Act

The FDIC chairs the FFIEC Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Working Group. Under the auspices of the BSA/AML Working Group, the FDIC, the other federal banking agencies, and FinCEN updated the FFIEC BSA/AML Examination Manual in July 2006. The revised manual reflects the ongoing commitment of the federal banking agencies and FinCEN to provide current and consistent guidance on risk-based policies, procedures, and processes for banking organizations to comply with the BSA and safeguarding operations from money laundering and terrorist financing. Following the release of the manual, the FDIC coordinated and hosted four interagency conference calls for the banking industry and examination staff regarding changes to the manual. Over 1,500 examiners and 10,650 bankers and industry representatives participated in those outreach events. During 2006, the FDIC also participated in more than 145 additional industry outreach and regulatory training events nationwide relating to BSA/AML topics.

Cyber Fraud and Financial Crimes

The FDIC continued to take a leadership role in consumer education initiatives related to identity theft with a public education campaign that included sponsoring identity theft symposia focusing on e-commerce. The symposia, held in San Francisco, CA, Mesa, AZ, and Miami Beach, FL, brought together representatives from federal and state governments, industry, consumer and community organizations, and law enforcement to discuss issues related to identity theft and e-commerce.

Other major accomplishments during 2006 in combating identity theft included the following:

- Assisted financial institutions in identifying and shutting down approximately 900 "phishing" Web sites. The term "phishing"– as in fishing for confidential information – refers to a scam that encompasses fraudulently obtaining and using an individual's personal or financial information.
- Issued 342 special alerts of reported cases of counterfeit or fraudulent bank checks.
- Released an online training tool entitled "Don't Be an On-line Victim: How to Guard Against Internet Thieves and Electronic Scams" (available through the FDIC's Web site and on CD-ROM).
- Participated in the President's Identity Theft Task Force and five of its primary subgroups.

Office of International Affairs

Increasing globalization and interdependence heighten the potential for financial and economic instability to transcend national geographic boundaries. The promotion of sound, stable banking systems abroad is a key ingredient for greater global prosperity and stability which, in turn, will benefit the U.S. financial system and the banking public. The FDIC created the Office of International Affairs in 2006 to coordinate the FDIC's international activities with a focus on building strong relationships with foreign regulators and deposit insurers, other U.S. government entities and international organizations. The programs overseen by the office provide training, expert consultation, and technical assistance to foreign deposit insurers, bank supervisory authorities and other foreign government agencies to support the development and maintenance of effective deposit insurance programs and stable, sound banking systems worldwide.

Consumer Complaints and Inquiries

The FDIC investigates consumer complaints about FDIC-supervised institutions and answers inquiries from the public about consumer protection laws and banking practices. In 2006, the FDIC received 9,652 written complaints, of which 3,442 were against state nonmember institutions. The Corporation responded to over 97 percent of these complaints within corporate timeliness standards. The FDIC also responded to 3,870 written and 4,188 telephone inquiries from consumers and members of the banking community about consumer protection issues.

In April 2006, the FDIC hosted the first Interagency Consumer Affairs Conference in Arlington, VA, with approximately 140 attendees, including representatives from the Federal Reserve Board, Office of Thrift Supervision, Office of the Comptroller of the Currency, National Credit Union Administration, and the Federal Trade Commission. Discussions included best practices for investigating and responding to consumer complaints, banking practices, and financial trends that have and will continue to challenge consumers in 2006 and beyond.

Deposit Insurance Education

An important part of the FDIC's role in insuring deposits and protecting the rights of depositors is its responsibility to ensure that bankers and consumers have access to accurate information about the FDIC's deposit insurance rules. The FDIC has an extensive deposit insurance education program consisting of seminars for bankers, electronic tools for estimating deposit insurance coverage, and written and electronic information targeting both bankers and consumers. The FDIC also responds directly to inquiries from bankers and the public about deposit insurance. During 2006, the FDIC responded to over 86,134, or 99 percent, of written and telephone inquiries from bankers and consumers about the FDIC's deposit insurance program and insurance coverage issues within the time frames established by policy. This was an increase of approximately 34 percent over the number of inquiries received in 2005, in large part due to the enactment of new coverage limits as part of deposit insurance reform.

In 2006, the FDIC also completed development of Spanish-language versions of two of its most popular educational resources for consumers and bankers, a Spanish language version of EDIE (available on the FDIC's Web site beginning in early 2007) and a 30-minute Spanish-language video for bank employees and customers (now available on the FDIC's Web site) that provides an overview of the FDIC's rules and requirements for deposit insurance coverage, with specific emphasis on the most common account ownership categories used by individuals and families.

The FDIC continued publication of its quarterly consumer newsletter, *FDIC Consumer News*, which covers a wide range of financial topics of interest to consumers. Three special age-based issues of *FDIC Consumer News* – for seniors, young adults and teens – were published during the year. The how-to financial guide for seniors won an Achievement in Consumer Education Award from the National Association of Consumer Agency Administrators. Current and past issues of *FDIC Consumer News* are available online at www.fdic.gov/consumernews.

Financial Education and Community Development

Five years ago, the FDIC – recognizing the need for enhanced financial education across the country – inaugurated its award-winning *Money Smart* curriculum, which is now available in seven languages as well as in a computer-based instruction version. In 2006, the FDIC introduced the Russian language, large print and Braille versions of *Money Smart*. The large print and Braille versions are the first financial education program specifically targeted for individuals with visual impairments. Since its inception, over 864,000 individuals (including approximately 207,000 in 2006) have participated in *Money Smart* classes and approximately 128,000 of these participants have subsequently established new banking relationships.

During 2006, the FDIC also undertook 370 community development, technical assistance and outreach activities. These activities were designed to promote: awareness of investment opportunities to financial institutions, access to capital within communities, knowledge-sharing among the public and private sector, and wealth building opportunities for families. Representatives throughout the financial industry and their stakeholders collaborated with FDIC on a broad range of initiatives structured to meet local and regional needs for financial products and services, credit, asset-building, affordable housing, small business and micro-enterprise development and financial education.

Receivership Management

The FDIC has the unique mission of protecting depositors of insured banks and savings associations. No depositor has ever experienced a loss on the insured amount of their deposit in an FDIC-insured institution due to a failure. Once an institution is closed by its chartering authority – the state for state-chartered institutions, the Office of the Comptroller of the Currency (OCC) for national banks and the Office of Thrift Supervision (OTS) for federal savings associations – the FDIC is responsible for resolving that failed bank or savings association. The FDIC gathers data about the troubled institution, estimates the potential loss to the insurance fund from various resolution alternatives, solicits and evaluates bids from potential acquirers, and recommends the least-costly resolution method to the FDIC's Board of Directors.

Resolving Financial Institution Failures

For the second consecutive calendar year, there was no failure of an insured depository institution in 2006, further extending the longest period in the history of the FDIC during which no insured institution failed – a record 31 months. The Corporation's remaining receivership management workload also continued to decline. The accompanying chart provides liquidation highlights and trends for the past three years.

Liquidation Highlights 2004-2006

Dollars in billions (except where noted)

	2006•	2005•	2004
Total Resolved Banks	0	0	3
Assets of Resolved Banks	$ 0.00	$ 0.00	$ 0.15
Total Resolved Savings Associations	0	0	1
Assets of Resolved Savings Associations	$ 0.00	$ 0.00	$ 0.01
Net Collections from Assets in Liquidation▪	$ 0.17	$ 0.37	$ 0.38
Total Assets in Liquidation▪	$ 0.35	$ 0.44	$ 0.61
Total Dividends Paid▪	$ 0.17	$ 0.44	$ 0.38
Savings Over Cost of Liquidation▾	$ 0	$ 0	$11.6 million

• No failures in 2005 and 2006.
▪ Includes activity from thrifts resolved by the former Federal Savings and Loan Insurance Corporation and the Resolution Trust Corporation.
▾ Least Cost Test Savings.

Large Bank Contingency Planning

The FDIC must ensure that it has the tools and strategies necessary to fulfill its missions as deposit insurer and receiver for all insured banks and thrifts. As the banking industry has become more concentrated and as larger insured institutions have grown significantly, the FDIC has undertaken a number of concrete steps to enhance its capabilities to manage the resolution of a large bank. Some of the initiatives involved in this ongoing process are contingency planning exercises, system and process improvements for determination of deposit insurance claims and management of failing bank assets, consultations with domestic and international regulators, improvements to the FDIC's supervisory program for larger banks, and the designation of internal and external expertise to focus on larger bank issues. The Claims Administration System (CAS), described in the following section, is one of these initiatives. This effort will continue and evolve as the challenges change in the future.

Claims Modernization Project

The FDIC is taking advantage of the hiatus in resolution activity by modernizing the way it determines the insurance status of depositors in the event of failure by streamlining its business processes and modernizing the internal systems used to facilitate a deposit insurance determination through improved use of current technology. This includes development and implementation of a new insurance determination system called the Claims Administration System (CAS) to be implemented in 2008, which will provide an integrated solution that will meet the current and future deposit insurance determination needs of the FDIC. The new system will minimize the potential for FDIC losses, reduce any spillover effects that could lead to systemic risks, preserve franchise value, and produce deposit insurance results in a timely manner in order to quickly provide funds to claimants.

Professional Liability Recoveries

The FDIC works to identify potential claims against directors and officers, accountants, appraisers, attorneys and other professionals who may have contributed to the failure of an insured financial institution. Once a claim is deemed viable and cost-effective to pursue, the FDIC initiates legal action against the appropriate parties. The FDIC strives to make a decision to close or pursue 80 percent of all potential claims within 18 months of the failure date.

During 2006, the FDIC recovered approximately $36.2 million from these professional liability suits. In addition, as part of the sentencing process for those convicted of criminal wrongdoing against failed institutions, the court may order a defendant to pay restitution to the receivership. The FDIC, working in conjunction with the U.S. Department of Justice, collected approximately $10.5 million in criminal restitution payments during the year. The FDIC's caseload at the end of 2006 included investigations, lawsuits and ongoing settlement collections involving 13 claims and 95 other active collection matters, down from 127 at the beginning of 2006. At the end of 2006, there were 814 pending restitution orders, down from 995. This includes orders won by the former Resolution Trust Corporation for which the FDIC assumed responsibility on January 1, 1996.

Protecting Insured Depositors

Although the FDIC's focus in recent years has shifted from resolving large numbers of failed institutions to addressing existing and emerging risks in insured depository institutions, the FDIC continues to protect depositors and other stakeholders of those institutions that fail. The FDIC's ability to attract healthy institutions to assume deposits and purchase assets of failed banks and savings associations minimizes the disruption to customers and allows some assets to be returned to the private sector immediately. Assets remaining after resolution are liquidated by the FDIC in an orderly manner, and the proceeds are used to pay creditors, including depositors whose accounts exceeded the insured limit. During 2006, the FDIC paid dividends of 80.2 percent of the deposit amount exceeding the insured limit, which represents an increase of 2.3 percent from 2005.

Effective Management of Strategic Resources

The FDIC recognizes that it must effectively manage its human, financial, and technological resources in order to successfully carry out its mission and meet the performance goals and targets set forth in its annual performance plan. The Corporation must align these strategic resources with its mission and goals and deploy them where they are most needed in order to enhance its operational effectiveness and minimize potential financial risks to the DIF. Major accomplishments in improving the Corporation's operational efficiency and effectiveness during 2006 are described in this section.

Human Capital Management

The FDIC's employees are its most important resource. The intellectual capital supplied by FDIC employees is the single most important contributor to achieving the Corporation's mission of maintaining public confidence in our nation's financial system. As such, the FDIC strives to be the best employer within the financial regulatory community and pursues human capital programs and strategies that will enable it to attract, develop and retain a highly skilled, diverse, and results-oriented workforce.

The FDIC has a human capital framework that guides its human capital activities. Using this framework as a guide, the Corporation continues to develop and maintain a workforce that is highly functional and cross-trained in multiple disciplines and stands ready to redirect its attention and efforts in response to changes in the banking industry or changes in workload priorities.

Corporate Employee Program

Development and implementation of the new Corporate Employee Program (CEP) continued in 2006. The program emphasizes cross-training of employees at all levels to provide greater flexibility to be able to respond to changes in workload as well as unexpected external events. During the past year, the primary focus was on the implementation of a new recruiting strategy for entry-level employees and refinement of the first-year training program under which new employees are exposed to each of the Corporation's three major business lines. By the end of 2006, almost 200 employees had begun the three-year career internship and training program that is the core component of the CEP and will in the future constitute the primary source of new employees for the Corporation's business divisions.

Employee Learning and Growth

The Corporation emphasizes continuous employee learning and growth. During 2006, the Corporation finalized plans for the 2007 implementation of the new Professional Learning Account program that will give employees a greater role in planning their career development and provide substantially increased funding for external training. The Corporation also began to increase its emphasis on industry-recognized professional certifications and completed pilot tests of two new internally-developed certificate programs covering Bank Secrecy Act/Anti-Money Laundering, and Resolutions and Receivership Claims. A career path for large complex bank specialists will be explored, and training requirements for this specialty will be evaluated. As these and other programs are implemented, a database of FDIC employee skills will track and monitor the availability of specialized human capital resources.

Succession Management

The FDIC will have the opportunity over the next decade to substantially reshape its workforce in conjunction with the projected retirements of a large number of employees from the "baby boom" generation. To proactively plan for and address these projected retirements, the FDIC developed two succession management programs in 2006: the Executive Talent Review and the Corporate Executive Development Program. These programs were designed to assess executive leadership strength, identify potential skill set shortages or gaps and then institute strategies for closing these gaps, including rigorous leadership development programs. In late 2006, the FDIC's senior leadership conducted an initial "talent review" of all of its executive managers to determine where there may be gaps in the availability and skills of qualified successors for key executive positions. This process identified a number of "at risk" positions – those in which the incumbents were likely to leave in the near future with no or few obvious internal candidates available to replace them. In 2007, the Corporation will develop strategies to fill these potential succession gaps for positions with a high risk of loss in the near term. The talent review process will also be extended to assess potential succession in management gaps for supervisory and managerial positions as well as senior technical professionals.

Information Technology Management

Information technology (IT) resources are one of the most valuable assets available to the FDIC in fulfilling its corporate mission. The FDIC operates a nationwide computing network and maintains approximately 270 application systems through which employees perform their duties.

IT Transformation

For the past several years, the Corporation has been engaged in a major effort to transform and improve its IT program. In 2006, the IT program continued to evolve as it continued to implement key elements of its transformation plan. The Corporation adopted the Rational Unified Process® as its new system development life cycle methodology and customized it to meet the FDIC's unique IT project environment.

E-Exam Programs

In 2006, the FDIC also implemented an e-Exam Policy, including related security procedures, for use in conducting examination activities at institutions utilizing an electronic exchange of documents/data with the FDIC. A significant component of the e-Exam Policy involves the flexibility to increase the amount of examination work conducted off-site. Factors considered in the decision to utilize this program include the type and extent of the information available, the institution's risk profile, and management's willingness to transfer examination documents electronically.

E-Government

The FDIC continued to collect quality and timely information in 2006 with the use of FDIC*connect*, the secure Web site that facilitates electronic communication with FDIC-insured institutions. In 2006, over 400,000 transactions were completed by financial institutions using FDIC*connect*.

Central Data Repository

The Federal Financial Institutions Examination Council (FFIEC), which includes the FDIC, won a 2006 award from *Government Computer News* for outstanding and innovative use of IT in government for the successful launch of the new Central Data Repository (CDR) to collect Call Report data using XBRL (eXtensible Business Reporting Language). The CDR project was also awarded the Chief Information Officer's Top 100 award for its outstanding work using XBRL for financial reporting.

Enhanced Information Security Program

The FDIC's information security program seeks to proactively assure the integrity, confidentiality and availability of corporate information requiring an ongoing commitment by employees throughout the organization. In 2006, the information security program continued its ongoing cycle for assessing risks, developing and implementing effective security procedures and monitoring the effectiveness of those procedures.

Corporate Privacy Program

The FDIC continued to enhance its IT Privacy Program in 2006 with an emphasis on protecting personally identifiable information (PII) from unauthorized use, access, disclosure or sharing, and protecting associated information systems from unauthorized access, modification, disruption or destruction. Initiatives undertaken during the year included the following:

- Developing an overarching privacy directive.
- Developing a strategy for the protection of PII processed, stored, transmitted or accessed by FDIC contractors, and ensuring appropriate assessment of the security of data.
- Continuing the review and remediation of PII in FDIC application systems.

- Identifying all contracts that process or use PII or other sensitive information, ensuring that updated privacy and nondisclosure clauses are included.

- Continuing to participate in the Office of Management and Budget Privacy Work Group.

Emergency Preparedness Program

During 2006, the FDIC continued work on its Emergency Preparedness Program, and made improvements to the Emergency Response Plan (ERP) and Business Continuity Plan (BCP). Completed initiatives included the development of a computer-based instruction module on emergency preparedness for all FDIC personnel to be activated in early 2007; expansion and improvement of FDIC alternate site facilities; expansion of FDIC emergency notification systems to all regional and area offices; revision of both the ERP and BCP; and participation in the Federal government's *Forward Challenge* simulation exercise. Other accomplishments included the conduct of additional classroom training on emergency preparedness for employees, contractors and floor marshals; shelter-in-place and evacuation drills; and tabletop exercises at all headquarters and regional office locations. Disaster recovery testing of FDIC's key information technology resources was also performed.

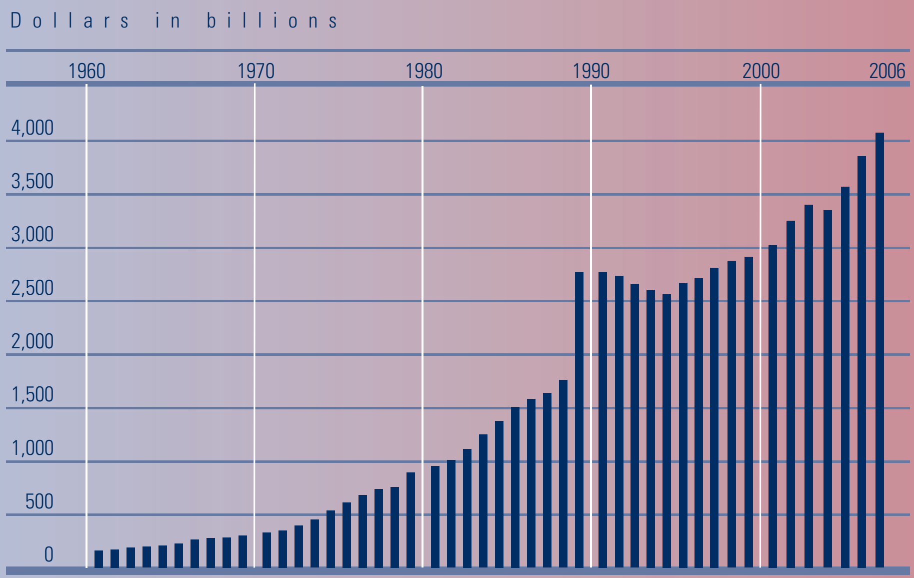
II. Financial Highlights

Deposit Insurance Fund Performance

The FDIC administers the Deposit Insurance Fund (DIF) and the FSLIC Resolution Fund (FRF), which fulfills the obligations of the former Federal Savings and Loan Insurance Corporation (FSLIC) and the former Resolution Trust Corporation (RTC). (See the accompanying tables on FDIC-DIF Insured Deposits and DIF Insurance Fund Reserve Ratios.)

For the year 2006, DIF's comprehensive income totaled $1.6 billion compared to $1.1 billion in 2005, a year-over-year increase of 44 percent. Excluding the recognition of exit fees earned of $345 million (a one-time adjustment), comprehensive income rose by $133 million from a year ago. This year-over-year increase is primarily due to a decrease in the unrealized loss on available-for-sale (AFS) securities of $348 million, which was offset by decreases in both interest earned on U.S. Treasury obligations of $101 million and the negative provision for loss of $108 million.

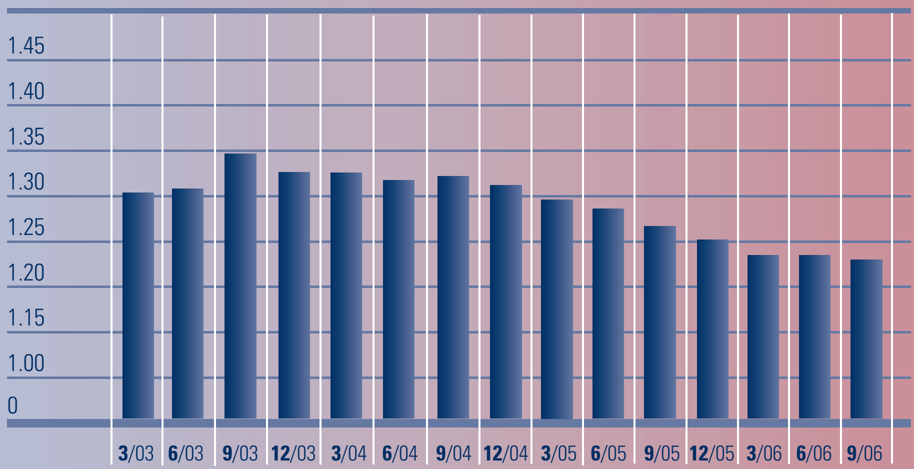
FDIC-DIF Insured Deposits (estimated 1960-2006)•



• All amounts are year-end except 2006 is at 9/30/06.
Prior to 2006, amounts represent the sum of separate BIF and SAIF amounts.
Source: Commercial Bank Call Reports and Thrift Financial Reports.

The significantly lower unrealized loss on AFS securities primarily resulted from: 1) a smaller total market value of AFS securities, 2) a lower average duration for the AFS securities, and 3) a smaller increase in the market yields of the AFS securities. However, the lower unrealized loss was partially offset by a decrease in interest revenue on U.S. Treasury obligations that resulted from lower inflation compensation on Treasury Inflation-Protected Securities.

DIF Insurance Fund Reserve Ratios (Fund Balances as a Percent of Insured Deposits)



Prior to 2006, amounts represent the sum of separate BIF and SAIF amounts.

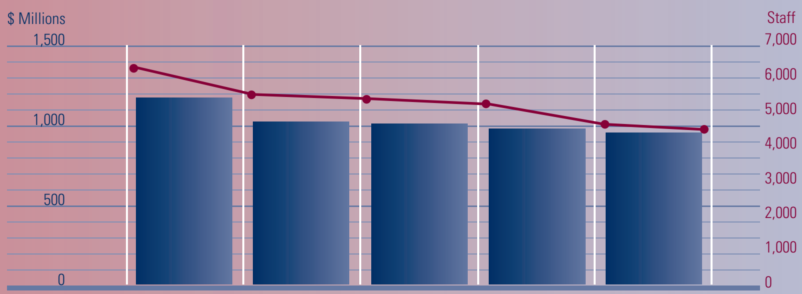
Corporate Operating Budget Spending

The FDIC has had an exceptional record of controlling operating costs over the past five years, and 2006 was no exception. Corporate Operating Budget expenses totaled $973 million in 2006, including $961 million for ongoing operations and $12 million for receivership funding. During the five-year period from 2002 through 2006, the FDIC's annual Corporate Operating Budget expenses declined from $1,189 million to $973 million, a reduction of $216 million, or 18 percent, despite the effects of inflation on the FDIC's costs. That reduction was primarily attributable to significant reductions in staffing as well as a steady reduction in resolutions and receivership activities resulting from the historically low number of bank failures.

Cost Reductions Realized through Staff Reductions

The FDIC has engaged in a continuing effort to realign staffing to reflect reduced workload requirements as it has moved past the banking and thrift crisis. Total FDIC staffing fell from 6,167 at the beginning of 2002 to 4,476 at year-end 2006, a 27 percent reduction over five years. As a result, spending for salaries and benefits decreased by 15 percent, from $737 million in 2002 to $626 million in 2006, despite an increase of 17.7 percent in the salaries of individual employees during this period.

FDIC Staffing and Operating Expenses 2002-2006

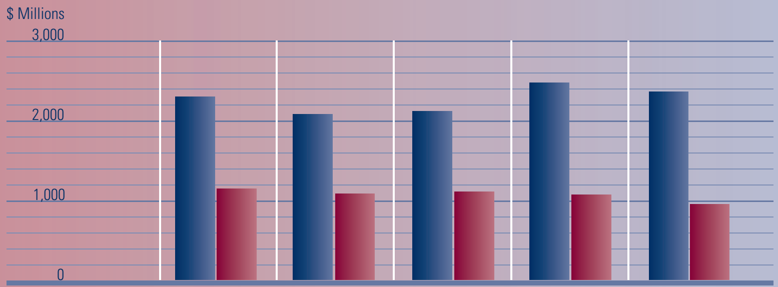


	2002	2003	2004	2005	2006
Operating Expenses	$1,189	1,008	1,004	990	973
Staff	5,430	5,311	5,078	4,514	4,476

A Continuing Record of Prudent Stewardship

The FDIC relies primarily upon interest earned on the investments of the insurance and resolution funds for its operations. It is notable that the Corporation has reduced its operational spending even as the interest earned on the funds has increased significantly. As a result, the FDIC's annual spending has dramatically declined as a percentage of interest revenue on the DIF and the FRF. The aggregate interest revenue of the DIF and FRF grew to $2,392 million in 2006, while combined operating and investment budget spending fell to 42 percent of interest revenue, down from 52 percent in 2002.

Total Interest Revenue vs. Operating and Investment Budget Spending



	2002	2003	2004	2005	2006
Total Interest Revenue•	$2,303	2,095	2,148	2,440	2,392
Total Budget Spending	$1,190	1,035	1,112	1,052	998

•Includes interest revenue from DIF, BIF, SAIF, and FRF funds

2007 Corporate Operating Budget

Although its staffing realignment was essentially completed in 2006, the FDIC will continue to emphasize control of spending in 2007 and future years. In December 2006, the Board of Directors approved a 2007 Corporate Operating Budget of approximately $1.107 billion, including $1.032 billion for ongoing operations. The approved 2007 budget is 4.6 percent higher than the 2006 Corporate Operating Budget. This limited budget increase was required for negotiated employee pay increases and included funding for a number of major new initiatives, including additional staff for compliance examinations and other supervision functions, as well as increased funding for employee training, enhanced IT security and privacy programs, and completion of system changes required to support the implementation of deposit insurance reform.

Investment Spending

The FDIC instituted a separate Investment Budget in 2003. It has a disciplined process for reviewing proposed new investment projects and managing the construction and implementation of approved projects. Most of the projects in the current investment portfolio are major IT system initiatives. Proposed IT projects are carefully reviewed to ensure that they are consistent with the Corporation's enterprise architecture. The project approval and monitoring processes also enable the FDIC to be aware of risks to the major capital investment projects and facilitate appropriate, timely intervention to address these risks throughout the development process. An investment portfolio performance review is provided to the FDIC's Board of Directors quarterly.

The Corporation undertook significant capital investments during the 2003-2006 period, including construction of a major expansion of its Virginia Square facility and the implementation of 11 major new IT systems. Investment spending totaled $222 million during this period, peaking at $108 million in 2004. Spending for investment projects in 2006 totaled approximately $25 million. During 2006, the Corporation completed both the New Financial Environment (NFE) and Virginia Square Phase II investment projects.

Federal Deposit Insurance Corporation

Deposit Insurance Fund (combined BIF and SAIF for 2005)

Balance Sheet at December 31, condensed

Dollars in Thousands

	2006	2005
Assets		
Cash and cash equivalents	$ 2,953,995	$ 3,209,444
Cash and other assets: *Restricted for SAIF-member exit fees (Includes cash and cash equivalents of $20.9 million at December 31, 2005)*	0	341,656
Investment in U.S. Treasury obligations, net:		
Held-to-maturity securities	37,184,214	34,253,237
Available-for-sale securities	8,958,566	9,987,223
Interest receivable on investments and other assets, net	747,715	737,566
Receivables from resolutions, net	538,991	533,474
Property and equipment, net	376,790	378,064
Total Assets	**$ 50,760,271**	**$ 49,440,664**
Liabilities		
Accounts payable and other liabilities	$ 154,283	$ 296,540
Postretirement benefit liability	129,906	0
Contingent liabilities for:		
Anticipated failure of insured institutions	110,775	5,366
Litigation losses	200,000	200,500
SAIF-member exit fees and investment proceeds held in escrow	0	341,656
Total Liabilities	**594,964**	**844,062**
Commitments and off-balance-sheet exposure		
Fund Balance		
Accumulated net income	49,929,226	48,190,062
Unrealized gain on available-for-sale securities, net	233,822	406,540
Unrealized postretirement benefit gain	2,259	0
Total Fund Balance	**50,165,307**	**48,596,602**
Total Liabilities and Fund Balance	**$ 50,760,271**	**$ 49,440,664**

Deposit Insurance Fund (combined BIF and SAIF for 2005)

Statement of Income and Fund Balance for the Years Ended December 31, condensed

Dollars in Thousands

	2006	2005
Revenue		
Interest on U.S. Treasury obligations	$ 2,240,723	$ 2,341,505
Exit fees earned	345,295	0
Assessments	31,945	60,884
Other revenue	25,565	18,073
Total Revenue	**2,643,528**	**2,420,462**
Expenses and Losses		
Operating expenses	950,618	965,652
Provision for insurance losses	(52,097)	(160,170)
Insurance and other expenses	5,843	3,821
Total Expenses and Losses	**904,364**	**809,303**
Net Income	**1,739,164**	**1,611,159**
Unrealized loss on available-for-sale securities, net	(172,718)	(521,350)
Unrealized postretirement benefit gain	2,259	0
Comprehensive Income	**1,568,705**	**1,089,809**
Fund Balance - Beginning	**48,596,602**	**47,506,793**
Fund Balance - Ending	**$ 50,165,307**	**$ 48,596,602**

Deposit Insurance Fund (combined BIF and SAIF for 2005)

Statement of Cash Flows for the Years Ended December 31, condensed

Dollars in Thousands

	2006	2005
Operating Activities		
Net Income:	$ 1,739,164	$ 1,611,159
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of U.S. Treasury obligations	599,274	834,118
Treasury inflation-protected securities (TIPS) inflation adjustment	(109,394)	(345,023)
Depreciation on property and equipment	52,919	56,006
Provision for insurance losses	(52,097)	(160,170)
Terminations/adjustments of work-in-process accounts	433	178
Exit fees earned	(345,295)	0
Change in Operating Assets and Liabilities:		
Decrease/(Increase) in unamortized premium and discount of U.S. Treasury obligations (restricted)	1,359	(6,565)
(Increase)/Decrease in interest receivable and other assets	(14,635)	5,590
Decrease in receivables from resolutions	147,258	348,173
(Decrease)/Increase in accounts payable and other liabilities	(166,822)	27,145
Increase in postretirement benefit liability	129,906	0
(Decrease) in contingent liabilities for litigation losses	0	(182)
Increase in exit fees and investment proceeds held in escrow	3,639	28,556
Net Cash Provided by Operating Activities	**1,985,709**	**2,398,985**
Investing Activities		
Provided by:		
Maturity of U.S. Treasury obligations, held-to-maturity	5,955,000	8,220,000
Maturity of U.S. Treasury obligations, available-for-sale	845,000	1,830,000
Used by:		
Purchase of property and equipment	(11,721)	(47,197)
Purchase of U.S. Treasury obligations, held-to-maturity	(9,050,372)	(11,693,984)
Net Cash Used by Investing Activities	**(2,262,093)**	**(1,691,181)**
Net (Decrease)/Increase in Cash and Cash Equivalents	**(276,384)**	**707,804**
Cash and Cash Equivalents - Beginning	**3,230,379**	**2,522,575**
Unrestricted Cash and Cash Equivalents - Ending	**2,953,995**	**3,209,444**
Restricted Cash and Cash Equivalents - Ending	**0**	**20,935**
Cash and Cash Equivalents - Ending	**$ 2,953,995**	**$ 3,230,379**

FSLIC Resolution Insurance Fund

Balance Sheet at December 31, condensed

Dollars in Thousands

	2006	2005
Assets		
Cash and cash equivalents	$ 3,616,466	$ 3,602,703
Receivables from thrift resolutions and other assets, net	36,730	38,746
Receivables from U.S. Treasury for goodwill judgments	251,827	0
Total Assets	**$ 3,905,023**	**$ 3,641,449**
Liabilities		
Accounts payable and other liabilities	$ 5,497	$ 7,799
Contingent liabilities for litigation losses and other	279,327	257,503
Total Liabilities	**284,824**	**265,302**
Resolution Equity		
Contributed capital	127,453,996	127,007,441
Accumulated deficit	(123,833,797)	(123,631,294)
Total Resolution Equity	**3,620,199**	**3,376,147**
Total Liabilities and Resolution Equity	**$ 3,905,023**	**$ 3,641,449**

FSLIC Resolution Insurance Fund

Statement of Income and Accumulated Deficit for the Years Ended December 31, condensed

Dollars in Thousands

	2006	2005
Revenue		
Interest on U.S. Treasury obligations	$ 151,648	$ 98,260
Other revenue	17,650	24,176
Total Revenue	**169,298**	**122,436**
Expenses and Losses		
Operating expenses	12,002	24,626
Provision for losses	(19,257)	(16,112)
Goodwill/Guarini litigation expenses	411,056	975,598
Recovery of tax benefits	(34,783)	(45,946)
Other expenses	2,783	10,333
Total Expenses and Losses	**371,801**	**948,499**
Net (Loss)	**(202,503)**	**(826,063)**
Accumulated Deficit - Beginning	**(123,631,294)**	**(122,805,231)**
Accumulated Deficit - Ending	**$ (123,833,797)**	**$ (123,631,294)**

FSLIC Resolution Insurance Fund

Statement of Cash Flows for the Years Ended December 31, condensed

Dollars in Thousands

	2006	2005
Operating Activities		
Net (Loss)	$ (202,503)	$ (826,063)
Adjustments to reconcile net (loss) to net cash (used by) operating activities:		
Provision for losses	(19,257)	(16,112)
Change in Assets and Liabilities:		
Decrease in receivables from thrift resolutions and other assets	21,273	59,630
(Decrease)/Increase in accounts payable and other liabilities	(2,302)	2,196
Increase in contingent liabilities for litigation losses and other	21,824	257,104
Net Cash (Used by) Operating Activities	**(180,965)**	**(523,245)**
Financing Activities		
Provided by:		
U.S.Treasury payments for goodwill litigation	194,728	624,564
Net Cash Provided by Financing Activities	**194,728**	**624,564**
Net Increase in Cash and Cash Equivalents	**13,763**	**101,319**
Cash and Cash Equivalents - Beginning	**3,602,703**	**3,501,384**
Cash and Cash Equivalents - Ending	**$ 3,616,466**	**$ 3,602,703**

GAO
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Comptroller General
of the United States

United States Government Accountability Office
Washington, D.C. 20548

To the Board of Directors
The Federal Deposit Insurance Corporation

We audited the Federal Deposit Insurance Corporation's (FDIC) balance sheets as of December 31, 2006 and 2005, for the two funds administered by FDIC (the Deposit Insurance Fund (DIF) and the FSLIC Resolution Fund (FRF)), the related statements of income and fund balance (accumulated deficit), and the statements of cash flows for the years then ended, and in our report dated January 31, 2007, we expressed an unqualified opinion on those statements.

In that report, we stated that we found the following:

- the financial statements of each fund are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- FDIC had effective internal control over financial reporting and compliance with laws and regulations for each fund; and
- no reportable noncompliance with the laws and regulations we tested.

In addition, we referred the reader to note 1 of the DIF's financial statements that discussed the enactment, on February 8, 2006, of the Federal Deposit Insurance Reform Act of 2005 (the Act). The Act called for the merger of the Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) into a single deposit insurance fund. In accordance with the Act, on March 31, 2006, FDIC established the DIF with the merger of the BIF and SAIF. As further discussed in note 2 to DIF's financial statements, the merger resulted in a new reporting entity. The financial results of the newly formed DIF were retrospectively applied as though they had been combined at the beginning of the reporting year as well as for prior periods presented for comparative purposes.

In our opinion, the information set forth in the accompanying condensed financial statements is presented fairly, in all material respects, in relation to the financial statements from which it has been derived.

As discussed in our January 31, 2007 report, in our prior year audit, we reported on weaknesses in FDIC's information system controls that increased the risk of unauthorized modification and disclosure of critical FDIC financial and sensitive personnel information, disruption of critical operations, and loss of assets. During 2006, FDIC corrected many of these weaknesses and implemented mitigating controls. These actions enabled us to conclude that the remaining issues, along with other control deficiencies identified during our 2006 audits, do not constitute a significant deficiency.

We performed our work in accordance with U.S. generally accepted government auditing standards.

David M. Walker
Comptroller General of the United States

January 31, 2007

FDIC
Federal Deposit Insurance Corporation
550 17th Street, NW Washington, DC 20429 — Deputy to the Chairman and Chief Financial Officer

February 8, 2007

Mr. David M. Walker
Comptroller General of the United States
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Re: FDIC Management Response on the GAO 2006 Financial Statements Audit Report

Dear Mr. Walker:

Thank you for the opportunity to comment on the U.S. Government Accountability Office's (GAO) draft audit report titled, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2006 and 2005 Financial Statements, GAO-07-371*. The report presents GAO's opinions on the calendar year 2006 and 2005 financial statements of the Deposit Insurance Fund (DIF) and the Federal Savings and Loan Insurance Corporation Resolution Fund (FRF). The report also presents GAO's opinion on the effectiveness of FDIC's internal controls as of December 31, 2006, and GAO's evaluation of FDIC's compliance with selected laws and regulations.

We are pleased to accept GAO's unqualified opinions on the DIF and the FRF financial statements and to note that there were no material weaknesses identified during the 2006 audits. The GAO reported that the funds' financial statements were presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles; FDIC had effective internal control over financial reporting and compliance with laws and regulations for each fund; and there were no instances of noncompliance with laws and regulations that were tested.

In addition, we appreciate that GAO recognized the improvements that FDIC made over the past year to its information systems environment. We believe that our sustained commitment to enhancing information systems controls adequately addressed the concerns that GAO highlighted in the prior year report, thus enabling GAO to conclude that the remaining issues related to such controls do not constitute a significant deficiency. Our goal is to maintain an effective information security program going forward. Accordingly, we will work diligently to resolve any control issues that GAO identified during its 2006 audits, as well as any that may arise in the future.

We look forward to continuing our cooperative working relationship with the GAO in the coming year. Our collaborative efforts and open communication at all levels of our organizations should ensure continued success. If you have any questions or concerns, please do not hesitate to contact me.

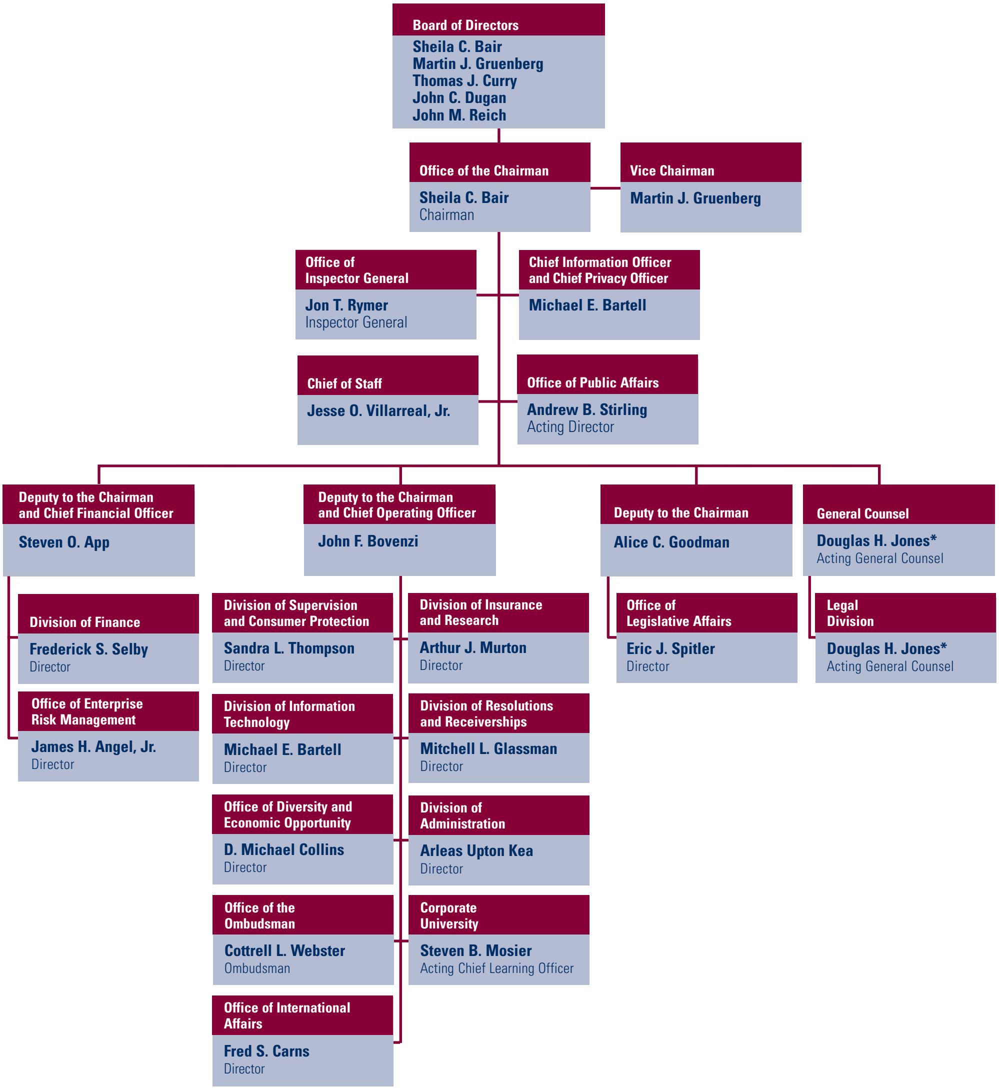
Sincerely,

Steven O. App

Steven O. App
Deputy to the Chairman and Chief Financial Officer

IV. Other Information

FDIC Organization Chart/Officials as of December 31, 2006



*Sara A. Kelsey became General Counsel on January 7, 2007.

Sources of Information

Home Page on the Internet

www.fdic.gov

A wide range of banking, consumer and financial information is available on the FDIC's Internet home page. This includes the FDIC's Electronic Deposit Insurance Estimator (EDIE), which estimates an individual's deposit insurance coverage; the Institution Directory – financial profiles of FDIC-insured institutions; Community Reinvestment Act evaluations and ratings for institutions supervised by the FDIC; Call Reports – banks' reports of condition and income; and *Money Smart*, a training program to help individuals outside the financial mainstream enhance their money management skills and create positive banking relationships. Readers also can access a variety of consumer pamphlets, FDIC press releases, speeches and other updates on the agency's activities, as well as corporate databases and customized reports of FDIC and banking industry information.

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FDIC publications, press releases, speeches and congressional testimony, directives to financial institutions, policy manuals and other documents are available on request or by subscription through the Public Information Center. These documents include the *Quarterly Banking Profile, FDIC Consumer News* and a variety of deposit insurance and consumer pamphlets.

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The Office of the Ombudsman (OO) is an independent, neutral and confidential resource and liaison for the banking industry and the general public. The OO responds to inquiries about the FDIC in a fair, impartial and timely manner. It researches questions and complaints primarily from bankers. The OO also recommends ways to improve FDIC operations, regulations and customer service.

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