Deposit Insurance Fund (DIF)

Deposit Insurance Fund Balance Sheet at December 31

Dollars in Thousands

	2009	2008
Assets		
Cash and cash equivalents	$ 54,092,423	$ 1,011,430
Cash and cash equivalents—restricted—systemic risk (Note 16)	6,430,589	2,377,387
Investment in U.S. Treasury obligations, net (Note 3)	5,486,799	27,859,080
Assessments receivable, net (Note 9)	280,510	1,018,486
Receivables and other assets—systemic risk (Note 16)	3,298,819	1,138,132
Trust preferred securities (Note 5)	1,961,824	0
Interest receivable on investments and other assets, net	220,588	405,453
Receivables from resolutions, net (Note 4)	38,408,622	15,765,465
Property and equipment, net (Note 6)	388,817	368,761
Total Assets	**$ 110,568,991**	**$ 49,944,194**
Liabilities		
Accounts payable and other liabilities	$ 273,338	$ 132,597
Unearned revenue—prepaid assessments (Note 9)	42,727,101	0
Liabilities due to resolutions (Note 7)	34,711,726	4,724,462
Deferred revenue—systemic risk (Note 16)	7,847,447	2,077,880
Postretirement benefit liability (Note 13)	144,952	114,124
Contingent liabilities for:		
Anticipated failure of insured institutions (Note 8)	44,014,258	23,981,204
Systemic risk (Note 16)	1,411,966	1,437,638
Litigation losses (Note 8)	300,000	200,000
Total Liabilities	**131,430,788**	**32,667,905**
Commitments and off-balance-sheet exposure (Note 14)		
Fund Balance		
Accumulated Net (Loss) Income	(21,001,312)	15,001,272
Unrealized Gain on U.S. Treasury investments, net (Note 3)	142,127	2,250,052
Unrealized postretirement benefit (Loss) Gain (Note 13)	(2,612)	24,965
Total Fund Balance	**(20,861,797)**	**17,276,289**
Total Liabilities and Fund Balance	**$ 110,568,991**	**$ 49,944,194**

The accompanying notes are an integral part of these financial statements.

Deposit Insurance Fund Statement of Income and Fund Balance for the Years Ended December 31

Dollars in Thousands

	2009	2008
Revenue		
Interest on U.S. Treasury obligations	$ 704,464	$ 2,072,317
Assessments (Note 9)	17,717,374	2,964,518
Systemic risk revenue (Note 16)	1,721,626	1,463,537
Realized gain on sale of securities (Note 3)	1,389,285	774,935
Other revenue (Note 10)	3,173,611	31,017
Total Revenue	**24,706,360**	**7,306,324**
Expenses and Losses		
Operating expenses (Note 11)	1,271,099	1,033,490
Systemic risk expenses (Note 16)	1,721,626	1,463,537
Provision for insurance losses (Note 12)	57,711,772	41,838,835
Insurance and other expenses	4,447	3,693
Total Expenses and Losses	**60,708,944**	**44,339,555**
Net Loss	**(36,002,584)**	**(37,033,231)**
Unrealized (Loss) Gain on U.S. Treasury investments, net (Note 3)	(2,107,925)	1,891,144
Unrealized postretirement benefit (Loss) Gain (Note 13)	(27,577)	5,340
Comprehensive Loss	**(38,138,086)**	**(35,136,747)**
Fund Balance—Beginning	**17,276,289**	**52,413,036**
Fund Balance—Ending	**$ (20,861,797)**	**$ 17,276,289**

The accompanying notes are an integral part of these financial statements.

Deposit Insurance Fund Statement of Cash Flows for the Years Ended December 31

Dollars in Thousands

	2009	2008
Operating Activities		
Net Loss	**$ (36,002,584)**	**$ (37,033,231)**
Adjustments to reconcile net loss to net cash provided by (used by) operating activities:		
Amortization of U.S. Treasury obligations	210,905	457,289
Treasury inflation-protected securities inflation adjustment	10,837	(271,623)
Gain on sale of U.S. Treasury obligations	(1,389,285)	(774,935)
Depreciation on property and equipment	70,488	55,434
Loss on retirement of property and equipment	924	447
Provision for insurance losses	57,711,772	41,838,835
Unrealized (Loss) Gain on postretirement benefits	(27,577)	5,340
Guarantee termination fee from Citigroup	(1,961,824)	0
Systemic risk expenses	0	(2,352)
Change in Operating Assets and Liabilities:		
Decrease (Increase) in assessments receivable, net	737,976	(773,905)
Decrease in interest receivable and other assets	192,750	402,225
(Increase) in receivables from resolutions	(60,229,760)	(32,955,471)
(Increase) in receivable—systemic risk	(2,160,688)	(21,285)
Increase (Decrease) in accounts payable and other liabilities	140,740	(18,838)
Increase (Decrease) in postretirement benefit liability	30,828	(2,034)
(Decrease) in contingent liabilities—systemic risk	(25,672)	0
Increase in liabilities due to resolutions	29,987,265	4,724,462
Increase in unearned revenue—prepaid assessments	42,727,101	0
Increase in deferred revenue—systemic risk	5,769,567	2,377,387
Net Cash Provided by (Used by) Operating Activities	**35,793,763**	**(21,992,255)**

Deposit Insurance Fund Statement of Cash Flows *(continued)*

Dollars in Thousands

	2009	2008
Investing Activities		
Provided by:		
Maturity of U.S. Treasury obligations, held-to-maturity	0	3,304,350
Maturity of U.S. Treasury obligations, available-for-sale	6,382,027	3,930,226
Sale of U.S. Treasury obligations	15,049,873	13,974,732
Used by:		
Purchase of property and equipment	(91,468)	(72,783)
Net Cash Provided by Investing Activities	**21,340,432**	**21,136,525**
Net Increase (Decrease) in Cash and Cash Equivalents	**57,134,195**	**(855,730)**
Cash and Cash Equivalents—Beginning	**3,388,817**	**4,244,547**
Unrestricted Cash and Cash Equivalents—Ending	**54,092,423**	**1,011,430**
Restricted Cash and Cash Equivalents—Ending	**6,430,589**	**2,377,387**
Cash and Cash Equivalents—Ending	**$ 60,523,012**	**$ 3,388,817**

The accompanying notes are an integral part of these financial statements.

1. Legislation and Operations of the Deposit Insurance Fund

Overview

The Federal Deposit Insurance Corporation (FDIC) is the independent deposit insurance agency created by Congress in 1933 to maintain stability and public confidence in the nation's banking system. Provisions that govern the operations of the FDIC are generally found in the Federal Deposit Insurance (FDI) Act, as amended (12 U.S.C. 1811, *et seq.*). In carrying out the purposes of the FDI Act, as amended, the FDIC insures the deposits of banks and savings associations (insured depository institutions), and in cooperation with other federal and state agencies promotes the safety and soundness of insured depository institutions by identifying, monitoring and addressing risks to the Deposit Insurance Fund (DIF). An active institution's primary federal supervisor is generally determined by the institution's charter type. Commercial and savings banks are supervised by the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve Board, while savings associations (known as "thrifts") are supervised by the Office of Thrift Supervision.

The FDIC is the administrator of the DIF. The DIF is responsible for protecting insured bank and thrift depositors from loss due to institution failures. The FDIC is required by 12 U.S.C. 1823(c) to resolve troubled institutions in a manner that will result in the least possible cost to the deposit insurance fund unless a systemic risk determination is made that compliance with the least-cost test would have serious adverse effects on economic conditions or financial stability and any action or assistance taken under the systemic risk determination would avoid or mitigate such adverse effects. A systemic risk determination can only be invoked by the Secretary of the U.S. Treasury, in consultation with the President, and upon the written recommendation of two-thirds of both the FDIC Board of Directors and the Board of Governors of the Federal Reserve System. The systemic risk provision requires the FDIC to recover any related losses to the DIF through one or more special assessments from all insured depository institutions and, with the concurrence of the U.S. Treasury (Treasury), depository institution holding companies (see Note 16).

The FDIC is also the administrator of the FSLIC Resolution Fund (FRF). The FRF is a resolution fund responsible for the sale of remaining assets and satisfaction of liabilities associated with the former Federal Savings and Loan Insurance Corporation (FSLIC) and the Resolution Trust Corporation. The DIF and the FRF are maintained separately to carry out their respective mandates.

Recent Legislation

Helping Families Save Their Homes Act of 2009 (Public Law 111-22) was enacted on May 20, 2009. This legislation provides for: 1) extending the FDIC's deposit insurance coverage from $100,000 to $250,000 until 2013, 2) extending FDIC's authority to borrow from the Treasury in amounts necessary to carry out the increased insurance coverage, notwithstanding the amount limitations contained in Sections 14(a) and 15(c)

of the FDI Act, 3) repealing the prohibition against the FDIC taking the increased insurance coverage into account for purposes of setting assessments, 4) extending the generally applicable time limit from 5 years to 8 years for an FDIC Restoration Plan to rebuild the reserve ratio of the DIF, 5) permanently increasing the FDIC's authority to borrow from the Treasury from $30 billion to $100 billion and, if necessary, up to $500 billion through 2010, and 6) allowing FDIC to charge systemic risk special assessments by rulemaking on both insured depository institutions and, with Treasury concurrence, depository institution holding companies.

The *Emergency Economic Stabilization Act of 2008* (EESA), legislation to help stabilize the financial markets, was enacted on October 3, 2008. The legislation requires that Treasury consult with the FDIC and other federal agencies in the establishment of the troubled asset relief program (known as TARP).

Operations of the DIF

The primary purpose of the DIF is to: 1) insure the deposits and protect the depositors of DIF-insured institutions and 2) resolve DIF-insured failed institutions upon appointment of FDIC as receiver in a manner that will result in the least possible cost to the DIF (unless a systemic risk determination is made).

The DIF is primarily funded from deposit insurance assessments and interest earned on investments in U.S. Treasury obligations. Additional funding sources, if necessary, are borrowings from the Treasury, Federal Financing Bank (FFB), Federal Home Loan Banks, and insured depository institutions. The FDIC has borrowing authority of $100 billion from the Treasury, and if necessary, up to $500 billion through 2010. Additionally, FDIC has a Note Purchase Agreement with the FFB not to exceed $100 billion to enhance DIF's ability to fund deposit insurance obligations.

A statutory formula, known as the Maximum Obligation Limitation (MOL), limits the amount of obligations the DIF can incur to the sum of its cash, 90 percent of the fair market value of other assets, and the amount authorized to be borrowed from the Treasury. The MOL for the DIF was $118.2 billion and $69.0 billion as of December 31, 2009 and 2008, respectively. In connection with the temporary increase in the basic deposit insurance coverage limit from $100,000 to $250,000, the FDIC may borrow from the Treasury to carry out the increase in the maximum deposit insurance amount without regard to the MOL or the $100 billion limit.

Operations of Resolution Entities

The FDIC is responsible for managing and disposing of the assets of failed institutions in an orderly and efficient manner. The assets held by receiverships, pass-through conservatorships and bridge institutions (collectively, resolution entities), and the claims against them, are accounted for separately from DIF assets and liabilities to ensure that proceeds from these entities are distributed in accordance with applicable laws and regulations. Accordingly, income and expenses attributable to resolution entities are accounted for as transactions of those entities. All are billed by the FDIC for services provided on their behalf.

2. Summary of Significant Accounting Policies

General

These financial statements pertain to the financial position, results of operations, and cash flows of the DIF and are presented in accordance with U.S. generally accepted accounting principles (GAAP). As permitted by the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, the FDIC prepares financial statements in conformity with standards promulgated by the Financial Accounting Standards Board (FASB). These statements do not include reporting for assets and liabilities of resolution entities because these entities are legally separate and distinct, and the DIF does not have any ownership interests in them. Periodic and final accountability reports of resolution entities are furnished to courts, supervisory authorities, and others upon request.

Use of Estimates

Management makes estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Where it is reasonably possible that changes in estimates will cause a material change in the financial statements in the near term, the nature and extent of such changes in estimates have been disclosed. The more significant estimates include the assessments receivable and associated revenue; the allowance for loss on receivables from resolutions (including loss-share agreements); the estimated losses for: anticipated failures, litigation, and representations and warranties; guarantee obligations for: the Temporary Liquidity Guarantee Program and debt of limited liability companies; valuation of trust preferred securities; and the postretirement benefit obligation.

Cash Equivalents

Cash equivalents are short-term, highly liquid investments consisting primarily of U.S. Treasury Overnight Certificates. The majority of cash equivalents held by the DIF at December 31, 2009, resulted from the collection of $45.7 billion in prepaid assessments on December 30, 2009 for all quarterly assessment periods through December 31, 2012 (see Note 9).

Investment in U.S. Treasury Obligations

DIF funds are required to be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States; the Secretary of the Treasury must approve all such investments in excess of $100,000. The Secretary has granted approval to invest DIF funds only in U.S. Treasury obligations that are purchased or sold exclusively through the Bureau of the Public Debt's Government Account Series (GAS) program.

DIF's investments in U.S. Treasury obligations are classified as available-for-sale. Securities designated as available-for-sale are shown at fair value. Unrealized gains and losses are reported as other comprehensive income. Realized gains and losses are included in the Statement of Income and Fund Balance as components of Net Income. Income on securities is calculated

and recorded on a daily basis using the effective interest method.

Revenue Recognition for Assessments

Assessment revenue is recognized for the quarterly period of insurance coverage based on an estimate. The estimate is derived from an institution's risk-based assessment rate and assessment base for the prior quarter adjusted for the current quarter's available assessment credits, any changes in supervisory examination and debt issuer ratings for larger institutions, and a modest deposit insurance growth factor. At the subsequent quarter-end, the estimated revenue amounts are adjusted when actual assessments for the covered period are determined for each institution. (See Note 9 for additional information on assessments.)

Capital Assets and Depreciation

The FDIC buildings are depreciated on a straight-line basis over a 35 to 50 year estimated life. Leasehold improvements are capitalized and depreciated over the lesser of the remaining life of the lease or the estimated useful life of the improvements, if determined to be material. Capital assets depreciated on a straight-line basis over a five-year estimated useful life include mainframe equipment; furniture, fixtures, and general equipment; and internal-use software. Personal computer equipment is depreciated on a straight-line basis over a three-year estimated useful life.

Related Parties

The nature of related parties and a description of related party transactions are discussed in Note 1 and disclosed throughout the financial statements and footnotes.

Reclassifications

Certain reclassifications have been made in the 2008 financial statements to conform to the presentation used in 2009.

Disclosure about Recent Accounting Pronouncements

- FASB Accounting Standards Codification (ASC) 105, *Generally Accepted Accounting Principles* (formerly SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*, issued in June 2009), became effective for financial statements covering periods ending after September 15, 2009. On July 1, 2009, the FASB ASC was launched and became the sole source of authoritative accounting principles applicable to the FDIC.

  All existing standards that were used to create the Codification have become superseded. As a result, references to generally accepted accounting principles in these Notes will consist of the numbers used in the Codification and, if appropriate, the former pronouncement number. The Codification's purpose was not to create new accounting or reporting guidance, but to organize and simplify authoritative GAAP literature. Consequently, there will be no change to the DIF's financial statements due to the implementation of this Codification.

- Statement of Financial Accounting Standards (SFAS) No. 167, *Amendments to FASB Interpretation No. 46(R)*, was issued by the FASB in June 2009, and subsequently codified

upon issuance of Accounting Standards Update No. 2009-17, *Consolidations (ASC 810) - Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*. SFAS 167, effective for reporting periods beginning after November 15, 2009, modifies the former quantitative approach for determining the primary beneficiary of a variable interest entity (VIE) to a qualitative assessment. An enterprise must determine qualitatively whether it has (1) the power to direct the activities of the VIE that most significantly impact the entity's economic performance and (2) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. If an enterprise has both of these characteristics, the enterprise is considered the primary beneficiary and must consolidate the VIE. Management is currently reviewing the possible impact, if any, of SFAS 167 (now codified in ASC 810) on DIF's accounting and financial reporting requirements for 2010.

- SFAS No. 166, *Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140*, was issued by the FASB in June 2009. Subsequently, the FASB issued Accounting Standards Update No. 2009-16, *Transfers and Servicing (ASC 860) - Accounting for Transfers of Financial Assets*, to formally incorporate the provisions of SFAS No. 166 into the Codification. SFAS 166 removes the concept of a qualifying *special-purpose entity* from GAAP, changes the requirements for derecognizing financial assets, and requires additional disclosures about a transferor's continuing involvement in transferred financial assets. The FASB's objective is to improve the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets.

  The provisions of SFAS 166 (now codified in ASC 860) become effective for the DIF for all transfers of financial assets occurring on or after January 1, 2010.

- SFAS No. 165, *Subsequent Events*, was issued in May 2009 and subsequently codified in FASB ASC 855, *Subsequent Events*. ASC 855 represents the inclusion of guidance on subsequent events in the accounting literature. Historically, management had relied on auditing literature for guidance on assessing and disclosing subsequent events. ASC 855 now requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date—that is, whether that date represents the date the financial statements were issued or were available to be issued. These new provisions, effective for the DIF as of December 31, 2009, do not have a significant impact on the financial statements.

- FASB Staff Position (FSP) FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, was issued in April 2009 and subsequently codified in FASB ASC 320, *Investments-Debt and Equity Securities*. It modifies the other-

than-temporary impairment (OTTI) guidance for debt securities. An OTTI is considered to have occurred if 1) an entity has the intent to sell an impaired security, 2) it is more likely than not that it will be required to sell the security before its anticipated recovery, or 3) an entity does not expect to recover the entire amortized cost basis when there is no intent or likely requirement to sell the security.

In addition, the FSP requires that an OTTI loss should be recognized in earnings or other comprehensive income. If the entity has the intent to sell the security or it is more likely than not that it will be required to sell the security, the entire impairment (amortized cost basis over fair value) will be recognized in earnings. However, if an entity's management asserts that it does not have the intent to sell a debt security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, then an entity must separate the impairment loss into two components: 1) the amount related to credit loss, which is recorded in earnings, and 2) the remainder of the impairment loss, which is recorded in other comprehensive income. The provisions of the FSP, now codified in ASC 320, became effective for the DIF as of June 30, 2009.

- Other recent accounting pronouncements have been deemed to be not applicable or material to the financial statements as presented.

3. Investment in U.S. Treasury Obligations, Net

As of December 31, 2009 and 2008, investments in U.S. Treasury obligations, net, were $5.5 billion and $27.9 billion, respectively. As of December 31, 2009 and 2008, the DIF held $2.1 billion and $2.7 billion, respectively, of Treasury inflation-protected securities (TIPS). These securities are indexed to increases or decreases in the Consumer Price Index for All Urban Consumers (CPI-U).

For the year ended December 31, 2009, available-for-sale securities were sold for total proceeds of $15.2 billion. The gross realized gains on these sales totaled $1.4 billion. To determine gross realized gains, the cost of securities sold is based on specific identification. Net unrealized holding losses on available-for-sale securities of $2.1 billion are included in other comprehensive loss.

Total Investment in U.S. Treasury Obligations, Net at December 31, 2009

Dollars in Thousands

Maturity	Yield at Purchase (a)	Face Value	Net Carrying Amount	Unrealized Holding Gains	Unrealized Holding Losses	Fair Value
U.S. Treasury notes and bonds						
Within 1 year	5.04%	$ 3,058,000	$ 3,062,038	$ 48,602	$ 0	$ 3,110,640
After 1 year through 5 years	4.15%	300,000	302,755	11,648	0	314,403
U.S. Treasury inflation-protected securities						
After 1 year through 5 years	3.14%	1,968,744	1,979,879	81,877	0	2,061,756
Total		**$ 5,326,744**	**$ 5,344,672**	**$ 142,127**	**$ 0**	**$ 5,486,799**

(a) For TIPS, the yields in the above table are stated at their real yields at purchase, not their effective yields. Effective yields on TIPS include a long-term annual inflation assumption as measured by the CPI-U. The long-term CPI-U consensus forecast is 1.1 percent, based on figures issued by the Congressional Budget Office and *Blue Chip Economic Indicators* in early 2009.

Total Investment in U.S. Treasury Obligations, Net at December 31, 2008

Dollars in Thousands

Maturity (a)	Yield at Purchase (b)	Face Value	Net Carrying Amount	Unrealized Holding Gains	Unrealized Holding Losses (c)	Fair Value
U.S. Treasury notes and bonds						
Within 1 year	4.25%	$ 6,192,000	$ 6,350,921	$ 130,365	$ 0	$ 6,481,286
After 1 year through 5 years	4.72%	9,503,000	9,451,649	1,030,931	0	10,482,580
After 5 years through 10 years	4.79%	6,130,000	7,090,289	1,142,753	0	8,233,042
U.S. Treasury inflation-protected securities						
Within 1 year	3.82%	726,550	726,561	0	(5,627)	720,934
After 1 year through 5 years	3.14%	1,973,057	1,989,608	0	(48,370)	1,941,238
Total		**$ 24,524,607**	**$ 25,609,028**	**$ 2,304,049**	**$ (53,997)**	**$ 27,859,080**

(a) For purposes of this table, all callable securities are assumed to mature on their first call dates. Their yields at purchase are reported as their yield to first call date. Callable U.S. Treasury bonds may be called five years prior to the respective bonds' stated maturity on their semi-annual coupon payment dates upon 120 days notice.
(b) For TIPS, the yields in the above table are stated at their real yields at purchase, not their effective yields. Effective yields on TIPS include a long-term annual inflation assumption as measured by the CPI-U. The long-term CPI-U consensus forecast is 2.2 percent, based on figures issued by the Congressional Budget Office and *Blue Chip Economic Indicators* in early 2008.
(c) The unrealized losses on the U.S. Treasury inflation-protected securities (TIPS) is attributable to the two-month delay in adjusting TIPS' principal for changes in the November and December Consumer Price Index for all Urban Consumers. As the losses occurred over a period less than a year and the December 31, 2008, unrealized losses converted to unrealized gains by February 28, 2009, the FDIC does not consider these securities to be other than temporarily impaired at December 31, 2008.

4. Receivables From Resolutions, Net

Receivables From Resolutions, Net at December 31
Dollars in Thousands

	2009	2008
Receivables from closed banks	$ 98,647,508	$ 27,389,467
Receivables from operating banks	0	9,406,278
Allowance for losses	(60,238,886)	(21,030,280)
Total	**$ 38,408,622**	**$ 15,765,465**

The receivables from resolutions include payments made by the DIF to cover obligations to insured depositors (subrogated claims), advances to resolution entities for working capital, and administrative expenses paid on behalf of resolution entities. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. Estimated future payments on losses incurred on assets sold to an acquiring institution under a loss-sharing agreement are factored into the computation of the expected repayment. Assets held by DIF resolution entities are the main source of repayment of the DIF's receivables from resolutions.

As of December 31, 2009, there were 179 active receiverships which includes 140 established in 2009. As of December 31, 2009 and 2008, DIF resolution entities held assets with a book value of $49.3 billion and $45.8 billion, respectively (including cash, investments, and miscellaneous receivables of $7.7 billion and $5.1 billion, respectively). Ninety-nine percent of the current asset book value of $49.3 billion is held by resolution entities established in 2008 and 2009.

Estimated cash recoveries from the management and disposition of assets that are used to determine the allowance for losses were based on asset recovery rates from several sources including: actual or pending institution-specific asset disposition data; failed institution-specific asset valuation data; aggregate asset valuation data on several recently failed or troubled institutions; and empirical asset recovery data based on failures as far back as 1990. Methodologies for determining the asset recovery rates incorporate estimating future cash recoveries, net of applicable liquidation cost estimates, and discounting based on market-based risk factors applicable to a given asset's type and quality. The resulting estimated cash recoveries are then used to derive the allowance for loss on the receivables from these resolutions.

For failed institutions resolved using a whole bank purchase and assumption transaction with an accompanying loss-share agreement, the projected future loss-share payments and monitoring costs on the covered assets sold to the acquiring institution under the agreement are considered in determining the allowance for loss on the receivables from these resolutions. The loss-share cost projections are based on the intrinsic value of the covered assets. The intrinsic value is determined using economic models that consider the quality and type of covered assets, current and future market conditions, risk factors and estimated asset holding periods.

Estimated asset recoveries are regularly evaluated during the year, but remain subject to uncertainties because of potential changes in economic and market conditions. Continuing economic uncertainties could cause the DIF's

actual recoveries to vary significantly from current estimates.

Whole Bank Purchase and Assumption Transactions with Loss-sharing Agreements

The FDIC resolved 90 of the 140 failures in 2009 using a Whole Bank Purchase and Assumption resolution transaction with an accompanying Loss-Share Agreement on assets purchased by the acquirer. The acquiring institution assumes all of the deposits and purchases essentially all of the assets of a failed institution. The majority of the commercial and residential assets are purchased under a loss-share agreement, where the FDIC agrees to share in future losses experienced by the acquirer on those assets covered under the agreement. Loss-share agreements are used by the FDIC to keep assets in the private sector and minimize disruptions to loan customers.

Losses on the covered assets will be shared between the acquirer and the FDIC in its capacity as receiver of the failed institution when losses occur through the sale, foreclosure, loan modification, or the write-down of loans in accordance with the terms of the loss-share agreement. The agreement typically covers a 5 to 10 year period with the receiver covering 80 percent of the losses incurred by the acquirer up to a stated threshold amount (which varies by agreement) and the acquiring bank covering 20 percent. Any losses above the stated threshold amount will be reimbursed by the receiver at 95 percent of the losses booked by the acquirer. The estimated liability for loss-sharing is accounted for by the receiver and is considered in the determination of the DIF's allowance for loss against the corporate receivable from the resolution. As loss-share claims are asserted and proven, DIF receiverships will satisfy these loss-share payments using available liquidation funds and/or amounts due from the DIF for funding the deposits assumed by the acquirer (see Note 7).

Through December 31, 2009, 93 DIF receiverships are estimated to pay approximately $22.2 billion over the length of these loss-share agreements on approximately $126.4 billion in total covered assets at the inception date of these agreements. To date, 37 receiverships have made loss-share payments totaling $892.2 million.

Financial instruments that potentially subject the DIF to concentrations of credit risk are receivables from resolutions. The repayment of DIF's receivables from resolutions is primarily influenced by recoveries on assets held by DIF receiverships and payments on the covered assets under loss-sharing agreements. The majority of the $165.5 billion in remaining assets in liquidation ($41.4 billion) and current loss-share covered assets ($124.1 billion) are concentrated in commercial loans ($71.7 billion), residential loans ($70.3 billion), and securities ($14.7 billion). Most of the assets in these asset types originated from failed institutions located in California ($55.6 billion), Florida ($15.7 billion), Alabama ($15.6 billion), Texas ($11.3 billion), and Illinois ($7.3 billion).

5. Trust Preferred Securities

On January 15, 2009, subject to a systemic risk determination, the Treasury, the FDIC and the Federal Reserve Bank of New York executed terms of a guarantee agreement with Citigroup to provide protection against the possibility of unusually large losses on an asset pool of approximately $301.0 billion of loans and securities backed by residential and commercial real estate and other such assets that would remain on the balance sheet

of Citigroup. The term of the loss-share guarantee was 10 years for residential assets and 5 years for non-residential assets. The FDIC exposure from this guarantee was capped at $10 billion.

In consideration for its portion of the loss-share guarantee at inception, the FDIC received 3,025 shares of Citigroup's designated cumulative perpetual preferred stock (Series G) with a liquidation preference at the time of $1,000,000 per share for a total of $3.025 billion paying dividends at a rate of 8 percent annually. On July 30, 2009, all shares of preferred stock initially received were exchanged for 3,025,000 of Citigroup Capital XXXIII trust preferred securities (TruPs) with a liquidation amount of $1,000 per security. The principal amount is due in 2039. The equivalent exchange of $3.025 billion pays a quarterly distribution at a rate of 8 percent annually. The Treasury initially received $4.034 billion in preferred stock for its loss-share protection and received an equivalent, aggregate amount of $4.034 billion in trust preferred securities at the time of the exchange for TruPs.

On December 23, 2009, Citigroup terminated the loss-sharing agreement citing improvements in its financial condition and in financial market stability. The FDIC incurred no loss from the guarantee prior to termination of the agreement. In connection with the early termination of the guarantee program, the Treasury and the FDIC agreed that Citigroup would reduce the combined $7.1 billion liquidation amount of the TruPs by $1.8 billion. Pursuant to an agreement between the Treasury and the FDIC, TruPs held by the Treasury were reduced by $1.8 billion and the FDIC initially retained all TruPs holdings of $3.025 billion. The FDIC will transfer an aggregate liquidation amount of $800 million in TruPs to the Treasury, plus any related interest, less any payments made or required to be made by the FDIC for guaranteed debt instruments issued by Citigroup or any of its affiliates under the Temporary Liquidity Guarantee Program (TLGP; see Note 16). This transfer will occur within 5 days of the date on which no Citigroup debt remains outstanding under the TLGP. The fair value of the TruPs and related interest are recorded as systemic risk assets described in Note 16.

The remaining $2.225 billion (par value) of TruPs held by the FDIC are classified as available-for-sale debt securities in accordance with FASB ASC Topic 320, *Investments—Debt and Equity Securities.* Upon termination of the guarantee agreement, the DIF recognized revenue of $1.962 billion for the fair value of the TruPs. (See Note 10, *Other Revenue* and Note 15, *Disclosures About the Fair Value of Financial Instruments*).

6. Property and Equipment, Net

Property and Equipment, Net at December 31
Dollars in Thousands

	2009	2008
Land	$ 37,352	$ 37,352
Buildings (including leasehold improvements)	295,265	281,401
Application software (including work-in-process)	179,479	173,872
Furniture, fixtures, and equipment	117,430	84,574
Accumulated depreciation	(240,709)	(208,438)
Total	**$ 388,817**	**$ 368,761**

The depreciation expense was $70 million and $55 million for 2009 and 2008, respectively.

7. Liabilities Due to Resolutions

As of December 31, 2009, the DIF recorded liabilities totaling $34.7 billion to resolution entities representing the agreed-upon value of assets transferred from the receiverships, at the time of failure, to the acquirers/bridge institutions for use in funding the deposits assumed by the acquirers/bridge institutions. Ninety-seven percent of these liabilities are due to failures resolved under a whole bank purchase and assumption transaction, most with an accompanying loss-share agreement. The DIF satisfies these liabilities either by directly sending cash to the receiverships to fund loss-share and other expenses or by offsetting receivables from resolutions when a receivership declares a dividend. Inherent in these liabilities are $470 million in unreimbursed deposit claims subrogated by the DIF on behalf of the Temporary Liquidity Guarantee Program (see Note 16).

In addition, there were $150 million in unpaid brokered deposit claims related to multiple receiverships. The DIF pays these liabilities when the claims are approved.

8. Contingent Liabilities for:

Anticipated Failure of Insured Institutions

The DIF records a contingent liability and a loss provision for DIF-insured institutions that are likely to fail, absent some favorable event such as obtaining additional capital or merging, when the liability is probable and reasonably estimable. The contingent liability is derived by applying expected failure rates and loss rates to institutions based on supervisory ratings, balance sheet characteristics, and projected capital levels.

During the year, the conditions of the banking industry continued to deteriorate. The difficult economic and credit environment continued to challenge the soundness of many DIF-insured institutions. The ongoing weakness in housing and commercial real estate markets led to asset quality problems and volatility in financial markets, which hurt the banking industry performance and weakened many institutions with significant portfolios of residential and commercial mortgages. The impact of the economic deterioration in the banking industry caused a significant increase in the contingent loss reserve. As of December 31, 2009 and 2008, the contingent liabilities for anticipated failure of insured institutions were $44.0 billion and $24.0 billion, respectively.

In addition to these recorded contingent liabilities, the FDIC has identified risk in the financial services industry that could result in an additional loss to the DIF should potentially vulnerable insured institutions ultimately fail. As a result of these risks, the FDIC believes that it is reasonably possible that the DIF could incur additional estimated losses up to approximately $24 billion. The actual losses, if any, will largely depend on future economic and market conditions and could differ materially from this estimate.

During 2009, 140 banks with combined assets of $171.2 billion failed. It is uncertain how long and how deep the current downturn will be. Supervisory and market data suggest that the banking industry will continue to experience elevated levels of stress over the coming year. The FDIC continues to evaluate the ongoing risks to affected institutions in light of the existing economic and financial conditions, and the extent to which such risks will continue to put stress on the resources of the insurance fund.

Litigation Losses

The DIF records an estimated loss for unresolved legal cases to the extent that those losses are considered probable and reasonably estimable. The FDIC recorded probable litigation losses of $300 million and $200 million for the DIF as of December 31, 2009 and 2008, respectively, and has determined that there are no reasonably possible losses from unresolved cases.

Other Contingencies

Representations and Warranties

In an effort to maximize the return from the sale of assets from bank and thrift resolutions, FDIC as receiver offered representations and warranties, and guarantees on certain loan and servicing rights sales. Although these representations and warranties were offered by the receiver, DIF guaranteed the obligations under these agreements. In general, the guarantees, representations, and warranties relate to the completeness and accuracy of loan documentation, the quality of the underwriting standards used, the accuracy of the delinquency status, and the conformity of the loans with characteristics of the pool in which they were sold at the time of sale.

As a result of loans and servicing rights sold in connection with the asset disposition of IndyMac Federal Bank, the unpaid principal balance for loans subject to representations and warranties increased by $184 billion to $195 billion as of December 31, 2009. Since the receiverships are the primary guarantors and they have sufficient funds to pay asserted claims, the DIF did not record contingent liabilities from any of the outstanding claims asserted in connection with representations and warranties at December 31, 2009 and 2008.

In addition, until the contracts offering the representations and warranties and guarantees have expired, future losses could be incurred, some as late as 2032. Consequently, the FDIC believes it is possible that losses may be incurred by the DIF from the universe of outstanding contracts with unasserted representation and warranty claims. However, because of the uncertainties surrounding the timing of when claims may be asserted, the FDIC is unable to reasonably estimate a range of loss to the DIF from outstanding contracts with unasserted representation and warranty claims.

Purchase and Assumption Indemnification

In connection with Purchase and Assumption agreements for resolutions, the FDIC in its receivership capacity generally indemnifies the purchaser of a failed institution's assets and liabilities in the event a third party asserts a claim against the purchaser unrelated to the explicit assets purchased or liabilities assumed at the time of failure. The FDIC in its Corporate capacity is a secondary guarantor if and when a receiver is unable to pay. These indemnifications generally extend for a term of six years after the date of institution failure. The FDIC is unable to estimate the maximum potential liability for these types of guarantees as the agreements do not specify a maximum amount and any payments are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. During 2009 and 2008, the FDIC in its Corporate capacity has not made any indemnification payments under such agreements and no amount

has been accrued in the accompanying financial statements with respect to these indemnification guarantees.

FDIC Guaranteed Debt of Limited Liability Companies

During 2009, the FDIC in its corporate capacity offered guarantees on loans issued by newly-formed limited liability companies (LLCs) that were created to dispose of certain residential mortgage loans, construction loans, and other assets of two receiverships. The receiverships transferred a portfolio of assets with an unpaid principal balance of $5.8 billion to the LLCs. Private investors purchased a 40–50 percent ownership interest in the LLCs for $615 million in cash and the LLCs issued notes of $2.1 billion to the receiverships to partially fund the purchase of the assets. The receiverships hold the remaining 50–60 percent equity interest in the LLCs. In exchange for the guarantees, the DIF expects to receive estimated fees totaling $71.4 million, which equals one percent per annum over the estimated life of the notes.

The term of the guarantees extends until the earliest of 1) payment in full of the notes or 2) two years following the maturity date of the notes (12 years). In the event of note payment default by an LLC, the FDIC in its corporate capacity can take one or more of the following remedies: 1) accelerate the payment of the unpaid principal amount of the notes; 2) sell the assets held as collateral; and 3) foreclose on the equity interests of the debtor.

The DIF has recorded a receivable for the estimated guarantee fees of $71.4 million and an offsetting deferred revenue liability, included in the "Interest receivable on investments and other assets, net" and "Accounts payable and other liabilities" line items, respectively. Guarantee fees are recognized as revenue on a straight-line basis over the term of the notes.

The source of payment for the LLC-issued debt is the collections from the LLC assets. If cash flow collections from the LLC assets are insufficient to cover the payments on the notes in accordance with priority of payments, then the FDIC as guarantor is required to make a guarantee payment for any shortfall. The estimated loss of the guarantees to the DIF is based on the discounted present value of the expected guarantee payments by the FDIC, reimbursements to the FDIC for guarantee payments, and guarantee fee collections. Under both a base case and a more stressful modeling scenario, the cash flows from the LLC assets provide sufficient coverage to fully pay the debts by their maturity dates. Therefore, the estimated loss to the DIF from these guarantees is zero.

As of December 31, 2009, the maximum estimated guarantee exposure equals the total outstanding debt of $2.1 billion.

9. Assessments

The FDI Act, as amended, requires a risk-based assessment system. The Act allows the FDIC discretion in defining risk and, by regulation, the FDIC has established several assessment risk categories based upon supervisory and capital evaluations. On March 4, 2009, the Board issued a final rule on Assessments to: 1) make it fairer and more sensitive to risk, 2) improve the way the risk-based assessment system differentiates risk among insured institutions, and 3) increase deposit insurance assessment

rates to raise assessment revenue to help meet the requirements of the Restoration Plan. The assessment rate averaged approximately 23.32 cents and 4.18 cents per $100 of the assessment base, as defined in part 327.5(b) of FDIC Rules and Regulations, for 2009 and 2008, respectively. (The assessment rate would have been 16.19 cents if the special assessment imposed on June 30, 2009 was excluded from the 2009 assessment income.)

In compliance with provisions of the FDI Act, as amended, and implementing regulations, the FDIC is required to:

- annually establish and publish a designated reserve ratio (DRR) within the statutory range from 1.15 to 1.50 percent of estimated insured deposits. As of December 31, 2009, the DIF reserve ratio was (0.39) percent of estimated insured deposits and the FDIC has set the DRR at 1.25 percent for 2010;
- adopt a DIF restoration plan to return the reserve ratio to 1.15 percent generally within eight years, if the reserve ratio falls below 1.15 percent or is expected to fall below 1.15 percent within six months (see paragraph titled, *Amended Restoration Plan*);
- annually determine if a dividend should be paid, based on the statutory requirement generally to declare dividends for one-half of the amount between 1.35 and 1.50 percent and all amounts exceeding 1.50 percent.

Assessment Revenue

During 2009, the FDIC implemented actions to supplement DIF's revenue through a special assessment and liquidity through prepaid assessments from insured depository institutions:

- On May 22, 2009, the FDIC adopted a final rule imposing a 5 basis point special assessment on each insured depository institution's total assets minus Tier 1 capital as reported in its report of condition as of June 30, 2009. The special assessment of $5.5 billion was collected on September 30, 2009, at the same time the regular quarterly risk-based assessment for the second quarter 2009 was collected.
- On November 17, 2009, the FDIC issued a Final Rule, *Prepaid Assessments,* to address the DIF's liquidity needs to pay for projected near-term failures and to ensure that the deposit insurance system remains industry-funded. Pursuant to the Rule, on December 30, 2009, a majority of insured depository institutions prepaid estimated quarterly risk-based assessments of $45.7 billion for the period October 2009 through December 2012. The prepaid amount was based on maintaining assessment rates at their current levels through the end of 2010 and adopting a uniform 3 basis point increase in assessment rates effective January 1, 2011. An institution's quarterly risk-based deposit insurance assessments thereafter will be offset by the amount prepaid until that amount is exhausted or until June 30, 2013, when any amount remaining would be returned to the institution.

Prepaid assessments were mandatory for all institutions, but the FDIC exercised its discretion as supervisor and insurer to exempt an institution from the prepayment requirement if the FDIC determined that the prepayment would adversely affect the safety and soundness of the institution. In

addition, institutions were allowed to request exemption from payment under certain circumstances.

For those institutions that prepaid assessments, the DIF recognized revenue of $3.0 billion for the fourth quarter insurance period. The remaining prepaid amount of $42.7 billion is included in the "Unearned revenue—prepaid assessments" line item on the Balance Sheet. For those institutions that did not prepay assessments, the "Assessments Receivable, net" line item of $281 million represents the estimated gross premiums due from insured depository institutions for the fourth quarter of the year. The actual deposit insurance assessment for the fourth quarter was billed and collected at the end of the first quarter of 2010. During 2009 and 2008, $17.7 billion and $3.0 billion, respectively, were recognized as assessment revenue from institutions.

The FDI Act, as amended, granted a one-time assessment credit of approximately $4.7 billion to certain eligible insured depository institutions (or their successors) based on the assessment base of the institution as of December 31, 1996, as compared to the combined aggregate assessment base of all eligible institutions. Of the credits granted, $2.7 million remained as of December 31, 2009.

Amended Restoration Plan

A Federal Register notice for *Amendment of FDIC Restoration Plan* was issued on October 2, 2009, amending DIF's Restoration Plan which was originally adopted on October 7, 2008 and subsequently amended on February 27, 2009. The Amended Restoration Plan addresses the need to return the DIF to its mandated minimum reserve ratio of 1.15 percent of estimated insured deposits. The Restoration Plan provided for the following: 1) the period of the Plan was extended to eight years; 2) current assessment rates will be maintained through December 31, 2010, with a uniform increase in risk-based assessment rates of 3 basis points effective January 1, 2011; and 3) at least semi-annually hereafter, the FDIC will update its loss and income projections for the Fund and, if necessary, will increase assessment rates prior to the end of the eight-year period, to return the reserve ratio to 1.15 percent.

Assessments Related to FICO

Assessments continue to be levied on institutions for payments of the interest on obligations issued by the Financing Corporation (FICO). The FICO was established as a mixed-ownership government corporation to function solely as a financing vehicle for the former FSLIC. The annual FICO interest obligation of approximately $790 million is paid on a pro rata basis using the same rate for banks and thrifts. The FICO assessment has no financial impact on the DIF and is separate from deposit insurance assessments. The FDIC, as administrator of the DIF, acts solely as a collection agent for the FICO. During 2009 and 2008, approximately $784 million and $791 million, respectively, was collected and remitted to the FICO.

10. Other Revenue

Other Revenue for the Years Ended December 31 *Dollars in Thousands*		
	2009	2008
Guarantee termination fees	$ 2,053,825	$ 0
Debt guarantee surcharges	871,746	0
Dividends and interest on Citigroup trust preferred securities	231,227	0
Other	16,813	31,017
Total	**$ 3,173,611**	**$ 31,017**

Guarantee Termination Fees

Bank of America

In January 2009, the FDIC, Treasury, and the Federal Reserve Bank of New York (federal parties) signed a Summary of Terms (Term Sheet) with Bank of America to guarantee or lend against a pool of up to $118.0 billion of financial instruments consisting of securities backed by residential and commercial real estate loans and corporate debt and related derivatives. In May 2009, prior to completing definitive documentation, Bank of America notified the federal parties of its desire to terminate negotiations with respect to the guarantee contemplated in the Term Sheet. All parties agreed that Bank of America received value for entering into the Term Sheet and that the federal parties should be compensated for out-of-pocket expenses and a fee equal to the amount Bank of America would have paid for the guarantee from the date of the signing of the Term Sheet through the termination date. Under the terms of the settlement, the federal parties received a total of $425 million. Of this amount, the FDIC received and recognized revenue of $92 million for the DIF. No losses were borne by the FDIC prior to the settlement.

Citigroup

In connection with the termination of the loss-share agreement with Citigroup, the DIF recognized revenue of $1.962 billion for the fair value of the trust preferred securities received as consideration for the guarantee as agreed to in the termination and recorded $231 million in dividends and interest from Citigroup (see Note 5).

Surcharges on FDIC-Guaranteed Debt

On June 3, 2009, the FDIC published a final rule in the Federal Register amending the Temporary Liquidity Guarantee Program (TLGP) to provide a limited extension of the Debt Guarantee Program (DGP) for insured depository institutions and other participating entities (see Note 16). The amendment also imposed surcharges on FDIC-guaranteed debt issued after March 31, 2009, with a maturity of one year or more. The DGP extensions, coupled with the surcharges, were designed to facilitate an orderly transition period for all participants to return to the non-guaranteed debt market and to reduce the potential for market disruptions at the end of the program. Unlike other TLGP fees, which are reserved for projected TLGP losses, the amount of surcharges collected were deposited into the DIF. During 2009, the DIF collected surcharges in the amount of $872 million.

11. Operating Expenses

Operating expenses were $1.3 billion for 2009, compared to $1 billion for 2008. The chart below lists the major components of operating expenses.

Operating Expenses for the Years Ended December 31
Dollars in Thousands

	2009	2008
Salaries and benefits	$ 901,836	$ 702,040
Outside services	244,479	159,170
Travel	97,744	67,592
Buildings and leased space	65,286	53,630
Software/Hardware maintenance	40,678	29,312
Depreciation of property and equipment	70,488	55,434
Other	37,563	32,198
Services reimbursed by TLGP	(3,613)	(2,352)
Services billed to resolution entities	(183,362)	(63,534)
Total	**$ 1,271,099**	**$ 1,033,490**

12. Provision for Insurance Losses

Provision for insurance losses was $57.7 billion for 2009 and $41.8 billion for 2008. The following chart lists the major components of the provision for insurance losses.

Provision for Insurance Losses for the Years Ended December 31
Dollars in Thousands

	2009	2008
Valuation Adjustments		
Closed banks and thrifts	$ 37,586,603	$ 17,974,530
Other assets	(7,885)	7,377
Total Valuation Adjustments	**37,578,718**	**17,981,907**
Contingent Liabilities Adjustments:		
Anticipated failure of insured institutions	20,033,054	23,856,928
Litigation	100,000	0
Total Contingent Liabilities Adjustments	**20,133,054**	**23,856,928**
Total	**$ 57,711,772**	**$ 41,838,835**

13. Employee Benefits

Pension Benefits and Savings Plans

Eligible FDIC employees (permanent and term employees with appointments exceeding one year) are covered by the federal government retirement plans, either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Although the DIF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The DIF also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported on and accounted for by the U.S. Office of Personnel Management (OPM).

Eligible FDIC employees also may participate in a FDIC-sponsored tax-deferred 401(k) savings plan with matching contributions up to five percent. Under the Federal Thrift Savings Plan (TSP), the FDIC provides FERS employees with an automatic contribution of 1 percent of pay and an additional matching contribution up to 4 percent of pay. CSRS employees also can contribute to the TSP. However, CSRS employees do not receive agency matching contributions.

Pension Benefits and Savings Plans Expenses for the Years Ended December 31
Dollars in Thousands

	2009	2008
Civil Service Retirement System	$ 6,401	$ 6,204
Federal Employees Retirement System (Basic Benefit)	56,451	44,073
FDIC Savings Plan	25,449	21,786
Federal Thrift Savings Plan	20,503	16,659
Total	**$ 108,804**	**$ 88,722**

Postretirement Benefits Other Than Pensions

The DIF has no postretirement health insurance liability, since all eligible retirees are covered by the Federal Employees Health Benefit (FEHB) program. FEHB is administered and accounted for by the OPM. In addition, OPM pays the employer share of the retiree's health insurance premiums.

The FDIC provides certain life and dental insurance coverage for its eligible retirees, the retirees' beneficiaries, and covered dependents. Retirees eligible for life and dental insurance coverage are those who have qualified due to: 1) immediate enrollment upon appointment or five years of participation in the plan and 2) eligibility for an immediate annuity. The life insurance program provides basic coverage at no cost to retirees and allows converting optional coverages to direct-pay plans. For the dental coverage, retirees are responsible for a portion of the dental premium.

The FDIC has elected not to fund the postretirement life and dental benefit liabilities. As a result, the DIF recognized the underfunded status (difference between the accumulated postretirement benefit obligation and the plan assets at fair value) as a liability. Since there are no plan assets, the plan's benefit liability is equal to the accumulated postretirement benefit obligation. At December 31, 2009 and 2008, the liability was $145.0 million and $114.1 million, respectively, which is recognized in the "Postretirement benefit liability" line item on the Balance Sheet. The cumulative actuarial gains/losses (changes in assumptions and plan experience) and prior service costs/credits (changes to plan provisions that increase or decrease benefits) were ($2.6) million and $25.0 million at December 31, 2009 and 2008, respectively. These amounts are reported as accumulated other comprehensive income in the "Unrealized postretirement benefit (loss) gain" line item on the Balance Sheet.

The DIF's expenses for postretirement benefits for 2009 and 2008 were $7.7 million each year, which are included in the current and prior year's operating expenses on the Statement of Income and Fund Balance. The changes in the actuarial gains/losses and prior service costs/credits for 2009 and 2008 of ($27.6) million and

$5.3 million, respectively, are reported as other comprehensive income in the "Unrealized post-retirement benefit (loss) gain" line item. Key actuarial assumptions used in the accounting for the plan include the discount rate of 5.25 percent, the rate of compensation increase of 4.10 percent, and the dental coverage trend rate of 7.0 percent. The discount rate of 5.25 percent is based upon rates of return on high-quality fixed income investments whose cash flows match the timing and amount of expected benefit payments.

14. Commitments and Off-Balance-Sheet Exposure

Commitments:

Leased Space

The FDIC's lease commitments total $158 million for future years. The lease agreements contain escalation clauses resulting in adjustments, usually on an annual basis. The DIF recognized leased space expense of $29 million and $21 million for the years ended December 31, 2009 and 2008, respectively.

Leased Space Commitments
Dollars in Thousands

2010	2011	2012	2013	2014	2015/ Thereafter
$ 37,630	$ 37,553	$ 30,982	$ 21,182	$ 17,995	$ 13,041

Off-Balance-Sheet Exposure:

Deposit Insurance

As of December 31, 2009, the estimated insured deposits for DIF were $5.4 trillion. This estimate is derived primarily from quarterly financial data submitted by insured depository institutions to the FDIC. This estimate represents the accounting loss that would be realized if all insured depository institutions were to fail and the acquired assets provided no recoveries.

15. Disclosures About the Fair Value of Financial Instruments

Financial assets recognized and measured at fair value on a recurring basis at each reporting date include cash equivalents (Note 2), the investment in U.S. Treasury obligations (Note 3) and trust preferred securities (Note 5). The following tables present the DIF's financial assets measured at fair value as of December 31, 2009 and 2008.

Assets Measured at Fair Value at December 31, 2009
Dollars in Thousands

	Fair Value Measurement Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Assets at Fair Value
Assets				
Cash and cash equivalents (Special U.S. Treasuries)[1]	$ 54,092,423			$ 54,092,423
Investment in U.S. Treasury Obligations (Available-for-Sale)[2]	5,486,799			5,486,799
Trust preferred securities (Available-for-Sale)			$ 1,961,824	1,961,824
Trust preferred securities held for UST (Note 16)			705,375	705,375
Total Assets	**$ 59,579,222**	**$ 0**	**$ 2,667,199**	**$ 62,246,421**

[1] Cash equivalents are Special U.S. Treasury Certificates with overnight maturities valued at prevailing interest rates established by the U.S. Bureau of Public Debt.
[2] The investment in U.S. Treasury obligations is measured based on prevailing market yields for federal government entities.

Assets Measured at Fair Value at December 31, 2008
Dollars in Thousands

	Fair Value Measurement Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Assets at Fair Value
Assets				
Cash and cash equivalents (Special U.S. Treasuries)[1]	$ 1,011,430	$ 0	$ 0	$ 1,011,430
Investment in U.S. Treasury Obligations (Available-for-Sale)[2]	27,859,080	0	0	27,859,080
Total Assets	**$ 28,870,510**	**$ 0**	**$ 0**	**$ 28,870,510**

[1] Cash equivalents are Special U.S. Treasury Certificates with overnight maturities valued at prevailing interest rates established by the U.S. Bureau of Public Debt.
[2] The investment in U.S. Treasury obligations is measured based on prevailing market yields for federal government entities.

In exchange for prior loss-share guarantee coverage provided to Citigroup as described in Note 5, the FDIC and the Treasury received trust preferred securities. The fair value of the trust preferred securities was derived from a proprietary valuation model developed by the Treasury to estimate the value of financial instruments obtained as consideration for actions taken to stabilize the financial system under the Troubled Asset Relief Program pursuant to the Emergency Economic Stabilization Act of 2008. The model establishes the fair value of the TruPs based on the discounted present value of expected cash flows. Key inputs include assumptions about default probabilities, dividend deferral probabilities and call options. The FDIC independently performed benchmark procedures to ensure the reasonableness of the model outputs.

Some of the DIF's financial assets and liabilities are not recognized at fair value but are recorded at amounts that approximate fair value due to their short maturities and/or comparability with current interest rates. Such items include interest receivable on investments, assessment receivables, other short-term receivables, accounts payable and other liabilities.

The net receivables from resolutions primarily include the DIF's subrogated claim arising from obligations to insured depositors. The resolution entity assets that will ultimately be used to pay the corporate subrogated claim are valued using discount rates that include consideration of market risk. These discounts ultimately affect the DIF's allowance for loss against the net receivables from resolutions. Therefore, the corporate subrogated claim indirectly includes the effect of discounting and should not be viewed as being stated in terms of nominal cash flows.

Although the value of the corporate subrogated claim is influenced by valuation of resolution entity assets (see Note 4), such valuation is not equivalent to the valuation of the corporate claim. Since the corporate claim is unique, not intended for sale to the private sector, and has no established market, it is not practicable to estimate a fair value.

The FDIC believes that a sale to the private sector of the corporate claim would require indeterminate, but substantial, discounts for an interested party to profit from these assets because of credit and other risks. In addition, the timing of resolution entity payments to the DIF on the subrogated claim does not necessarily correspond with the timing of collections on resolution entity assets. Therefore, the effect of discounting used by resolution entities should not necessarily be viewed as producing an estimate of fair value for the net receivables from resolutions.

There is no readily available market for guarantees associated with systemic risk (see Note 16).

16. Systemic Risk Transactions

Pursuant to systemic risk determinations, the FDIC established the Temporary Liquidity Guarantee Program (TLGP) for insured depository institutions, designated affiliates and certain holding companies during 2008, and provided loss-share guarantee assistance to Citigroup on a pool of covered assets in 2009, which was subsequently terminated as described in Note 5. The FDIC received consideration in exchange for guarantees issued under the TLGP and guarantee assistance provided to Citigroup.

At inception of the guarantees, the DIF recognized a liability for the non-contingent fair value of the obligation the FDIC has undertaken to stand ready to perform over the term of the guarantees. As required by FASB ASC 460, *Guarantees,* this non-contingent liability was measured at the amount of consideration received in exchange for issuing the guarantee. As systemic risk expenses are incurred (including contingent liabilities and valuation allowances), the DIF will reduce deferred revenue and recognize an offsetting amount as systemic risk revenue. Revenue recognition will also occur during the term of the guarantee if a supportable and documented analysis has determined that the consideration and any related interest/dividend income received exceeds the projected systemic risk losses. Any deferred revenue not absorbed by losses during the guarantee period will be recognized as revenue to the DIF.

Temporary Liquidity Guarantee Program

The FDIC established the TLGP on October 14, 2008 in an effort to counter the system-wide crisis in the nation's financial sector. The TLGP consists of two components: (1) the Debt Guarantee Program (DGP), and (2) the Transaction Account Guarantee Program (TAG). On November 26, 2008, a final rule for the program was published in the Federal Register and codified in part 370 of title 12 of the Code of Federal Regulations (12 CFR Part 370).

Debt Guarantee Program

The Debt Guarantee Program initially permitted participating entities to issue FDIC-guaranteed senior unsecured debt between October 14, 2008 and June 30, 2009, with the FDIC's guarantee for such debt to expire on the earlier of the maturity of the debt (or the conversion date, for mandatory convertible debt issued on or after February 27, 2009) or June 30, 2012. To reduce market disruption at the conclusion of the DGP and to facilitate the orderly phase-out of the program, the FDIC issued a final rule on June 3, 2009, that extended the period during which participating entities could issue FDIC-guaranteed debt, through October 31, 2009. Concurrently, the FDIC extended the expiration of the guarantee period from June 30, 2012 to December 31, 2012. Upon the expiration of the extended DGP, the final rule grants existing participating entities access to a limited six-month emergency FDIC guarantee facility expiring on April 30, 2010. The FDIC's guarantee for all debt expires on the earliest of the mandatory convertible debt, the stated date of maturity, or December 31, 2012.

Fees for participation in the DGP are reserved for possible TLGP losses. Since inception, the FDIC has recorded $8.3 billion of guarantee fees and fees of $1.2 billion from participating entities that elected to issue senior unsecured non-guaranteed debt. During 2009, the total amount collected under the DGP was $7.1 billion, comprised of $6.1 billion for guaranteed debt and $1.0 billion for non-guaranteed debt. The fees are included in the "Cash and cash equivalents—restricted—systemic risk" line item and recognized as "Deferred revenue-systemic risk" on the Balance Sheet.

Additionally, as described in Note 5, the FDIC holds $800 million (par value) of Citigroup trust preferred securities (and any related interest) as security in the event payments are required to be made by the FDIC for guaranteed debt instru-

ments issued by Citigroup or any of its affiliates under the TLGP. At December 31, 2009, the fair value of these securities totaled $705.4 million, and was determined using the valuation methodology described in Note 15 for other trust preferred securities held by the DIF. Because these TruPs are held on behalf of the Treasury, the decline in value has no impact on the fund balance of the DIF.

The FDIC's payment obligation under the DGP will be triggered by a payment default. In the event of default, the FDIC will continue to make scheduled principal and interest payments under the terms of the debt instrument through its maturity, or in the case of mandatory convertible debt, through the mandatory conversion date. The debtholder or representative must assign to the FDIC the right to receive any and all distributions on the guaranteed debt from any insolvency proceeding, including the proceeds of any receivership or bankruptcy estate, to the extent of payments made under the guarantee.

Since inception of the program, $618 billion in total guaranteed debt has been issued. To date, one debt issuer has defaulted on guaranteed debt of $2.0 million. Eighty-four financial entities (54 insured depository institutions and 30 affiliates and holding companies) had $309 billion in guaranteed debt outstanding at year-end 2009. At December 31, 2009, the contingent liability for this guarantee was $87.9 million and is included in the "Contingent liability for Systemic Risk" line item. The FDIC believes that it is reasonably possible that additional estimated losses of approximately $2.5 billion could occur under the DGP.

Transaction Account Guarantee Program

The Transaction Account Guarantee Program provides unlimited coverage for non-interest bearing transaction accounts held by insured depository institutions on all deposit amounts exceeding the fully insured limit (generally $250,000). In August 2009, the FDIC extended the expiration date of the TAG program from December 31, 2009 to June 30, 2010. During 2009, the FDIC collected TAG fees of $639.2 million which are earmarked for TLGP possible losses and payments.

Upon the failure of a participating insured depository institution, payment of guaranteed claims of depositors with non-interest bearing transaction accounts are funded with TLGP restricted cash. The FDIC will be subrogated to these claims of depositors against the failed entity, and dividend payments by the receivership are deposited back into TLGP restricted accounts.

At December 31, 2009, the "Receivables and other assets—systemic risk" line item includes $187.5 million of estimated TAG fees due from insured depository institutions. This receivable was collected at the end of the first quarter of 2010.

The contingent liability resulting from the anticipated failure of insured institutions participating in the TAG was $1.3 billion at December 31, 2009. For the 2009 failures, estimated losses of $1.7 billion were recorded for the non-interest bearing transaction accounts. The provision for anticipated failures and the loss recorded at resolution are both recorded as "Systemic risk expenses" with a corresponding amount of guarantee fees recognized as "Systemic risk revenue." The FDIC believes that it is reasonably possible that additional estimated losses of approximately $721 million could occur under the TAG.

As of December 31, 2009, the maximum estimated exposure under the TAG is $834 billion. However, 525 institutions elected to exit the TAG program after December 31, 2009. The reported TAG deposits associated with these institutions at December 31, 2009, totaled $568 billion. Consequently, the maximum exposure under the TAG as of January 1, 2010, is estimated to be $266 billion.

Systemic Risk Activity at December 31, 2009
Dollars in Thousands

	Cash and cash equivalents—restricted—systemic risk	Receivables and other assets—systemic risk	Deferred revenue—systemic risk	Contingent liability—systemic risk	Revenue/ Expenses—systemic risk
Balance at 01-01-09	$ 2,377,387	$ 1,138,132	$ (2,077,880)	$ (1,437,638)	
Guaranteed and non-guaranteed debt fees collected	7,066,423	(1,026,870)	(6,039,553)		
TAG fees collected	639,176	(89,977)	(549,199)		
Receivable for TAG fees		187,541	(187,541)		
Receivable for TAG accounts at failed institutions		4,124,849			
TruPs and accrued interest held for UST		801,422	(801,422)		
Market value adjustment on TruPs held for UST		(94,624)	94,624		
Estimated losses for TAG accounts at failed institutions		(1,741,653)	1,741,653		$ 1,741,653
Provision for TLGP losses in future failures			(25,672)	25,672	(25,672)
Default of guaranteed debt issued by a failed bank	(16)		16		2,033
Overnight investment interest collected	6,085		(6,085)		
TLGP operating expenses			3,612		3,612
Reimbursement to DIF for TLGP operating expenses incurred	(3,658,466)				
Totals	**$ 6,430,589**	**$ 3,298,820(a)**	**$ (7,847,447)**	**$ (1,411,966)**	**$ 1,721,626**

(a) Total may not equal the line item due to rounding

17. Subsequent Events

Subsequent events have been evaluated through June 14, 2010, the date the financial statements are available to be issued.

FDIC Guaranteed Debt of Limited Liability Companies

During 2010, the FDIC in its corporate capacity offered guarantees on $997.4 million in purchase money notes issued by newly-formed limited liability companies (LLCs). The terms of the guarantees expire no later than the final note maturing in 2020. The LLCs were created to dispose of $4.6 billion of performing and non-performing commercial and residential real estate loans as well as related assets purchased from multiple receiverships (multibank structured transactions). Private investors purchased 40-50 percent ownership interests in the LLCs, with the receiverships holding the remaining 50-60 percent equity interest. In exchange for the guarantees, the DIF expects to receive estimated fees totaling $29.0 million. Based upon modeling scenarios, the cash flows from the assets of each LLC provide sufficient coverage to defease the debts by their maturity dates. Therefore, the estimated loss to the DIF from these guarantees is zero.

During 2010, FDIC-guaranteed notes issued by three LLCs to receiverships during 2009 and 2010 were sold to private investors. The timely payment of principal due on the notes will continue to be fully guaranteed by the FDIC (see Note 8).

FDIC Guaranteed Debt of Notes

On March 12, 2010, the FDIC issued $1.8 billion of notes backed by approximately $3.6 billion of residential mortgage-backed securities (RMBS) from seven failed bank receiverships. The underlying securities were sold to a statutory trust, which subsequently issued two series of senior notes. The notes mature in 2038 and 2048 and are backed by the RMBS. Investors included banks, investment funds, insurance funds, and pension funds. The $1.8 billion in proceeds will go to the seven failed bank receiverships and eventually be used to pay creditors, including the DIF. This will maximize recoveries for the receiverships and recover substantial funds for the DIF. The FDIC, in its corporate capacity, will fully and unconditionally guarantee the timely payment of principal and interest due and payable on the senior notes. In exchange for the guarantees, the DIF expects to receive monthly payments based on the outstanding principal balance of the senior notes.

Amendment of the TLGP to Extend the Transaction Account Guarantee Program (TAG)

An *Interim Rule with request for comments*, issued on April 19, 2010, amends the TLGP to extend the expiration date for the TAG from June 30, 2010 to December 31, 2010, and grants the FDIC discretion to extend the program to December 31, 2011, without additional rulemaking, if economic conditions warrant such an extension. Assessment rates for institutions participating in the TAG remain unchanged under the interim rule. Additionally, the interim rule would: 1) require TAG assessment reporting based on average daily account balances; 2) reduce the maximum interest rate for qualifying negotiable order of withdrawal (NOW) accounts guaranteed pursuant to the TAG to 0.25 percent from

0.50 percent; 3) provide an irrevocable, one-time opportunity for institutions currently participating in the TAG to opt-out of the program, effective on July 1, 2010; and 4) establish conforming disclosure requirements for institutions that opt-out of and those that continue to participate in the extended program.

Proposed Revision of the Deposit Insurance Assessment System

On April 13, 2010, the FDIC Board of Directors approved for issuance a Notice of Proposed Rulemaking on Assessments (NPR) to revise the assessment system applicable to large banks. The NPR would eliminate risk categories and the use of long-term debt issuer ratings, and replace the financial ratios currently used with a scorecard consisting of well-defined financial measures that are more forward looking and better suited for large institutions. Additionally, the proposal would alter the assessment rates applicable to all insured depository institutions to ensure that the revenue collected under the proposed assessment system would approximately equal that under the existing assessment system.

2010 Failures Through June 14, 2010

Through June 14, 2010, 82 insured institutions failed with total losses to the DIF estimated to be $16.8 billion.

FSLIC Resolution Fund (FRF)

FSLIC Resolution Fund Balance Sheet at December 31
Dollars in Thousands

	2009	2008
Assets		
Cash and cash equivalents (Note 2)	$ 3,470,125	$ 3,467,227
Receivables from thrift resolutions and other assets, net (Note 3)	32,338	34,952
Receivables from U.S. Treasury for goodwill judgments (Note 4)	405,412	142,305
Total Assets	**$ 3,907,875**	**$ 3,644,484**
Liabilities		
Accounts payable and other liabilities	$ 2,972	$ 8,066
Contingent liabilities for litigation losses and other (Note 4)	405,412	142,305
Total Liabilities	**408,384**	**150,371**
Resolution Equity (Note 5)		
Contributed capital	127,847,696	127,442,179
Accumulated deficit	(124,348,205)	(123,948,066)
Total Resolution Equity	**3,499,491**	**3,494,113**
Total Liabilities and Resolution Equity	**$ 3,907,875**	**$ 3,644,484**

The accompanying notes are an integral part of these financial statements.

FSLIC Resolution Fund Statement of Income and Accumulated Deficit for the Years Ended December 31

Dollars in Thousands

	2009	2008
Revenue		
Interest on U.S. Treasury obligations	$ 3,167	$ 56,128
Other revenue	5,276	7,040
Total Revenue	**8,443**	**63,168**
Expenses and Losses		
Operating expenses	4,905	3,188
Provision for losses	2,051	(891)
Goodwill/Guarini litigation expenses (Note 4)	408,997	254,247
Recovery of tax benefits	(10,279)	(26,846)
Other expenses	2,908	11,623
Total Expenses and Losses	**408,582**	**241,321**
Net Loss	**(400,139)**	**(178,153)**
Accumulated Deficit—Beginning	**(123,948,066)**	**(123,769,913)**
Accumulated Deficit—Ending	**$ (124,348,205)**	**$ (123,948,066)**

The accompanying notes are an integral part of these financial statements.

FSLIC Resolution Fund Statement of Cash Flows for the Years Ended December 31

Dollars in Thousands

	2009	2008
Operating Activities		
Net Loss	**$ (400,139)**	**$ (178,153)**
Adjustments to reconcile net loss to net cash used by operating activities:		
Provision for losses	2,051	(891)
Change In Operating Assets and Liabilities:		
Decrease in receivables from thrift resolutions and other assets	563	751
(Decrease)/Increase in accounts payable and other liabilities	(5,094)	3,791
Increase in contingent liabilities for litigation losses and other	263,107	106,954
Net Cash Used by Operating Activities	**(139,512)**	**(67,548)**
Financing Activities		
Provided by:		
U.S. Treasury payments for goodwill litigation (Note 4)	142,410	142,642
Used by:		
Payments to Resolution Funding Corporation (Note 5)	0	(225,000)
Net Cash Provided/(Used) by Financing Activities	**142,410**	**(82,358)**
Net Increase/(Decrease) in Cash and Cash Equivalents	**2,898**	**(149,906)**
Cash and Cash Equivalents—Beginning	**3,467,227**	**3,617,133**
Cash and Cash Equivalents—Ending	**$ 3,470,125**	**$ 3,467,227**

The accompanying notes are an integral part of these financial statements.

1. Legislative History and Operations/Dissolution of the FSLIC Resolution Fund

Legislative History

The Federal Deposit Insurance Corporation (FDIC) is the independent deposit insurance agency created by Congress in 1933 to maintain stability and public confidence in the nation's banking system. Provisions that govern the operations of the FDIC are generally found in the Federal Deposit Insurance (FDI) Act, as amended, (12 U.S.C. 1811, et seq). In carrying out the purposes of the FDI Act, as amended, the FDIC insures the deposits of banks and savings associations, and in cooperation with other federal and state agencies promotes the safety and soundness of insured depository institutions by identifying, monitoring and addressing risks to the deposit insurance fund established in the FDI Act, as amended. In addition, FDIC is charged with responsibility for the sale of remaining assets and satisfaction of liabilities associated with the former Federal Savings and Loan Insurance Corporation (FSLIC) and the Resolution Trust Corporation (RTC).

The U.S. Congress created the FSLIC through the enactment of the National Housing Act of 1934. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) abolished the insolvent FSLIC, created the FSLIC Resolution Fund (FRF), and transferred the assets and liabilities of the FSLIC to the FRF-except those assets and liabilities transferred to the RTC-effective on August 9, 1989. Further, the FIRREA established the Resolution Funding Corporation (REFCORP) to provide part of the initial funds used by the RTC for thrift resolutions.

The RTC Completion Act of 1993 (RTC Completion Act) terminated the RTC as of December 31, 1995. All remaining assets and liabilities of the RTC were transferred to the FRF on January 1, 1996. Today, the FRF consists of two distinct pools of assets and liabilities: one composed of the assets and liabilities of the FSLIC transferred to the FRF upon the dissolution of the FSLIC (FRF-FSLIC), and the other composed of the RTC assets and liabilities (FRF-RTC). The assets of one pool are not available to satisfy obligations of the other.

The FDIC is the administrator of the FRF and the Deposit Insurance Fund. These funds are maintained separately to carry out their respective mandates.

Operations/Dissolution of the FRF

The FRF will continue operations until all of its assets are sold or otherwise liquidated and all of its liabilities are satisfied. Any funds remaining in the FRF-FSLIC will be paid to the U.S. Treasury. Any remaining funds of the FRF-RTC will be distributed to the REFCORP to pay the interest on the REFCORP bonds. In addition, the FRF-FSLIC has available until expended $602.2 million in appropriations to facilitate, if required, efforts to wind up the resolution activity of the FRF-FSLIC.

The FDIC has conducted an extensive review and cataloging of FRF's remaining assets and liabilities. Some of the issues and items that remain open in FRF are: 1) criminal restitution

orders (generally have from 3 to 8 years remaining to enforce); 2) collections of settlements and judgments obtained against officers and directors and other professionals responsible for causing or contributing to thrift losses (generally have up to 10 years remaining to enforce); 3) numerous assistance agreements entered into by the former FSLIC (FRF could continue to receive tax benefits sharing through year 2013); 4) goodwill litigation (no final date for resolution has been established; see Note 4); and 5) affordable housing program monitoring (requirements can exceed 25 years). The FRF could potentially realize substantial recoveries from the tax benefits sharing of up to approximately $231 million; however, any associated recoveries are not reflected in FRF's financial statements given the significant uncertainties surrounding the ultimate outcome.

Receivership Operations

The FDIC is responsible for managing and disposing of the assets of failed institutions in an orderly and efficient manner. The assets held by receivership entities, and the claims against them, are accounted for separately from FRF assets and liabilities to ensure that receivership proceeds are distributed in accordance with applicable laws and regulations. Also, the income and expenses attributable to receiverships are accounted for as transactions of those receiverships. Receiverships are billed by the FDIC for services provided on their behalf.

2. Summary of Significant Accounting Policies

General

These financial statements pertain to the financial position, results of operations, and cash flows of the FRF and are presented in accordance with U.S. generally accepted accounting principles (GAAP). As permitted by the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, the FDIC prepares financial statements in conformity with standards promulgated by the Financial Accounting Standards Board (FASB). These statements do not include reporting for assets and liabilities of resolution entities because these entities are legally separate and distinct, and the FRF does not have any ownership interests in them. Periodic and final accountability reports of resolution entities are furnished to courts, supervisory authorities, and others upon request.

Use of Estimates

Management makes estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Where it is reasonably possible that changes in estimates will cause a material change in the financial statements in the near term, the nature and extent of such changes in estimates have been disclosed. The more significant estimates include allowance for losses on receivables from thrift resolutions and the estimated losses for litigation.

Cash Equivalents

Cash equivalents are short-term, highly liquid investments consisting primarily of U.S. Treasury Overnight Certificates.

Provision for Losses

The provision for losses represents the change in the valuation of the receivables from thrift resolutions and other assets.

Disclosure about Recent Accounting Pronouncements

- Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 105, *Generally Accepted Accounting Principles* (formerly SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*, issued in June 2009) became effective for financial statements covering periods ending after September 15, 2009. The FDIC follows accounting standards set by the FASB. On July 1, 2009, the FASB ASC was launched and became the sole source of authoritative accounting principles applicable to the FDIC.

  All existing standards that were used to create the Codification have become superseded. As a result, references to generally accepted accounting principles in these Notes will consist of the numbers used in the Codification and, if applicable, the former pronouncement number. The Codification's purpose was not to create new accounting or reporting guidance, but to organize and simplify authoritative GAAP literature. Consequently, there will be no change to FRF's financial statements due to the implementation of this Statement.

- SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, was issued by the FASB in June 2009, and subsequently codified upon issuance of Accounting Standards Update No. 2009-17, Consolidations (ASC 810)—*Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*. SFAS 167, effective for reporting periods beginning after November 15, 2009, modifies the former quantitative approach for determining the primary beneficiary of a variable interest entity (VIE) to a qualitative assessment. An enterprise must determine qualitatively whether it has (1) the power to direct the activities of the VIE that most significantly impact the entity's economic performance and (2) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. If an enterprise has both of these characteristics, the enterprise is considered the primary beneficiary and must consolidate the VIE. Management is currently reviewing the possible impact, if any, of SFAS 167 (now codified in ASC 810) on FRF's accounting and financial reporting requirements for 2010.

- SFAS No. 166, *Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140*, was issued by the FASB in June 2009. Subsequently, the FASB issued Accounting Standards Update No. 2009-16, *Transfers and Servicing (ASC 860)—Accounting for Transfers of Financial Assets*, to

formally incorporate the provisions of SFAS No. 166 into the Codification. SFAS 166 removes the concept of a qualifying special-purpose entity from GAAP, changes the requirements for derecognizing financial assets, and requires additional disclosures about a transferor's continuing involvement in transferred financial assets. The FASB's objective is to improve the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets.

The provisions of SFAS 166 (now codified in ASC 860) become effective for the FRF for all transfers of financial assets occurring on or after January 1, 2010.

- SFAS No. 165, *Subsequent Events*, was issued in May 2009 and subsequently codified in FASB ASC 855, *Subsequent Events.* ASC 855 represents the inclusion of guidance on subsequent events in the accounting literature. Historically, management had relied on auditing literature for guidance on assessing and disclosing subsequent events. ASC 855 now requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date—that is, whether that date represents the date the financial statements were *issued* or were *available to be issued*. These new provisions, effective for the FRF as of December 31, 2009, do not have a significant impact on the financial statements.

Other recent accounting pronouncements have been deemed to be not applicable to the financial statements as presented.

Related Parties

The nature of related parties and a description of related party transactions are discussed in Note 1 and disclosed throughout the financial statements and footnotes.

3. Receivables From Thrift Resolutions and Other Assets, Net

Receivables From Thrift Resolutions

The receivables from thrift resolutions include payments made by the FRF to cover obligations to insured depositors, advances to receiverships for working capital, and administrative expenses paid on behalf of receiverships. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. Assets held by the FDIC in its receivership capacity for the former RTC are a significant source of repayment of the FRF's receivables from thrift resolutions. As of December 31, 2009, 8 of the 850 FRF receiverships remain active primarily due to unresolved litigation, including goodwill matters.

The FRF receiverships held assets with a book value of $20 million as of December 31, 2009 and 2008, (which primarily consist of cash, investments, and miscellaneous receivables). The estimated cash recoveries from the management and disposition of these assets are used to derive the allowance for losses. The FRF receivership assets are valued by discounting projected cash flows, net of liquidation costs using current

market-based risk factors applicable to a given asset's type and quality. These estimated asset recoveries are regularly evaluated, but remain subject to uncertainties because of potential changes in economic and market conditions. Such uncertainties could cause the FRF's actual recoveries to vary from current estimates.

Other Assets

Other assets primarily include credit enhancement reserves valued at $21.3 million and $21.2 million as of December 31, 2009 and 2008, respectively. The credit enhancement reserves resulted from swap transactions where the former RTC received mortgage-backed securities in exchange for single-family mortgage loans. The RTC supplied credit enhancement reserves for the mortgage loans in the form of cash collateral to cover future credit losses over the remaining life of the loans. These reserves may cover future credit losses through 2020.

Receivables From Thrift Resolutions and Other Assets, Net at December 31
Dollars in Thousands

	2009	2008
Receivables from closed thrifts	$ 5,744,509	$ 5,725,450
Allowance for losses	(5,736,737)	(5,717,740)
Receivables from Thrift Resolutions, Net	**7,772**	**7,710**
Other assets	24,566	27,242
Total	**$ 32,338**	**$ 34,952**

4. Contingent Liabilities for:

Litigation Losses

The FRF records an estimated loss for unresolved legal cases to the extent those losses are considered probable and reasonably estimable. As of December 31, 2009 and 2008, respectively, $405.4 million and $142.3 million were recorded as probable losses. Additionally, at December 31, 2009, the FDIC has determined that there are no losses from unresolved legal cases considered to be reasonably possible.

In December 2008, FDIC concluded a 13½ year old legal case (*FDIC v. Hurwitz*) arising from the December 30, 1988 failure of United Savings Association of Texas. In August 2005, the District Court ordered sanctions against the FDIC in the amount of $72 million. However, in August 2008, the Fifth Circuit Court of Appeals reversed $57 million of the sanctions, but remanded the remaining $15 million to the District Court to determine what portion should be paid. Subsequently, in November 2008, an agreement was reached between the parties, whereby the FDIC would pay $10 million to settle the case. On December 17, 2008, the settlement agreement was fully executed and the settlement funds were paid. The $10 million payment is recognized in the "Other expenses" line item.

Additional Contingency

Goodwill Litigation

In *United States v. Winstar Corp.*, 518 U.S. 839 (1996), the Supreme Court held that when it became impossible following the enactment of FIRREA in 1989 for the federal government to perform certain agreements to count goodwill

toward regulatory capital, the plaintiffs were entitled to recover damages from the United States. Approximately eight remaining cases are pending against the United States based on alleged breaches of these agreements.

On July 22, 1998, the Department of Justice's (DOJ's) Office of Legal Counsel (OLC) concluded that the FRF is legally available to satisfy all judgments and settlements in the goodwill litigation involving supervisory action or assistance agreements. OLC determined that nonperformance of these agreements was a contingent liability that was transferred to the FRF on August 9, 1989, upon the dissolution of the FSLIC. On July 23, 1998, the U.S. Treasury determined, based on OLC's opinion, that the FRF is the appropriate source of funds for payments of any such judgments and settlements. The FDIC General Counsel concluded that, as liabilities transferred on August 9, 1989, these contingent liabilities for future nonperformance of prior agreements with respect to supervisory goodwill were transferred to the FRF-FSLIC, which is that portion of the FRF encompassing the obligations of the former FSLIC. The FRF-RTC, which encompasses the obligations of the former RTC and was created upon the termination of the RTC on December 31, 1995, is not available to pay any settlements or judgments arising out of the goodwill litigation.

The goodwill lawsuits are against the United States and as such are defended by the DOJ. On January 26, 2010, the DOJ again informed the FDIC that it is "unable at this time to provide a reasonable estimate of the likely aggregate contingent liability resulting from the Winstar-related cases." This uncertainty arises, in part, from the existence of significant unresolved issues pending at the appellate or trial court level, as well as the unique circumstances of each case.

The FDIC believes that it is probable that additional amounts, possibly substantial, may be paid from the FRF-FSLIC as a result of judgments and settlements in the goodwill litigation. Based on representations from the DOJ, the FDIC is unable to estimate a range of loss to the FRF-FSLIC from the goodwill litigation. However, the FRF can draw from an appropriation provided by Section 110 of the Department of Justice Appropriations Act, 2000 (Public Law 106-113, Appendix A, Title I, 113 Stat. 1501A-3, 1501A-20) such sums as may be necessary for the payment of judgments and compromise settlements in the goodwill litigation. This appropriation is to remain available until expended. Because an appropriation is available to pay such judgments and settlements, any liability for goodwill litigation should have a corresponding receivable from the U.S. Treasury and therefore have no net impact on the financial condition of the FRF-FSLIC.

The FRF paid $142.4 million as a result of judgments and settlements in four goodwill cases for the year ended December 31, 2009, compared to $142.6 million for four goodwill cases for the year ended December 31, 2008. As described above, the FRF received appropriations from the U.S. Treasury to fund these payments. Based on recent court decisions, the FRF accrued a $405.4 million contingent liability and offsetting receivable from the U.S. Treasury for judgments in six cases. During 2009, four of the six cases were fully adjudicated but not paid as of year end.

In addition, the FRF-FSLIC pays the goodwill litigation expenses incurred by DOJ based on a Memorandum of Understanding (MOU) dated

October 2, 1998, between the FDIC and DOJ. Under the terms of the MOU, the FRF-FSLIC paid $3.5 million and $4.3 million to DOJ for fiscal years (FY) 2010 and 2009, respectively. As in prior years, DOJ carried over and applied all unused funds toward current FY charges. At December 31, 2009, DOJ had an additional $3.3 million in unused FY 2009 funds that were applied against FY 2010 charges of $6.8 million.

Guarini Litigation

Paralleling the goodwill cases are similar cases alleging that the government breached agreements regarding tax benefits associated with certain FSLIC-assisted acquisitions. These agreements allegedly contained the promise of tax deductions for losses incurred on the sale of certain thrift assets purchased by plaintiffs from the FSLIC, even though the FSLIC provided the plaintiffs with tax-exempt reimbursement. A provision in the Omnibus Budget Reconciliation Act of 1993 (popularly referred to as the "Guarini legislation") eliminated the tax deductions for these losses.

All eight of the original Guarini cases have been settled. However, a case settled in 2006 further obligates the FRF-FSLIC as a guarantor for all tax liabilities in the event the settlement amount is determined by tax authorities to be taxable. The maximum potential exposure under this guarantee is approximately $81 million. However, the FDIC believes that it is very unlikely the settlement will be subject to taxation. More definitive information may be available during 2010, after the IRS completes its Large Case Program audit on the institution's 2006 returns. The FRF is not expected to fund any payment under this guarantee and no liability has been recorded.

Representations and Warranties

As part of the RTC's efforts to maximize the return from the sale of assets from thrift resolutions, representations and warranties, and guarantees were offered on certain loan sales. The majority of loans subject to these agreements have been paid off, refinanced, or the period for filing claims has expired. The FDIC's estimate of maximum potential exposure to the FRF is $13.2 million. No claims in connection with representations and warranties have been asserted since 1998 on the remaining open agreements. Because of the age of the remaining portfolio and lack of claim activity, the FDIC does not expect new claims to be asserted in the future. Consequently, the financial statements at December 31, 2009 and 2008, do not include a liability for these agreements.

5. Resolution Equity

As stated in the Legislative History section of Note 1, the FRF is comprised of two distinct pools: the FRF-FSLIC and the FRF-RTC. The FRF-FSLIC consists of the assets and liabilities of the former FSLIC. The FRF-RTC consists of the assets and liabilities of the former RTC. Pursuant to legal restrictions, the two pools are maintained separately and the assets of one pool are not available to satisfy obligations of the other.

The following table shows the contributed capital, accumulated deficit, and resulting resolution equity for each pool.

Resolution Equity at December 31, 2009
Dollars in Thousands

	FRF-FSLIC	FRF-RTC	FRF Consolidated
Contributed capital—beginning	$ 45,692,842	$ 81,749,337	$ 127,442,179
Add: U.S. Treasury payments/ receivable for goodwill litigation	405,517	0	405,517
Less: REFCORP payments	0	0	0
Contributed capital—ending	**46,098,359**	**81,749,337**	**127,847,696**
Accumulated deficit	(42,764,230)	(81,583,975)	(124,348,205)
Total	**$ 3,334,129**	**$ 165,362**	**$ 3,499,491**

Contributed Capital

The FRF-FSLIC and the former RTC received $43.5 billion and $60.1 billion from the U.S. Treasury, respectively, to fund losses from thrift resolutions prior to July 1, 1995. Additionally, the FRF-FSLIC issued $670 million in capital certificates to the Financing Corporation (a mixed-ownership government corporation established to function solely as a financing vehicle for the FSLIC) and the RTC issued $31.3 billion of these instruments to the REFCORP. FIRREA prohibited the payment of dividends on any of these capital certificates.

Through December 31, 2009, the FRF-RTC has returned $4.556 billion to the U.S. Treasury and made payments of $5.022 billion to the REFCORP. These actions serve to reduce contributed capital.

FRF-FSLIC received $142.4 million in U.S. Treasury payments for goodwill litigation in 2009. Furthermore, $405.4 million and $142.3 million were accrued for as receivables at year-end 2009 and 2008, respectively. The effect of this activity was an increase in contributed capital of $405.5 million in 2009.

Accumulated Deficit

The accumulated deficit represents the cumulative excess of expenses over revenue for activity related to the FRF-FSLIC and the FRF-RTC. Approximately $29.8 billion and $87.9 billion were brought forward from the former FSLIC and the former RTC on August 9, 1989, and January 1, 1996, respectively. The FRF-FSLIC accumulated deficit has increased by $13.0 billion, whereas the FRF-RTC accumulated deficit has decreased by $6.3 billion, since their dissolution dates.

6. Employee Benefits

Pension Benefits

Eligible FDIC employees (permanent and term employees with appointments exceeding one year) are covered by the federal government retirement plans, either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Although the FRF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The FRF also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported on and accounted for by the U.S. Office of Personnel Management. The FRF's pension-related expenses were $42 thousand and $169 thousand for 2009 and 2008, respectively.

Postretirement Benefits Other Than Pensions

The FRF no longer records a liability for the postretirement benefits of life and dental insurance (a long-term liability), due to the expected dissolution of the FRF. The liability is recorded by the DIF. However, the FRF does continue to pay its proportionate share of the yearly claim expenses associated with these benefits.

7. Disclosures About the Fair Value of Financial Instruments

The financial asset recognized and measured at fair value on a recurring basis at each reporting date is cash equivalents. The following tables present the FRF's financial asset measured at fair value as of December 31, 2009 and 2008.

Assets Measured at Fair Value at December 31, 2009
Dollars in Thousands

	Fair Value Measurement Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Assets at Fair Value
Assets				
Cash equivalents (Special U.S. Treasuries)[1]	$ 3,470,125	$ 0	$ 0	$ 3,470,125

[1] Cash equivalents are Special U.S. Treasury Certificates with overnight maturities valued at prevailing interest rates established by the U.S. Bureau of Public Debt.

Assets Measured at Fair Value at December 31, 2008
Dollars in Thousands

	Fair Value Measurement Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Assets at Fair Value
Assets				
Cash equivalents (Special U.S. Treasuries)[1]	$ 3,467,227	$ 0	$ 0	$ 3,467,227

[1] Cash equivalents are Special U.S. Treasury Certificates with overnight maturities valued at prevailing interest rates established by the U.S. Bureau of Public Debt.

Some of the FRF's financial assets and liabilities are not recognized at fair value but are recorded at amounts that approximate fair value due to their short maturities and/or comparability with current interest rates. Such items include other short-term receivables and accounts payable and other liabilities.

The net receivable from thrift resolutions is influenced by the underlying valuation of receivership assets. This corporate receivable is unique and the estimate presented is not necessarily indicative of the amount that could be realized in a sale to the private sector. Such a sale would require indeterminate, but substantial, discounts for an interested party to profit from these assets because of credit and other risks. Consequently, it is not practicable to estimate its fair value.

Other assets primarily consist of credit enhancement reserves, which are valued by performing projected cash flow analyses using market-based assumptions (see Note 3).

United States Government Accountability Office
Washington, DC 20548

To the Board of Directors
The Federal Deposit Insurance Corporation

In accordance with Section 17 of the Federal Deposit Insurance Act, as amended, we are responsible for conducting audits of the financial statements of the two funds administered by the Federal Deposit Insurance Corporation (FDIC). In our audits of the Deposit Insurance Fund's (DIF) and the FSLIC Resolution Fund's (FRF) financial statements for 2009 and 2008, we found

- the financial statements as of and for the years ended December 31, 2009, and 2008, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- FDIC's internal control over financial reporting was not effective as of December 31, 2009 because of a material weakness in its process for estimating losses on loss-sharing agreements; and
- no reportable noncompliance with provisions of laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions; (2) our audit objectives, scope, and methodology; and (3) agency comments and our evaluation.

Opinion on DIF's Financial Statements

The financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, DIF's assets, liabilities, and fund balance as of December 31, 2009, and 2008, and its income and fund balance and its cash flows for the years then ended.

However, misstatements may nevertheless occur in other financial information reported by FDIC and not be detected as a result of the

material weakness in internal control described in this report related to FDIC's process for estimating losses on loss-sharing agreements.[1]

As discussed in note 8 to DIF's financial statements, FDIC-insured financial institutions continued to face significant challenges in 2009. The difficult economic and credit environment continued to challenge the soundness of many FDIC-insured institutions. In 2009, 140 banks, with combined assets of over $170 billion, failed. The DIF recognized losses totaling an estimated $58 billion associated with these bank failures and other insured institutions the banking regulators have determined are likely to fail. Regulatory and market data suggest that the banking industry will continue to experience elevated levels of stress over the coming year. In addition to the losses reflected on the DIF's financial statements as of December 31, 2009, FDIC has identified additional risk as of year-end 2009 that could result in further estimated losses to the DIF of up to approximately $24 billion should other potentially vulnerable insured institutions ultimately fail. FDIC continues to evaluate the ongoing risks to affected institutions in light of current economic and financial conditions, and the effect of such risks on the DIF. Actual losses, if any, will largely depend on future economic and market conditions and could differ materially from FDIC's estimates. As discussed in note 17 to DIF's financial statements, through June 14, 2010, 82 institutions have failed during 2010.

As of December 31, 2009, the DIF had a negative fund balance of $20.9 billion, and its ratio of reserves to estimated insured deposits was a negative 0.39 percent. During 2009, the FDIC took action to maintain the DIF's ability to continue to resolve problem institutions. As discussed in note 9 to the DIF's financial statements, FDIC supplemented the DIF's cash resources by charging and collecting from FDIC-insured institutions a special assessment of $5.5 billion in September 2009. Additionally, on December 30, 2009, FDIC charged and collected from insured institutions approximately 3 years of assessments paid in advance — prepaid assessments — totaling about $46 billion. These funds are included in the "Cash and cash equivalents" and "Unearned revenue — prepaid

[1] A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

assessments" line items on DIF's balance sheet. Further, as discussed in notes 4 and 7 of DIF's financial statements, during 2009, FDIC expanded the use of purchase and assumption resolution transactions containing loss-sharing agreements with acquirers of failed institutions as a means of both conserving the initial cash outlay required by the DIF in resolving a troubled institution and as a longer-term means of attempting to further minimize the ultimate losses to the DIF. Under such agreements, which typically cover a 5- to 10- year period, an acquiring institution assumes all of the deposits and purchases most, if not all, of the assets of a failed institution. FDIC, in turn, agrees to cover a large percentage of any losses on assets covered under the agreements up to a stated threshold amount. During 2009, 90 of the 140 institutions that failed and were resolved by FDIC were handled through the use of loss-sharing agreements with acquirers of these institutions.

The DIF has other resources available to carry out its insurance responsibilities. At December 31, 2009, the DIF had $5.5 billion in investments in U.S. Treasury obligations in addition to $54 billion in cash and cash equivalents, which provide a ready source of funds to carry out its insurance activities. In addition, as discussed in note 1 to DIF's financial statements, FDIC has a note agreement with the Federal Financing Bank enabling it to borrow up to $100 billion, and also has authority to borrow up to $100 billion and, in certain circumstances through 2010, up to $500 billion from the U.S. Treasury. FDIC may also borrow from Treasury, notwithstanding these amount limitations, any amount necessary to fund the temporary increase in deposit insurance coverage from $100,000 to $250,000.

In accordance with the Federal Deposit Insurance Reform Act of 2005, FDIC adopted a restoration plan in October 2008 calling for an increase in the assessment rates charged to insured institutions to replenish the DIF's reserves to the minimum ratio of 1.15 percent of insured deposits within a 5-year period. The FDIC has since amended this plan twice—the latest amendment was adopted in September 2009. The amended restoration plan calls for the DIF's reserves to be replenished to the minimum reserve ratio of 1.15 percent of insured deposits within an 8-year period.[2]

[2] As discussed in Note 1 to the DIF's financial statements, the Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, div. A, §204(b), 123 Stat.1632, 1648 (May 20, 2009), extended the time limit for a restoration plan to rebuild the reserve ratio of the DIF from 5 years to 8 years.

The DIF also faces continued exposure from actions taken by the federal government in 2008 to avoid further adverse effects on the nation's economic condition and financial stability. Specifically, during 2008, the Department of the Treasury, in consultation with the President and upon recommendation of the Boards of the FDIC and the Federal Reserve, made "systemic risk" determinations under a provision of the Federal Deposit Insurance Corporation Improvement Act of 1991 to counter identified systemwide crises in the nation's financial sector. As discussed in note 16 to DIF's financial statements, in response to systemic risk determinations in October 2008, FDIC established the Temporary Liquidity Guarantee Program (TLGP). The TLGP consists of a (1) Debt Guarantee Program, under which FDIC guarantees newly issued senior unsecured debt up to prescribed limits issued by insured institutions and certain holding companies, and (2) Transaction Account Guarantee Program, under which FDIC provides unlimited coverage for non-interest-bearing transaction accounts held by insured institutions. FDIC charges fees to participants that are to be used to cover any losses under both guarantee programs. As of December 31, 2009, the amount of debt guaranteed by FDIC under the Debt Guarantee Program was $309 billion, while FDIC's maximum exposure under the Transaction Account Guarantee Program was $834 billion, for total exposure under the TLGP of $1.14 trillion as of December 31, 2009. As further discussed in note 16, a total of 525 institutions elected to exit the Transaction Account Guarantee Program after year-end 2009. Consequently, at January 1, 2010, FDIC's maximum exposure under the Transaction Account Guarantee Program declined to $266 billion, and its maximum exposure under the TLGP declined to $575 billion.

Opinion on FRF's Financial Statements

The financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, FRF's assets, liabilities, and resolution equity as of December 31, 2009, and 2008, and its income and accumulated deficit and its cash flows for the years then ended.

Opinion on Internal Control

Because of the material weakness in internal control discussed below, FDIC did not maintain, in all material respects, effective internal control over financial reporting as of December 31, 2009, and thus did not provide reasonable assurance that material misstatements in relation to the financial statements would be prevented or detected and corrected on a timely basis. Our opinion is based on criteria established under 31 U.S.C. 3512 (c), (d), commonly known as the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

During our 2009 financial audit, we identified several control deficiencies over FDIC's process for deriving and reporting estimates of losses to the DIF from resolution transactions involving loss-sharing agreements. These deficiencies led to misstatements in the draft DIF financial statements which were ultimately corrected through adjustments to achieve fair presentation in the final financial statements. Although the net adjustments were ultimately not material to the DIF's financial statements, the nature of the control deficiencies we identified were such that a reasonable possibility existed that a material misstatement of the DIF's financial statements would not be prevented, or detected and corrected on a timely basis. Thus, these control deficiencies collectively represent a material weakness in FDIC's internal control over financial reporting. This material weakness is discussed in more detail later in this report.

In FDIC's Management Report on Internal Control over Financial Reporting, which is presented in appendix I to this report, FDIC asserted that it did not maintain, in all material respects, effective internal control over financial reporting as of December 31, 2009, due to a material weakness related to its process for estimating losses on loss-sharing agreements.

Despite its material weakness in internal control over financial reporting, FDIC was able to prepare financial statements that were fairly stated in all material respects for 2009 and 2008. However, the material weakness in internal control over financial reporting may adversely affect any decision by FDIC's management that is based, in whole or in part, on information that is inaccurate because of this weakness. In addition, unaudited financial information reported by FDIC may also contain misstatements resulting from this weakness. We considered the material weakness in determining the nature, timing, and extent of our audit procedures on the 2009 financial statements. We caution that misstatements may occur and not be detected by our tests and that such testing may not be sufficient for other purposes.

In addition to the material weakness noted above and discussed later in this report, we identified a significant deficiency[3] that, although not a material weakness, represents a combination of control deficiencies that,

[3]A significant deficiency is a control deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

collectively, we believe should be brought to the attention of those charged with governance. This significant deficiency concerns the effectiveness of FDIC's security over information systems. This significant deficiency is discussed in more detail later in this report.

We will be reporting additional details concerning the material weakness and the significant deficiency separately to FDIC management, along with recommendations for corrective actions. We also identified other deficiencies in FDIC's system of internal control which we do not consider to be material weaknesses or significant deficiencies but which merit FDIC management's attention and correction. We have communicated these matters to FDIC management and, as appropriate, will be reporting them in writing to FDIC separately, along with recommendations for corrective actions.

Compliance with Laws and Regulations

Our tests for compliance with selected provisions of laws and regulations disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our audits was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Objectives, Scope, and Methodology

FDIC management is responsible for (1) preparing the annual financial statements in conformity with U.S. generally accepted accounting principles; (2) establishing and maintaining effective internal control over financial reporting and evaluating its effectiveness; and (3) complying with applicable laws and regulations. Management evaluated the effectiveness of FDIC's internal control over financial reporting as of December 31, 2009, based on criteria established under FMFIA. FDIC management provided an assertion concerning the effectiveness of its internal control over financial reporting (see appendix I).

We are responsible for planning and performing the audit to obtain reasonable assurance and provide our opinion about whether (1) the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, and (2) FDIC management maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009. We are also responsible for testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by FDIC management;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of FDIC and its operations, including its internal control over financial reporting;
- considered FDIC's process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA;
- assessed the risk that a material misstatement exists in the financial statements and the risk that a material weakness exists in internal control over financial reporting;
- tested relevant internal control over financial reporting;
- evaluated the design and operating effectiveness of internal control over financial reporting based on the assessed risk;
- tested compliance with certain laws and regulations, including selected provisions of the Federal Deposit Insurance Act, as amended; and
- performed such other procedures as we considered necessary in the circumstances.

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws and regulations that could have a direct and material effect on the financial statements.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting. Because of inherent limitations in internal control, internal control may not prevent or detect and correct misstatements due to error or fraud, losses, or noncompliance. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

We did not test compliance with all laws and regulations applicable to FDIC. We limited our tests of compliance to those laws and regulations that have a direct and material effect on the financial statements for the year ended December 31, 2009. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our audit in accordance with U.S. generally accepted government auditing standards. We believe our audit provides a reasonable basis for our opinions and other conclusions.

Material Weakness in Controls over Loss Share Estimation Process

During our 2009 audit, we identified deficiencies in controls over FDIC's process for deriving and reporting estimates of losses to the DIF from resolution transactions involving loss-sharing agreements. These deficiencies resulted in errors in the draft 2009 DIF financial statements provided to us that went undetected by FDIC and that necessitated adjustments in finalizing the financial statements. Although the net effect of these errors was ultimately not material in relation to the financial statements taken as a whole, the nature of the control deficiencies we identified that resulted in these errors occurring and going undetected is such that there is a reasonable possibility that they could have led to material misstatements to DIF's financial statements that would not have been timely detected and corrected.

In 2009, FDIC began using whole bank purchase and assumption agreements with accompanying loss-sharing agreements as the primary means of resolving failed financial institutions. Under such an agreement, FDIC sells a failed institution to an acquirer with an agreement that the

FDIC, through the DIF, will share in any losses the acquirer experiences in servicing and disposing of assets purchased and covered under the loss-sharing agreement.[4] Typically, during 2009, loss-sharing agreements were structured such that FDIC assumed 80 percent of any such losses.[5] Ninety of the 140 resolutions of failed institutions were structured with such loss-sharing agreements in 2009, compared to 3 such agreements entered into for 25 failed institutions resolved in 2008. For financial reporting purposes, FDIC reflected the cumulative estimate of the losses that will likely be incurred on these loss-sharing agreements in the line item "Receivables from resolutions, net" on the DIF's balance sheet, as a component of the $60 billion allowance for losses established against this line item at December 31, 2009.[6] The FDIC's estimate of future payments (losses) under these loss-sharing agreements represented $22.2 billion (37 percent) of the total DIF allowance for losses as of December 31, 2009.

As part of our audit, we reviewed the process by which FDIC developed and reported on its estimates of losses to the DIF from loss-sharing agreements for the 2009 financial statements. In reviewing and testing this process, we identified control deficiencies that led to computational errors in the calculations and reporting of the year-end loss estimates that went undetected by FDIC. Control deficiencies existed throughout the loss-share estimation process, including the development of the initial estimates, the oversight or review of the calculations, the documentation of significant assumptions used, and the reporting of the estimates as part of the allowance for losses against the Receivable from Resolutions on DIF's financial statements.

[4]Losses covered under the loss-sharing agreements include losses incurred through the sale, foreclosure, loan modification, or write-down of loans in accordance with the terms of the loss-share agreement.

[5]The agreements varied in 2009, but typically included a provision whereby the acquiring institution would absorb losses up to a certain dollar amount (called a first tranche), at which point FDIC would begin sharing in the losses by paying the acquirer for 80 percent of the losses it experienced. If losses experienced by the acquirer are higher than expected, the agreements generally have a threshold at which the FDIC would begin paying 95 percent of the losses the acquiring institution experiences on the acquired assets.

[6]The allowance for losses represents the difference between the amount owed to the DIF by a receivership for payment of insured deposits and other resolution expenses and the amount expected to be repaid from the servicing and liquidation of the receivership's assets (such as from sale of loans and other assets of the failed institution).

In developing the initial loss estimates, although FDIC issued written guidance in February 2009 related to these calculations, we found that the methodology was inconsistently applied and that FDIC did not have adequate controls to reasonably assure that loss-sharing calculations were accurate. Specifically, we found differences in the formulas used by FDIC personnel in performing the calculations and differences in how certain types of assets were combined into consolidated asset categories.[7] Additionally, FDIC asserted that a review process was in place by which a limited number of staff prepared the calculations and reviewed each other's work for accuracy. However, there was no documentary evidence that supervisory or independent review or monitoring was performed on the calculations developed by FDIC personnel.

As a result of these control deficiencies, we identified significant error rates in FDIC's calculations of loss estimates that were not identified and corrected by FDIC through a review or monitoring process. Of 51 institutions with loss-sharing agreements in 2009 we sampled for testing, we found errors in the calculations of estimated losses for 9. After we apprised FDIC of these errors, management reviewed the computations for the remaining institutions with loss-sharing agreements and found another 16 institutions where the estimated loss calculations contained errors. In total, over 25 percent of the 93 individual loss share estimates for 2009 contained errors. While many of the individual errors were not large, some were significant. For example, one error resulted in an estimate of loss for an institution that was twice the amount it should have been. These computational errors in the loss share amounts FDIC estimated it would have to pay out under loss-sharing agreements totaled $386 million on an absolute value basis. Despite the large percentage of estimates with errors and the relatively high dollar impact of these errors, they were not detected by FDIC in the normal course of preparing the initial estimates, when updating the amounts for year-end reporting, or in its process for preparing and reviewing the DIF's 2009 financial

[7]The process by which FDIC estimates the expected loss to the DIF from loss-sharing agreements is complex and multifaceted. FDIC contracts with asset specialists to review the asset portfolio of the failed institution and to develop an anticipated loss rate, expressed as a percentage of book value, on the various categories of the failed bank's asset portfolio. During 2009, FDIC instructed the contractors to derive both high and low estimated loss rates on the various categories of assets. FDIC personnel took the contractor's estimates and consolidated them into two large asset category pools—single family mortgage loans and commercial loans. FDIC then calculated an estimated loss rate for each of these consolidated categories of assets, attempting to derive a midpoint estimated loss rate from the contractor's work.

statements. Once corrected, the computational errors lowered the loss-share cost estimates and resulted in a net increase to the "Receivables from resolutions" line item on the DIF's financial statements of about $270 million. The *Standards for Internal Control in the Federal Government*[8] provide that control activities are to help ensure that all transactions are completely and accurately recorded. These standards also state that internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations.

In addition to the computational errors, we could find no documentation supporting the assumptions contained in the complex spreadsheets that FDIC used to calculate its 2009 loss estimates, nor did we identify documentation demonstrating management's review and approval of the assumptions contained in the spreadsheets.[9] Because these assumptions can significantly affect the estimated losses under loss-sharing agreements, such evidence is critical to ensuring that management has reviewed and is in agreement with the underlying assumptions used in deriving these estimates. Similarly, we found no evidence that the data used in the program developed to assist in updating the loss estimates on loss-sharing agreements for financial reporting at December 31, 2009, was reviewed for accuracy.[10] This greatly increases the risk that inaccurate or incomplete data is used in the year-end calculations for a significant estimate on the DIF's financial statements. The *Standards for Internal Control in the Federal Government* provide that internal control and all transactions and other significant events need to be clearly documented,

[8]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1, (Washington, D.C.: November 1999).

[9]The loss-share estimates calculated by FDIC personnel are manually inputted into a spreadsheet—called the Loss Share Worksheet—to calculate an estimate of the loss on the portfolio of a failed institution's assets that FDIC expects to incur. The spreadsheet contains a series of built-in assumptions, such as estimated holding periods for assets and discount rates, which can significantly modify the original estimates developed by contracted asset specialists. A Loss Share Worksheet was prepared for each of the institutions with loss-sharing agreements prior to the time of resolution.

[10]To facilitate year-end reporting so as to avoid the time-consuming process of preparing revised individual Loss Share Worksheets for each institution, FDIC developed a Statistical Analysis System (SAS) program to reproduce the results of the worksheet. The SAS program takes the updated loss amounts—derived by taking the mid-point loss rate calculated by FDIC personnel for each consolidated category of assets and multiplying it by the updated book value of covered assets held by the acquiring institution—and, replicating the formulas and assumptions in the Loss Share Worksheet, calculates updated loss estimates. The output from this SAS program is then used in the calculation of the allowance for losses on DIF's Receivables from Resolutions.

and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals. While we performed audit procedures on the assumptions and data accuracy, this weakness results in a risk of misstatements in FDIC's loss-sharing computations.

Finally, our review of FDIC's financial reporting of the loss-share estimates through its Loan Loss Reserve process identified multiple additional errors that were not identified and corrected by FDIC's review or routine monitoring controls.[11] After we apprised FDIC of these additional errors, management reviewed all of the spreadsheets used in this process—one for each failed institution receivership—to identify and correct errors and inconsistencies. In total, 13 of the 93 spreadsheets for institutions with loss-sharing agreements (14 percent) used in the calculation of DIF's year-end allowance for losses contained errors. These errors totaled $225 million on an absolute value basis. When FDIC corrected these additional errors, it resulted in an increase to the loss-share cost estimates and a net decrease to the "Receivables from resolutions" line item on the DIF's financial statements totaling about $132 million.

The lack of effective controls over the estimation process and the reporting of those estimates resulted in misstatements in the initial draft of the DIF's 2009 financial statements, which FDIC corrected. In total, FDIC's initial 2009 financial reporting related to loss-share estimates contained gross errors of over $611 million. Because the errors included both those that increased and decreased individual loss estimates, the errors resulted in a $138 million net decrease in the allowance for losses and a corresponding net increase to the "Receivables from resolutions" line item that the FDIC made to correct the DIF's 2009 financial statements.

In 2009, FDIC substantially expanded the use of loss-sharing agreements in its resolution strategy to both minimize the initial outlay of funds by the DIF in resolving failed institutions and to attempt to minimize the ultimate loss incurred by the DIF through working to keep the assets of failed institutions in the market. Given the significance of these types of

[11]To calculate the allowance for losses, FDIC uses a separate spreadsheet—called the Loan Loss Reserve (LLR) template—for each failed institution receivership. For failed institutions resolved using a loss-sharing agreement, the estimate of future loss share payments is included as one of the resolution expenses included in the allowance for losses calculation.

transactions and their impact on DIF's financial statements, it is critical that FDIC establish effective controls to ensure that all steps in the estimation process are fully documented and that appropriate review and monitoring of key steps in the process, including all manual computations, assumptions used, and source input, are both performed and documented. In 2009, the controls over this highly manual process were not sufficient to ensure that the loss-share calculations were consistent and accurate, and that independent verification was performed to timely identify and correct errors that could impact the financial statements. While the actual net misstatements ultimately were not material to the year-end financial statements, due to the nature of the control deficiencies we identified, there is a reasonable possibility that a material misstatement of the DIF's financial statements could have occurred and not been detected and corrected absent the audit process. Consequently, we believe that the control deficiencies we identified in the process for deriving estimates under loss-sharing agreements collectively represented a material weakness in internal controls as of December 31, 2009.

FDIC has developed a corrective action plan to address the control deficiencies we identified in its loss-share estimation process. This action plan outlines specific steps FDIC indicates it has or is in the process of implementing, along with targeted dates for completion of the actions. We will review the effectiveness of FDIC's corrective actions as part of our 2010 financial audits. As discussed earlier, we will also be reporting additional details concerning the material weakness over FDIC's process for estimating losses under loss-sharing agreements in a separate report, along with our recommendations for corrective actions.

Significant Deficiency over Information Systems

As an integral part of our audits of the 2009 financial statements of the DIF and FRF, we reviewed FDIC's information system controls. Effective information system controls are essential to safeguarding financial and other critical data, protecting the integrity of computer application programs, securing networks, and ensuring continued computer operations in case of unexpected interruption. These controls include a corporatewide security management program, access controls, configuration management, segregation of duties, and contingency planning. They also include business process application controls.

During our 2009 financial audits, we identified FDIC information system control deficiencies that increased the risk of unauthorized modification and disclosure of financial and other sensitive information, and disruption of critical operations. These control deficiencies, which collectively

constitute a significant deficiency, reduced FDIC's ability to ensure that authorized users had only the access needed to perform their assigned duties, and that its systems were sufficiently protected from unauthorized access. This significant deficiency affects the confidentiality, integrity and availability of financial and other sensitive information processed, stored, and transmitted on FDIC's systems. Additionally, FDIC's controls to monitor the effectiveness of its information system controls were not fully effective. Examples of these deficiencies follow:

- FDIC had not controlled access to computer systems and a business application in a manner that effectively limited individuals' access to only those functions and data necessary to perform their assigned duties. To accommodate system updates and growth, FDIC changed network configurations that resulted in the ability for users to obtain unauthorized access to network controls and control information. In another case, FDIC had granted users inappropriate and excessive access privileges to a business application supporting resolution and receivership activities. As a result, users could obtain inappropriate access to and potentially modify information processed through this application.

- FDIC's policies and procedures governing the assignment, use, and monitoring of mainframe user identifications (IDs) intended to support technical assistance to business processes were not enforced. We found that audit logs showed a long-term, systemic pattern of questionable use of privileges that provided a limited number of system administrators full access to all data and programs on the mainframe. However, FDIC's review of audit logs did not identify and trigger corrective actions or management follow-up to determine if mainframe user IDs were being used to obtain inappropriate access.

- FDIC did not appropriately configure certain key systems, potentially allowing the systems to be manipulated by internal users without detection. For example, powerful mainframe programs that, if misused, could expose all data and programs on the system to unauthorized internal user access were not configured in accordance with FDIC policy. This resulted in FDIC's inability to detect unauthorized changes to the programs. FDIC's security monitoring and configuration management controls had not identified this situation and FDIC was not aware of this configuration.

- FDIC did not have policies and procedures in place to prevent users from having inappropriate or incompatible access to multiple applications. For example, FDIC did not have policies and procedures

to identify and govern the assignment of access privileges to combinations of systems that create logical access to data that is otherwise prevented by applications. As a result, a combination of access privileges were assigned to individuals that allowed for the circumvention of an accounting application's access controls. Additionally, FDIC did not have technical controls in place to identify or prevent the assignment of such combinations of access privileges that expose the data associated with certain applications from access outside of the access controls implemented within the functions of those applications. As a result, individuals could inappropriately obtain access to data in certain applications.

- FDIC made major changes to important accounting and system administration applications during 2009, but did not effectively test and verify that all system interfaces were properly configured for the new systems before placing them into production. We identified deficiencies in the interfaces of two applications that had not been detected by FDIC's pre-implementation testing and were not subsequently identified through FDIC's periodic monitoring activities. These deficiencies increased the risk of errors in data as it is transferred from one system to another.

Several of the vulnerabilities we identified with respect to FDIC's security over its information systems should have been identified through FDIC's routine monitoring of access privileges, audit logs, and adherence to established policies and procedures. Although FDIC has an information security monitoring program, deficiencies existed which had not been identified by this program, some of which resulted in significant reductions in FDIC's capability to maintain effective controls.

The *Standards for Internal Control in the Federal Government*[12] state that internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. Also, the Committee on Sponsoring Organizations of the Treadway Commission, in its *Guidance on Monitoring Internal Control Systems*,[13] notes that ongoing and/or separate evaluations enable management to determine

[12]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

[13]Committee on Sponsoring Organizations of the Treadway Commission, *Guidance on Monitoring Internal Control Systems*, January 2009.

whether other components of internal control continue to function over time, and notes that organizations can select from a wide variety of monitoring procedures, including but not limited to continuous monitoring programs built into information systems and supervisory reviews of controls. In addition, the National Institute of Standards and Technology in its *Recommended Security Controls for Federal Information Systems*[14] states that as part of a comprehensive continuous monitoring program, organizations should initiate specific actions to determine if there is a need to update the current security controls.

The deficiencies we identified were the result of ineffective monitoring of systems, including a failure to detect noncompliance with published policies and procedures. While the deficiencies we identified represent internal exposures—that is, they could only be exploited internally by individuals with system knowledge—FDIC needs to consider the significant increase in its business activities, its establishment of new physical locations to conduct its work, and its substantial expansion of staffing levels including a large influx of contractors. These realities, in light of FDIC's increased resolution activities, create increased risk from internal threats that need to be fully considered in FDIC's risk management decisions.

Based on the information system control deficiencies we identified, we conclude that, for 2009, FDIC's controls over information systems were not fully effective in preventing unauthorized access to data, systems configurations, or programs and did not provide management with sufficient capabilities to detect and respond to anomalous or unauthorized activity on internal networks and systems.

FDIC Comments and Our Evaluation

In commenting on a draft of this report, FDIC's Chief Financial Officer (CFO) noted that he was pleased to receive unqualified opinions on the DIF's and FRF's 2009 and 2008 financial statements. The CFO pointed out that the past year was unusually challenging and stated that FDIC recognizes the significance that internal control plays in achieving its mission and goals. Further, the CFO stated that financial management remains a high priority. With respect to the internal control weaknesses we identified in FDIC's loss share estimation process and over its

[14] National Institute of Standards and Technology, Special Publication 800-53 (Revision 2), *Recommended Security Controls for Federal Information Systems*, December 2007.

information systems, FDIC's CFO acknowledged that controls needed improvement, that such improvements are underway, and that our concerns should be resolved in 2010. We will evaluate the effectiveness of FDIC's corrective actions as part of our 2010 financial audits.

The complete text of FDIC's comments, and its Management Report containing its assertion on the effectiveness of its internal control over financial reporting, are reprinted in appendix I.

Steven J. Sebastian
Director
Financial Management and Assurance

June 14, 2010

Appendix I

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Deputy to the Chairman and CFO

June 14, 2010

Mr. Steven J. Sebastian
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Re: FDIC Management Response on the GAO 2009 Financial Statements Audit Report

Dear Mr. Sebastian:

Thank you for the opportunity to comment on the U.S. Government Accountability Office's (GAO's) draft report titled, **Financial Audit: Federal Deposit Insurance Corporation Funds' 2009 and 2008 Financial Statements, GAO-10-705**. We are pleased that the Federal Deposit Insurance Corporation (FDIC) received an unqualified opinion for the eighteenth consecutive year on the financial statements of its funds: the Deposit Insurance Fund (DIF) and the Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund (FRF). The unqualified opinion demonstrates our continued dedication to sound financial management. GAO reported that the funds' financial statements were presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles (GAAP) and that there was no reportable noncompliance with the laws and regulations that were tested. During the course of the audit, GAO and the FDIC also held detailed discussions regarding the level and sufficiency of internal controls during the surge in bank resolution and related crisis workload, with GAO concluding that a material weakness existed in the loss share estimation process, resulting in an opinion that internal controls over financial reporting were not effective in an overall sense. Separately, GAO identified a significant deficiency over information systems.

The perspective that the FDIC shared with GAO regarding the loss share estimation process was that despite the surge in resolution workload, a general review framework existed for the loss share agreements, with additional review on the larger agreements, albeit without our normal, well-documented audit trail. The weakness related to the loss share estimation process resulted in an absolute value error of $611 million, with the net effect of overstating the estimated loss share liability by $138 million against the overall loss share liability of $22.2 billion, or 2.75 percent absolute value and 0.62 percent net effect. Once corrected, this increased the "Receivables from Resolutions, Net" line item on the DIF's balance sheet by $138 million to $38.4 billion. Moreover, 68 percent of the overall absolute value error is attributable to loss share estimates for three receiverships. Though acknowledging that controls over the loss share estimation processes needed improvement during 2009, the FDIC believes that additional resources added throughout 2009, control improvements implemented during the fourth quarter of 2009, and control enhancements to be completed by the end of the second quarter of 2010 will largely address GAO's concerns in this area. The FDIC's action plans in this regard have

previously been shared with GAO. The FDIC is confident about the comprehensiveness of these control enhancements, which are straightforward in design, and does not expect GAO to identify repeat findings in the loss share estimation process for 2010. Similar control improvements are underway in the IT security area to resolve the identified control deficiencies in 2010.

During 2009, new audit standards went into effect that required management to provide a written assertion about the effectiveness of its internal control over financial reporting. In complying with this requirement, the FDIC prepared Management's Report on Internal Control over Financial Reporting (see attachment). The report acknowledges management's responsibility for establishing and maintaining internal control over financial reporting and provides the FDIC's conclusion regarding the effectiveness of its internal control.

The past year was unusually challenging due to the significant increase in bank resolution activity over prior years, coupled with unprecedented FDIC initiatives such as the Temporary Liquidity Guarantee Program (TLGP) and the successful collection of nearly $46 billion in prepaid assessments. However, as the FDIC continues to fulfill its mission to maintain stability and public confidence in the nation's financial system, we will continue to ensure that effective financial management remains a priority. The FDIC recognizes the significance that internal control plays in achieving its mission and goals and therefore will seek continual improvement in its internal control environment.

As always, we appreciated the professionalism and dedication of the GAO staff during the audit and look forward to continuing our productive and successful relationship during the 2010 audit. If you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

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

Management's Report on Internal Control over Financial Reporting

The Federal Deposit Insurance Corporation's (FDIC's) internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with U.S. generally accepted accounting principles (GAAP), and compliance with applicable laws and regulations. The objective of the FDIC's internal control over financial reporting is to reasonably assure that (1) transactions are properly recorded, processed and summarized to permit the preparation of financial statements in accordance with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with the laws and regulations that could have a direct and material effect on the financial statements.

Management is responsible for establishing and maintaining effective internal control over financial reporting. Management assessed the effectiveness of the FDIC's internal control over financial reporting as of December 31, 2009, through its enterprise risk management program that seeks to comply with the spirit of the following standards, among others: Federal Managers' Financial Integrity Act (FMFIA); Chief Financial Officers Act (CFO Act); Government Performance and Results Act (GPRA); Federal Information Security Management Act (FISMA); and OMB Circular A-123. In addition, other standards that the FDIC considers are the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control-Integrated Framework* and the U.S. Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government.*

Based on our evaluation, FDIC management concluded that as of December 31, 2009, the Corporation generally maintained effective internal controls, with the exception of a material weakness related to its process for estimating losses on loss-sharing arrangements. Therefore, the Corporation did not maintain, in all material respects, effective internal control over financial reporting.

Federal Deposit Insurance Corporation
June 14, 2010

Overview of the Industry

Total net income for the 8,012 FDIC-insured commercial banks and savings institutions that reported financial results as of December 31, 2009, was $12.5 billion for the year, up from $4.5 billion in 2008, but well below the $100 billion that insured institutions earned in 2007. The average return on assets (ROA), a basic yardstick of earnings performance, was 0.09 percent, compared to 0.03 percent in 2008. These are the two lowest annual ROAs for the industry in the past 22 years. Most of the year-over-year improvement in industry profitability occurred at the largest institutions. Almost two out of every three insured institutions (63.2 percent) reported a lower ROA in 2009 than in 2008, and 29.5 percent of all institutions reported a net loss for the year. This is the highest percentage of unprofitable institutions in the 26 years for which data are available.

Historically high expenses for credit-quality problems were the principal cause of earnings weakness. Insured institutions set aside $247.7 billion in loan-loss provisions during 2009, compared to $177 billion a year earlier. Total loss provisions in 2009 represented 38 percent of the industry's net operating revenue (net interest income plus total noninterest income) for the year, the largest proportion in any year since the creation of the FDIC.

Despite the burden of increased loan loss expenses and the weakness of the U.S. economy, the industry was considerably resilient in generating revenue during the year. Net operating revenue totaled $656.3 billion, an increase of $90.9 billion (16.1 percent) over 2008. Net interest income was $38.1 billion (10.7 percent) higher than a year earlier, while noninterest income increased by $52.8 billion (25.4 percent).

The improvement in net interest income was attributable to higher net interest margins (NIMs), as the industry's total interest-earning assets declined by $477.2 billion (4.1 percent) in 2009. The average NIM rose to 3.47 percent in 2009, up from 3.16 percent a year earlier. This is the highest annual NIM for the industry since 2005 and the first time in seven years that it has increased. Much of the year-over-year improvement in NIMs occurred at larger institutions, which benefitted from a sharp decline in average funding costs. More than half of all institutions (53.8 percent) reported lower NIMs compared to 2008.

Growth in noninterest income was led by increased trading revenue, which totaled $24.8 billion, compared to trading losses of $1.8 billion a year earlier. Servicing fees also posted strong growth, rising to $30.8 billion in 2009 from $13.6 billion in 2008. Income from securitization activities was a notable area of noninterest income weakness in 2009. Securitization income totaled only $4.8 billion, down from $15.3 billion the previous year.

Higher asset values contributed to a $14 billion reduction in realized losses on securities and other assets in 2009. In 2008, insured institutions reported $15.4 billion in realized losses; in 2009, realized losses totaled only $1.4 billion. Improvement in asset values was also evident in a $12.6 billion (38.6 percent) decline in charges for goodwill impairment and other intangible asset expenses. These charges, which reached $32.7 billion in 2008, fell to $20.1 billion in 2009.

Despite lower goodwill impairment costs, total noninterest expenses increased by $16.2 billion (4.4 percent) in 2009. Deposit insurance

premiums paid by insured institutions totaled $17.8 billion, an increase of $14.8 billion over 2008. Expenses for salaries and employee benefits were $11.4 billion (7.5 percent) higher than in 2008.

As was the case in 2008, failures significantly affected earnings reported for the full year because losses incurred by failed institutions were not included in the year-to-date income reported by surviving institutions as of December 31. During 2009, 119 failed institutions filed financial reports for one or more quarters prior to their failure. Together, these institutions reported more than $8.2 billion in net losses that are not included in full-year earnings for the industry. Similarly, for institutions that change ownership or are merged into other institutions, purchase accounting rules stipulate that the income and expenses that have been booked by acquired institutions are to be reset to zero as of the date of acquisition. Previously accrued income and expenses become adjustments to assets, equity capital, and reserves, and are not included in the subsequent reporting of year-to-date income and expense. If the 2009 losses reported by failed institutions had been included, the industry's net income for the year would have been less than $5 billion.

The industry's troubled loans continued to increase in 2009. At the end of December, the amount of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) was $391.3 billion, compared to $233.6 billion at the end of 2008. Noncurrent loans and leases represented 5.37 percent of all loans and leases, the highest percentage in the 26 years that insured institutions have reported noncurrent loan data. Residential mortgage loans accounted for more than half (51.2 percent) of the total increase in noncurrent loans in 2009, rising by $80.7 billion. Noncurrent real estate construction and development (C&D) loans rose by $20.3 billion, noncurrent loans to commercial and industrial (C&I) borrowers increased by $16.7 billion, and noncurrent real estate loans secured by nonfarm nonresidential properties increased by $24.3 billion.

Net charge-offs of loans and leases totaled $186.8 billion in 2009, compared to $100.4 billion in 2008. The full-year net charge-off rate of 2.49 percent was the highest annual rate since 1934. Net charge-offs of credit card loans totaled $37.5 billion for the year, net charge-offs of residential mortgage loans were $33.9 billion, C&I loan charge-offs totaled $31.8 billion, and net charge-offs of real estate C&D loans were $27.3 billion.

Total assets of insured institutions registered a historic decline in 2009, as weak loan demand, tighter loan underwriting standards, increased loan charge-offs, and deleveraging by institutions seeking to boost their regulatory capital ratios all contributed to a contraction in the industry's balance sheet. Assets fell by $731.7 billion (5.3 percent) during the year, the largest annual percentage decline since the inception of the FDIC. The reduction in assets was led by a $640.9 billion (8.3 percent) decline in net loans and leases. C&I loan balances declined by $273.2 billion (18.3 percent), residential mortgage loans fell by $128.5 billion (6.3 percent), and real estate C&D loans declined by $139.4 billion (23.6 percent). Real estate loans secured by nonfarm nonresidential properties (up $25.2 billion, or 2.4 percent) was the only major loan category that had meaningful growth in 2009.

In contrast to the reduction in industry assets, deposit balances increased by $191.1 billion (2.1 percent) during the year. Nondeposit liabilities fell by $1 trillion (31.3 percent). At year-end, deposits funded 70.4 percent of total industry assets, the highest proportion since March 31, 1996.

The number of insured institutions on the FDIC's "Problem List" rose from 252 institutions with assets of $159 billion to 702 institutions with assets of $402.8 billion in 2009. This is the largest number and asset total of "problem" institutions since the middle of 1993. At year-end, more than 95 percent of all insured institutions, representing more than 98 percent of total industry assets, met or exceeded the regulatory threshold defining "well-capitalized" for purposes of prompt corrective action.