

I. Management's Discussion and Analysis

Operations of the Corporation – The Year in Review

In 2002, the FDIC continued to position itself to meet the demands of an evolving banking industry – one that is being reshaped by institutional consolidation, globalization and technology. The Corporation assumed a major leadership role on significant economic and policy issues, pursuing the enactment of deposit insurance reform legislation and sponsoring several symposia for regulators, policymakers and others on other important public policy issues. It also directed increased attention to new and emerging risks in the banking system, focusing more resources on larger institutions and those identified as posing a higher potential risk to the deposit insurance funds. The FDIC implemented a streamlined organizational and management structure and appointed a new management team to lead it into the future.

Highlights of the Corporation's 2002 accomplishments in each of its three major business lines are presented below.

Insurance

The FDIC insures bank and savings association deposits to help ensure the stability of the financial system and the public's confidence in the U.S. banking system. As insurer, the FDIC continually evaluates how changes in the economy, the financial markets and the banking system affect the adequacy and the viability of the deposit insurance funds.

The FDIC's efforts in 2002 focused on deposit insurance reform, other activities to promote sound public policies, expanded examination activities and dedicated examiner program, new international capital standards, and resolving failed institutions.

Deposit Insurance Reform

The FDIC gave priority attention to enactment of comprehensive deposit insurance reform legislation in 2002. Legislation containing major elements of the FDIC deposit insurance reform proposals developed over the past three years was introduced both in the House of Representatives and the Senate. On April 23, the FDIC's Chairman testified before the Senate Banking Committee on the FDIC's proposals for deposit insurance reform.

The FDIC's recommendations, which were summarized in the testimony, include:

- Merging the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF).
- Granting the FDIC's Board of Directors the flexibility to manage the combined deposit insurance fund. Under the present system, statutorily mandated methods of managing the size of the BIF and SAIF may cause large premium swings and could force the FDIC to charge the highest premiums during difficult economic times when the industry can least afford it. Currently, safer institutions subsidize riskier institutions unnecessarily while new entrants and growing institutions avoid paying premiums. To correct these problems, the FDIC recommended that Congress give the Board of Directors the discretion to:

- Manage the combined fund within a range.
- Price deposit insurance according to risk at all times and for all insured institutions.
- Grant a one-time initial assessment credit to recognize institutions' past contributions to the fund and create an ongoing system of assessment credits and rebates to prevent the fund from growing too large.
- Indexing deposit insurance coverage to ensure that basic account coverage is not eroded over time by inflation and increasing the current level of deposit insurance coverage for retirement accounts.

The House passed H.R. 3717, the Federal Deposit Insurance Reform Act of 2002, on May 22 by a vote of 408 to 18. Although the Senate did not pass either H.R. 3717 or a similar Senate bill, S. 1945, the Safe and Fair Deposit Insurance Act of 2002, during the 107th Congress, the Corporation successfully addressed many key issues surrounding deposit insurance reform, establishing a sound base for future passage of legislation. Enactment of deposit insurance reform will remain a priority of the FDIC during the 108th Congress. The FDIC will continue to examine in greater detail how to implement risk-based pricing for deposit insurance and methods that could be used to create objective measurements of an insured depository institution's risk.

Since implementation of pending deposit insurance reform legislation was not enacted, development of a final pricing recommendation and implementation plan for inclusion in a notice and comment rulemaking during 2002 was put on hold. The FDIC continues to refine these options and explore other possibilities for using objective measures to price deposit insurance premiums.

Other Activities to Promote Sound Public Policies

In addition to its leadership on deposit insurance reform, the Corporation sponsored three policy symposia and hosted various conferences and workshops during 2002 on major issues of concern to the banking industry and regulators. In June, the FDIC held a symposium on "Enhancing Financial Transparency" that attracted Congressional members and staff, bankers, academics, regulatory policy makers, financial analysts and the media. In July, the FDIC and Credit Suisse First Boston co-sponsored a symposium on the "Rise of Risk Management: Basel and Beyond." At that meeting, top government officials and leading experts from Wall Street, the business sector, the accounting profession and academia discussed the importance of appropriate risk management policies and procedures. In September, the FDIC co-sponsored with the Journal of Financial Services Research a symposium on pricing the risks of deposit insurance. Leading scholars and researchers examined the latest developments in credit risk modeling and related risk measurement methods and their implications for deposit insurance pricing. The FDIC also hosted economic roundtables on the economic outlook and the risks of deflation and the U.S. housing market and consumer sector.

The FDIC also began publication in early 2002 of an electronic news bulletin called *FYI*, with over 5,000 subscribers by year-end. *FYI* summarizes emerging issues in banking, finance and the economy. The format is designed to complement the FDIC's in-depth reports and publications. *FYI* also serves as a vehicle for releasing analytical work as it becomes available. In addition, a quarterly communication entitled *Letter to the Stakeholders* has been released for FDIC-insured institutions, employees, and other stakeholders and highlights the FDIC's current initiatives and key performance indicators.

In February, Chairman Powell established a new FDIC Advisory Committee on Banking Policy to provide advice and recommendations to the FDIC on a wide range of issues relating to the Corporation's mission and activities, and examine how the FDIC can improve its effectiveness and address larger issues facing the financial services sector. The committee is composed of 12 members representing a cross-section of distinguished leaders from academia, economics, financial services, private industry, public affairs and the public interest community. The committee convened for the first time on November 13 in Washington, DC.

Expanded Special Examination Activities and Dedicated Examiner Program

In 2002, the FDIC focused increased examination resources on larger institutions and problem institutions where the risks to the funds are

greatest, while streamlining examinations for those posing less risk. One key component of this shift was an expansion of special examination activities in non-FDIC supervised institutions.

On January 29, the FDIC Board of Directors adopted an agreement with the Office of Thrift Supervision, the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System that enables the FDIC to examine insured depository institutions (IDIs) that represent a heightened risk to the deposit insurance funds. The Federal Deposit Insurance Act provides that the FDIC Board can authorize special examinations of any insured depository institution whenever such an examination is necessary for insurance purposes. The FDIC has long considered it a top priority to examine all insured banks and thrifts as needed to assess their financial condition and degree of risk to the insurance funds. This new agreement establishes an improved process for determining when the FDIC will use its authority to examine any insured institution and provides for enhanced coordination and cooperation of the agencies' supervisory efforts. These measures will ensure that the FDIC will be able to fulfill its responsibilities to protect the deposit insurance funds in the most efficient and least burdensome manner possible.

The agreement provides that the FDIC may conduct special examinations of any IDI that:

- Has a "3," "4" or "5" CAMELS composite rating (for the adequacy of **capital**, the quality of **assets**, the capability of **management**, the quality and level of **earnings**, the adequacy of **liquidity**, and the **sensitivity to market risk**), or
- Is undercapitalized as defined under the Prompt Corrective Action provisions of Section 38 of the Federal Deposit Insurance Act.

Under the interagency agreement, the FDIC may seek to participate in examinations or meetings with senior bank management of institutions that exhibit material deteriorating conditions or other adverse developments regardless of their current rating at the invitation of, or without the objection of, the primary federal regulator.

The interagency agreement also provides for the FDIC's establishment of a dedicated examiner program for the eight largest banking organizations. Because of their size and market share, these eight "large insured depository institutions" (LIDIs) expose the deposit insurance funds to substantial risk. Assets controlled by these eight institutions represent approximately 41 percent of industry assets. A similar level of concentration also exists on the deposit side – approximately nine percent of all domestic deposits are held by one LIDI.

The FDIC is not the primary regulator for the eight LIDIs. However, the FDIC's eight dedicated examiners, selected in August 2002, serve as the FDIC's primary points of contact for the oversight of these institutions. Pursuant to the agreement, to the fullest extent possible, the FDIC will continue to rely on results of the work performed by the primary federal bank supervisors in assessing the condition and risk-management practices of individual institutions. The dedicated examiners are provided access to supervisory personnel and supervisory information, including risk assessments, supervisory plans, reports of examination and other documents related to these eight banks, and are invited to participate in certain examination activities. The dedicated examiner program allows the FDIC first hand, timely access to information needed to stay fully abreast of the risks in these institutions and to quickly recognize when new risks emerge.

To assist the FDIC in quickly identifying and prioritizing areas of risk both to groups of banks and to specific institutions, a Risk Analysis Center (RAC) will be established in 2003 to serve as a central clearinghouse for vital bank risk information. The RAC will place special emphasis on the timely analysis of information generated by the dedicated examiner program.

New International Capital Standards

Internationally, the FDIC continues to participate in a number of global supervisory groups, including the Basel Committee on Banking Supervision. The FDIC actively participated in the Committee's

efforts to update and revise the 1988 Basel Capital Accord to make the capital standards of internationally active banks more comprehensive, risk-sensitive, and reflective of advances in banks' risk measurement and management practices, while continuing to ensure these banks maintain adequate capital reserves.

The FDIC invested resources on several fronts to ensure that the new Accord, when final, will be compatible with the agency's roles as both insurer and supervisor of banking organizations. The FDIC was well represented on several committees, task forces and groups that published documents for industry review during 2002. These included: "Quantitative Impact Study 3," which is serving as a comprehensive field test of the proposals for revising the 1988 Accord, and the "Second Working Paper on the Treatment of Asset Securitizations," which introduces more risk-sensitive approaches for addressing many of the emerging risks in the rapidly growing securitization market.

Resolving Failed Institutions

During 2002, the FDIC resolved 11 financial institution failures. These failed institutions had a total of \$2.6 billion in assets and \$2.2 billion in deposits. By the next business day after each failure, the FDIC had issued payout checks to insured depositors, or depositors had access to deposits determined to be insured. (See the accompanying table for details about liquidation activities.)

Liquidation Highlights 2000-2002

Dollars in billions	2002	2001	2000
Total Failed Banks	10	3	6
Assets of Failed Banks	\$ 2.5	\$.05	\$.38
Total Failed Savings Associations	1	1	1
Assets of Failed Savings Associations	\$.05	\$ 2.18	\$.03
Net Collections from Assets in Liquidation*	\$ 1.84	\$.31	\$.60
Total Assets in Liquidation*	\$ 1.24	\$.57	\$.54
Net Collections from Assets Not in Liquidation*	\$.02	\$.08	\$.16
Total Assets Not in Liquidation*	\$ 1.24	\$ 1.52	\$ 2.80

*Also includes assets from thrifts resolved by the former Federal Savings and Loan Insurance Corporation and the Resolution Trust Corporation.

Supervision

Supervision and consumer protection are the cornerstones of the FDIC's efforts to ensure the stability of and public confidence in the nation's financial system. As of year-end, the Corporation supervised 5,348 FDIC-insured state-chartered commercial banks that are not members of the Federal Reserve System (referred to as "state nonmember banks"). Through safety and soundness and consumer compliance examinations of these FDIC-supervised institutions, the FDIC assesses their management practices and policies as well as their compliance with applicable laws and regulations. The FDIC also educates bankers and consumers on matters of interest to bank customers, and addresses consumers' questions and concerns.

Safety and Soundness Examinations

During 2002, the FDIC conducted 2,534 statutorily required safety and soundness examinations. An on-site safety and soundness examination was not conducted for four institutions because specific circumstances regarding the institutions indicated an exception should be made.

A total of 1,806 examinations were conducted in 2002 by state authorities under the alternating examination program, and an additional 78 examinations were conducted with FDIC's assistance. Thirty-six institutions were due for an examination by state authorities, and five institutions had mergers pending at year-end. The remaining 31 institutions have examinations scheduled during the first and second quarters of 2003.

FDIC Examinations 2000-2002

	2002	2001	2000
Safety and Soundness:			
State Nonmember Banks	2,290	2,300	2,232
Savings Banks	229	241	235
National Banks	10	16	17
State Member Banks	5	9	2
Savings Associations	0	0	0
Subtotal	2,534	2,566	2,486
Compliance/Community Reinvestment Act	1,820	2,180	2,257
Trust Departments	524	466	533
Data Processing Facilities	1,681	1,625	1,585
Total	6,559	6,837	6,861

The number of FDIC-supervised institutions identified as “problem” institutions with a composite “4” or “5” CAMELS rating increased from 67 at year-end 2001 to 84 at year-end 2002. During 2002, 48 institutions were removed from problem status due to composite rating upgrades, mergers, consolidations, or sales, and 63 institutions were added to the problem bank list. The FDIC is required to conduct follow-up examinations of all designated problem institutions within 12 months of their last examination. As of December 31, 2002, all follow-up examinations for problem institutions had been performed on schedule.

Streamlining Examinations for Financially Sound Institutions

While directing increased resources to large and high-risk institutions and to the international front, the FDIC also implemented measures to improve efficiency by maximizing the use of risk-focused examination procedures at small well-managed banks in sound financial condition.

Specifically, in May 2002, the FDIC implemented a new program to streamline safety and soundness examinations of certain financially sound banks. The program, known as “MERIT” – for “**m**aximum **e**fficiency, **r**isk-focused, **i**nstitution-targeted examinations” – streamlines examinations for FDIC-supervised institutions with a supervisory rating of “1” or “2,” that have \$250 million or less in total assets and that are well-managed, and meet other program criteria while maintaining the quality and integrity of the examination. By year-end, the program had achieved more than a 20 percent reduction in examination hours for all eligible “1” and “2” rated FDIC-supervised institutions with under \$250 million in assets.

Reducing Regulatory Burden

The FDIC also continued efforts to explore options for reducing regulatory burden on the financial services industry. Based on input from the banking industry and the public, an interdivisional working group developed and began implementing short- and long-term strategies to reduce regulatory burden. These strategies include seeking accelerated compliance with the regulation review

requirements pursuant to the Economic Growth Recovery and Paperwork Reduction Act, improving communication of FDIC regulations and policies to financial institutions, and creating a new FDIC Regulatory Burden Web page to solicit industry input, and communicate initiatives in this area.

Minority Depository Institutions

The FDIC has historically taken steps to preserve and encourage minority ownership of insured financial institutions. On April 9, 2002, the FDIC Board adopted a new policy statement related to minority depository institutions. The new policy statement reflects changes in certain regulations and expands the FDIC’s Minority Depository Institutions Program. Enhancements to the program include increased communication with minority depository institutions, better coordination with trade associations that represent minority depository institutions, better defined roles for a national program coordinator and regional coordinators, and more opportunities for institutions to request technical assistance.

Compliance Examination Program

The FDIC takes seriously its statutory responsibilities to enforce consumer protection laws and regulations. It administers a compliance examination program to help ensure that consumers are able to make informed choices about credit transactions and deposit accounts and to help ensure equal access to the credit markets. The FDIC’s compliance examination program covers nearly 20 different federal statutes and regulations ranging from traditional disclosure laws (such as the Truth in Lending Act)

to fair lending statutes (such as the Equal Credit Opportunity and Fair Housing Acts) to the Community Reinvestment Act (CRA), which encourages insured depository institutions to help meet community credit needs. The FDIC has also added the privacy and insurance consumer protection provisions of the Gramm-Leach-Bliley Act of 1999 to its compliance examination program.

Compliance examinations are conducted on an established schedule by specially trained personnel. The interval between compliance examinations is typically two to three years for banks with strong compliance records. Banks with weak compliance performance are typically examined on an annual or shorter cycle. The FDIC uses the full extent of its enforcement authority, as appropriate, to address instances of noncompliance. Further, the FDIC meets its statutory responsibilities under the Equal Credit Opportunity Act to refer patterns or practices of credit discrimination to the Department of Justice. The FDIC conducted 1,820 compliance and CRA examinations in 2002, compared to 2,180 in 2001. Ten FDIC-supervised institutions due for an examination in 2002 were deferred, nine due to mergers or charter changes, and one to allow coordination with a scheduled safety and soundness examination. Nine institutions were assigned a composite "4" rating for compliance as of year-end 2002. None were assigned a composite "5" rating. Eight of the nine "4" rated institutions have entered into a Memorandum of Understanding (MOU) with the FDIC to correct compliance issues, and the ninth is currently reviewing a draft MOU, which is expected to be finalized in early 2003. (For more details, see the FDIC Examinations table on page 14.)

Financial Literacy

One of the FDIC's most important consumer protection goals is to promote financial education to those outside of the financial mainstream. The "Money Smart" program, unveiled in 2001, is primarily designed to help adults with little or no banking experience develop positive relationships with insured depository institutions. By year-end 2002, the FDIC had supplied more than 32,000 copies of the Money Smart training curriculum to various groups. Approximately 40 percent of the requests for Money Smart were from financial institutions and credit unions. The remainder were largely from educational service organizations, such as community colleges and adult education centers; community organizations; state and local government agencies; employment service organizations; and faith-based groups.

Over 1,000 representatives of community organizations, government agencies and financial institutions have attended orientation sessions on Money Smart held across the country. The Money Smart program also includes multi-partner agreements in which low and moderate-income adults can receive a variety of government services, and those outside of the financial mainstream are provided financial education with Money Smart as the principal curriculum.

As of year-end 2002, the FDIC had entered into partnership agreements with the Neighborhood Reinvestment Corporation, U.S. Department of Housing and Urban Development, U.S. Department of Labor, U.S. Small Business Administration,

Association of Military Banks of America, Independent Community Bankers of America, Internal Revenue Service, Office of the White House Initiative on Asian American Pacific Islanders, and over 300 other national and regional organizations. A Spanish version of the Money Smart curriculum was rolled out in mid-2002, and a Chinese version will be available in early 2003. The FDIC is pleased with the positive feedback from the Money Smart curriculum and will continue to improve and expand this important program.

Consumer Complaints and Inquiries

The FDIC investigates and responds to complaints and inquiries from consumers, financial institutions and other parties about consumer protection and fair lending laws, as well as deposit insurance matters. In 2002, the FDIC received 8,368 complaints, of which 3,987 were against state-chartered nonmember banks. Nearly 54 percent of the state nonmember bank complaints concerned credit card accounts. The most frequent complaints involved billing disputes and account errors, loan denials, credit card fees and service charges, and collection practices. In July 2002, the FDIC established a centralized Consumer Response Center (CRC) that is responsible for investigating all types of consumer complaints about FDIC-supervised institutions and for answering consumer inquiries about consumer protection laws and banking practices. The establishment of the CRC will facilitate timely responses to complaints and inquiries.

In addition, the FDIC received over 7,000 written inquiries and 8,000 telephone inquiries from consumers and bankers about FDIC insurance and consumer protection issues.

The largest percentage of inquiries related to whether specific financial institutions were insured by the FDIC and deposit insurance coverage. Other common inquiries were requests for copies of FDIC consumer publications, questions about banking practices and consumer rights under federal consumer protection laws, and how to obtain a personal credit report.

The FDIC has established a Central Call Center as its primary telephone point of contact for questions on deposit insurance from the banking community and the public. (For more information about the Call Center (toll-free, 1-877-275-3342), see page 127.)

To reach out to consumers needing assistance on matters arising from failed financial institutions, the FDIC also operates a Customer Service Center with staff dedicated primarily to handling records research and collateral releases. The records research staff responded to over 4,000 inquiries in 2002. This group researches the historical records of failed financial institutions to answer customer questions about deposit accounts, loan transaction histories, tax suits for delinquent real estate taxes and other issues. The collateral release staff researches and determines ownership of collateral securing loans from failed financial institutions in order to provide a release of lien, assignment or reconveyance to the borrower. This staff completed nearly 15,000 collateral release requests in 2002.

Receivership Management

The goal of the receivership management program is to minimize losses and maximize recoveries to creditors of receiverships. In 2002, the FDIC pursued this goal by quickly and actively marketing assets from failed institutions, providing for the expeditious and orderly terminations of receiverships, and implementing a service-billing methodology to ensure fair and reasonable charges to receiverships for the services provided by the Corporation.

Institution and Asset Marketing

The FDIC is proactive in its marketing efforts. Competitive marketing of failed institutions assures that the highest price is obtained for the deposit franchise and assets of the failed institution, thus minimizing the impact on the deposit insurance funds. All qualified and interested bidders were contacted regarding an opportunity to bid for each of the 11 institutions that failed in 2002. In addition, 85 percent of the book value of the marketable assets were marketed within 90 days of failure. This was done to minimize the costs associated with managing the assets and maximize the net recovery to the receivership estate, thereby benefiting the uninsured depositors and the creditors of the failed institution. (For details, see table on Liquidation Highlights on page 13.)

Two resolutions in 2002 warrant special note: Hamilton Bank and NextBank. The first involved Hamilton Bank, N.A., closed by the Office of the Comptroller of the Currency on January 11. Hamilton Bank had total assets of \$1.2 billion and total deposits of \$1.1 billion, and was headquartered in Miami, FL. The bank operated eight bank branches in Florida and a single bank branch in Puerto Rico. Hamilton Bank also had a small representative

office in Panama and another in Peru. What made this failure so unique was that it was the first time the FDIC was receiver for such a large volume of international loans. Hamilton's principal focus was commercial trade finance and lending to small companies operating in the United States and throughout Central America.

In resolving this failure, the FDIC took a rarely used approach to protect depositors by transferring all the insured deposits (savings and checking accounts, certificates of deposit, and Individual Retirement Accounts) from three of Hamilton's nine branches, and only the insured transactional accounts (savings and checking) from the remaining six branches. The Israel Discount Bank, New York, NY assumed \$531.6 million of the insured deposits. The FDIC paid out more than \$582.6 million of insured deposits through checks mailed directly to the remaining account holders.

By the end of June, more than \$1 billion of Hamilton's assets had been collected, sold or booked as a market-determined loss. At that time, Hamilton's Miami-based receivership office was closed, and responsibility for the remaining assets (approximate book value of \$100 million) was transferred to the FDIC's office in Dallas, TX. Those remaining assets principally involve bankruptcies, litigation or investigations. As of December 31, 2002, the cost of the Hamilton Bank failure to the Bank Insurance Fund was estimated to be \$172 million.

The second noteworthy resolution involved an Internet-only bank, NextBank, N.A., chartered in Phoenix, AZ. NextBank was closed by the Office of the Comptroller of the Currency on February 7. NextBank's principal business was the origination and sale of credit card receivables to a special-purpose trust (Master Trust), which paid for the receivables by selling securities to the public. These securities were backed by the cash flows generated from the receivables. The bank had no brick-and-mortar banking facilities, and its main business was issuing credit cards. The FDIC received no bids for the deposits and paid out the insured deposits by mailing checks directly to depositors.

The FDIC, as receiver, assumed servicing responsibilities for NextBank's credit card portfolio. The credit card portfolio consisted of over one million cards with about 800,000 belonging to the Master Trust and the remainder being bank-owned. The management and marketing of these assets required extensive negotiations with the many parties involved in the credit card processing and securitization business. Ultimately, the bank-owned cards were sold under a loss-sharing agreement. The FDIC, as servicer, marketed the bank's interest in the trust, but no buyer was found and the Master Trust cards were shut down on July 10. The FDIC is currently administering the receivership's remaining interests in the Master Trust.

The NextBank Instant Finance Network receivables were sold through Debt X, an asset-auction company that operates on the Internet. The sale, consisting of 900 accounts with a book value of approximately \$1 million, was conducted electronically via Debt X's secure Web site. As of

December 31, 2002, the cost of the NextBank failure to the Bank Insurance Fund was estimated to be between \$300 million and \$350 million.

In addition to these resolution activities, the FDIC filed a lawsuit in the district court for the Northern District of Illinois on November 1 against Ernst & Young, the outside auditors for Superior Bank, Hinsdale, Illinois. Superior Bank, a \$2 billion institution, failed on July 27, 2001. The complaint charges Ernst & Young with fraud and negligence in its audits of Superior and seeks actual damages of \$548 million and punitive damages in an amount three times the actual damages, as well as interest and costs. The FDIC's complaint asserts that Ernst & Young failed to properly audit Superior's residual assets and then concealed its erroneous auditing for fear that its acknowledgement would damage Ernst & Young's \$11 billion sale of its consulting arm to Cap Gemini, a French company. No trial date had been set as of year-end.

Terminations

The FDIC, as receiver, manages the receivership estate and its subsidiaries with the goal of expeditious and orderly termination. The oversight and prompt termination of receiverships preserves value for the uninsured depositors and other receivership claimants by reducing overhead and other holding costs. During 2002, the FDIC continued to meet its target of terminating 75 percent of receiverships within three years of the failure date.

Billing for Services Provided

In 2002, the Corporation implemented a new service-billing methodology to charge receiverships for the services provided by the FDIC. In addition, benchmark data were collected to permit the Corporation to better evaluate and set the rates to be charged for these services. During 2003, receivership management personnel will examine those areas in which FDIC costs significantly exceed those benchmarks and, where necessary, implement appropriate cost-management measures to address those cost differentials.

Operating More Efficiently

The Corporation took a number of steps in 2002 to improve its overall efficiency and effectiveness, from internal restructuring and downsizing to enhancing technology-related tools.

Corporate Reorganization

The FDIC substantially revamped its internal organizational structure to improve operational efficiency and unify corporate efforts in each of the three major business lines: insurance, supervision, and receivership management. As part of this major restructuring, the FDIC also streamlined the Corporation's management and support structures.

The major organizational changes made in 2002 include:

- The Division of Insurance and the Division of Research and Statistics were merged into a new Division of Insurance and Research to facilitate a more integrated and effective research and policy leadership capability.
- The Division of Supervision and the Division of Compliance and Consumer Affairs were merged into a new Division of Supervision and Consumer Protection. The regional and field structure of the new division was also streamlined, with a reduction in the number of regional offices from eight to six. Additionally, 89 field offices were consolidated into 52 territories for safety and soundness functions, and 73 field offices were consolidated into 30 territories for compliance functions.
- The receivership accounting operations of the Division of Finance were transferred to the Division of Resolutions and Receiverships to better align business processes in the Corporation's receivership management program.
- Personnel and training functions were merged to create a new Human Resources Branch within the Division of Administration.

Downsizing

The Corporation also took steps to complete the downsizing that it has been addressing for much of the past decade. Employment dropped from 6,167 at the beginning of 2002 to 5,430 at year-end 2002 as a result of declining workloads and organizational streamlining. Much of the needed reduction in staffing was accomplished voluntarily through

targeted buyout programs that resulted in the retirement or resignation of approximately 700 employees and the reassignment of surplus employees to vacant positions elsewhere within the Corporation. In addition, approximately 30 surplus attorney positions were eliminated through a reduction-in-force in May. The decade of downsizing is substantially completed.

The savings resulting from corporate restructuring, downsizing and other initiatives directed toward cost containment and improved operating efficiency will, when fully realized, reduce future corporate operating costs by an estimated \$80 million annually. The initial impact can be seen in the 2003 budget adopted by the Board of Directors in December 2002. Estimated 2003 spending will decline by seven percent from 2002 spending.

Corporate University

In another move to improve its long-term operational efficiency and effectiveness, the Corporation began developing a new Corporate University that will be modeled on the best practices of high-performing organizations in both the public and private sectors. The new Corporate University will provide an integrated framework for addressing future leadership development and skill requirements. It will include core training programs for the FDIC's three major business lines – insurance, supervision, and receivership management – and give employees the opportunity for cross-training and job rotation. This will facilitate the establishment, over time, of a flexible,

permanent workforce capable of responding expeditiously to changing workload needs and priorities. Leadership development programs will assist in providing a strong foundation for current and future FDIC leaders. The Corporate University will use technology, seminars, hands-on experience and traditional instruction to make learning easier, more convenient and continual.

Information Technology Initiatives

In 2002, the Corporation also continued to pursue a number of major technology-related investments that will, when implemented, reduce future operating costs. The largest of these projects, the New Financial Environment (NFE), will greatly improve operating efficiencies and provide substantial cost savings to the FDIC after it is implemented in mid-2004. The NFE will replace the Corporation's current accounting and related systems and will facilitate the implementation of streamlined work processes. It will also provide better information and support to FDIC management for decision-making.

In addition, the FDIC continued to develop *FDICconnect*, a secure electronic Web-enabled environment allowing the Corporation to electronically exchange information with insured financial institutions. With the automation of data exchanges, the FDIC will be able to streamline and improve business processes, and reduce costs. In particular, the faster receipt of information will enable the FDIC to provide more timely information to the public.

Phase II Construction of the Seidman Center

In March 2002, the FDIC Board of Directors unanimously approved the expenditure of \$110.9 million for Phase II construction at the FDIC's existing Seidman Center facility in Northern Virginia. The Corporation's decision was based on an extensive analysis of various lease, purchase and build scenarios. Phase II construction was determined to be the most economical option over the long term. The project will save the FDIC an estimated \$78 million over 20 years on a net present value basis compared to the projected costs of continued leasing in downtown Washington, DC. Phase II construction is targeted for completion by 2006.

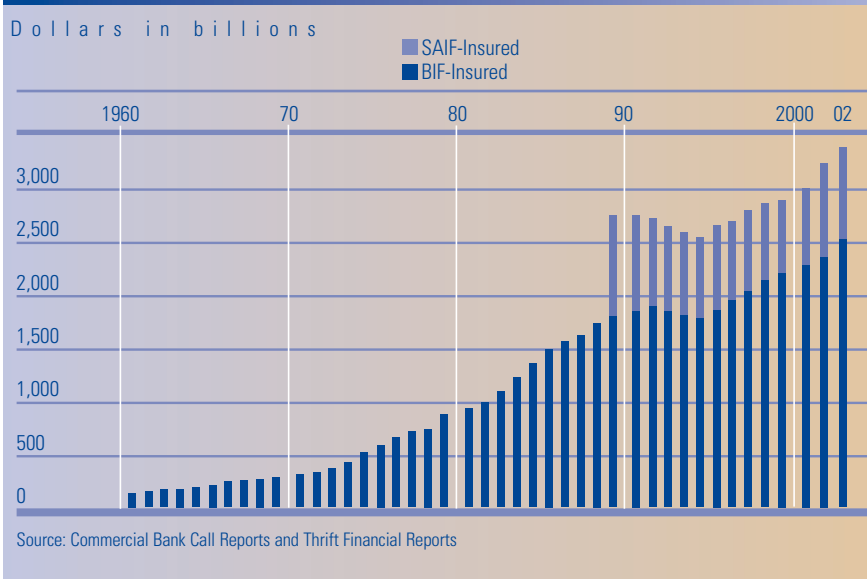
Financial Highlights

In its role as deposit insurer of banks and savings and loan associations, the FDIC promotes the safety and soundness of insured depository institutions. The financial highlights discussed below address the performance of the deposit insurance funds. It also includes a discussion of initiatives to restructure the internal budget to closely monitor operations and investments and the establishment of a Capital Investment Review Committee (CIRC) to better manage capital investments.

Deposit Insurance Fund Performance

The FDIC administers two deposit insurance funds – the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) – and manages the FSLIC Resolution Fund (FRF), which fulfills the obligations of the former Federal Savings and Loan

FDIC-Insured Deposits (estimated 1960-2002)

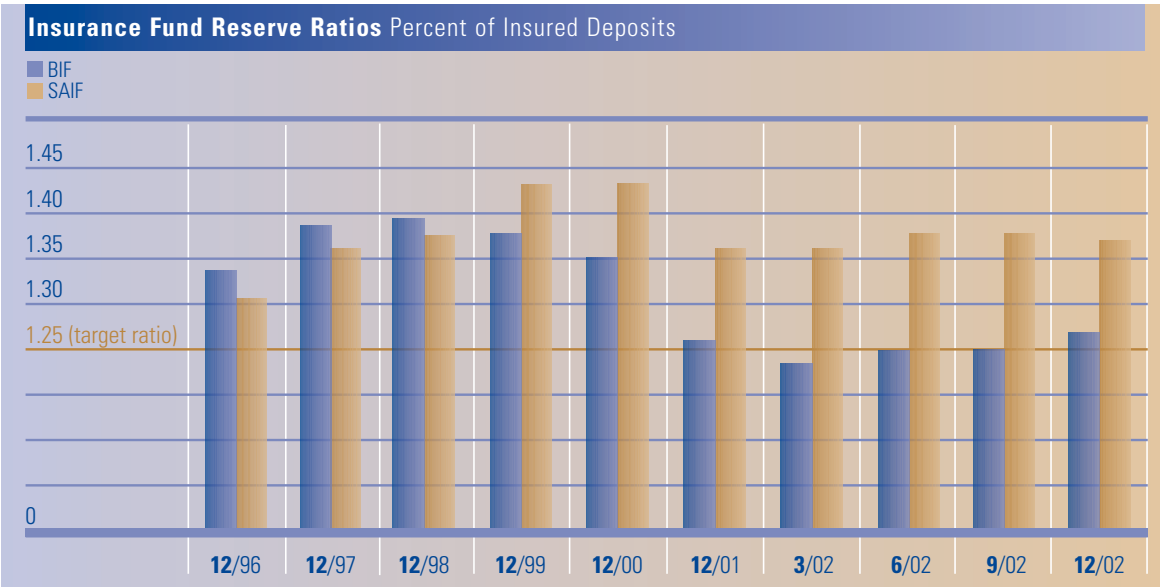


Insurance Corporation (FSLIC) and the former Resolution Trust Corporation (RTC). The following summarizes the condition of the FDIC's insurance funds.

The Corporation's investment strategy for the BIF and the SAIF reflects prudent management, with interest earned on investment securities of approximately \$1.69 billion for the BIF and \$564 million for the SAIF. Successful investing of the funds during the year yielded total returns that surpassed Merrill Lynch's (ML) 1-10 Year U.S. Treasury Index of 9.05 percent for calendar year 2002. The BIF and the SAIF portfolio investments yielded returns of 9.20 and 9.89 percent, which exceeded the ML Index by 15 and 84 basis points, respectively.

Deposit insurance assessment rates remained unchanged from 2001 for both the BIF and the SAIF, ranging from 0 to 27 cents annually per \$100 of assessable deposits. Under the assessment rate schedule, 91.5 percent of BIF-member institutions and 90.1 percent of SAIF-member institutions were in the lowest risk-assessment category and paid no deposit insurance assessment for the first semiannual period of 2003.

Deposits insured by the FDIC approached \$3.4 trillion in 2002, as the number of insured institutions fell below the 9,400 mark for the first time. Insured deposits rose by 1.2 percent during the fourth quarter, bringing the growth rate for the full year to 5.5 percent, the second-fastest annual growth rate in the past 16 years. Insured deposits of the 9,372 FDIC member institutions rose by \$177 billion in 2002, including an \$8.3 billion (4.3 percent) increase in insured brokered deposits.



During 2002, deposits insured by the BIF increased by 4.9 percent, to \$2.5 trillion. The BIF balance was \$32.1 billion at year-end 2002, or 1.27 percent of estimated insured deposits (compared to 1.25 percent at September 30, 2002). This was up from the year-end 2001 reserve ratio of 1.26 percent, as deposits insured by the BIF increased by \$117.9 billion and the BIF fund balance increased by \$1.6 billion.

The reserve ratio of the SAIF was 1.37 percent at year-end 2002 (compared to 1.38 percent at September 30, 2002), up from 1.36 percent at year-end 2001. The balance of the SAIF was \$11.7 billion on December 31, 2002. SAIF-insured deposits were \$860.4 billion at year-end 2002, having grown 7.4 percent for the year. (See the accompanying table on Insurance Fund Reserve Ratios.)

Despite the relatively rapid growth of insured deposits, insured institutions continued to rely increasingly on other funding alternatives. Insured deposits as a percentage of domestic liabilities continued a steady, 11-year decline, falling to 49.9 percent at the end of 2002, compared to 50.9 percent at the end of 2001. At year-end 2002, the ratio was 45 percent for institutions with total assets greater than \$1 billion, and 71 percent for smaller institutions. (See the accompanying tables on FDIC-insured Deposits on page 19 and Risk Related Premiums on page 21.)

During 2002, 11 FDIC-insured institutions failed. Ten of those institutions, with combined assets of \$2.5 billion, were insured by the BIF. The other institution, with assets of \$50 million, was insured by the SAIF. Losses for the 11 failures are estimated at \$630 million. In 2001, there were four failures of insured institutions, with total assets of \$2.2 billion and estimated losses of \$445 million. The contingent liabilities for anticipated failures of BIF- and SAIF-insured institutions as of December 31, 2002, were \$1.0 billion and \$90 million, respectively.

Risk-Related Premiums

The following tables show the number and percentage of institutions insured by the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF), according to risk classifications effective for the first semiannual assessment period of 2003. Each institution is categorized based on its capitalization and a supervisory subgroup rating (A, B, or C), which is generally determined by on-site examinations. Assessment rates are basis points, cents per \$100 of assessable deposits, per year.

BIF Supervisory Subgroups*

	A	B	C
Well Capitalized:			
Assessment Rate	0	3	17
Number of Institutions	7,470 (91.7%)	441 (5.4%)	97 (1.2%)
Adequately Capitalized:			
Assessment Rate	3	10	24
Number of Institutions	106 (1.3%)	13 (0.2%)	10 (0.1%)
Undercapitalized:			
Assessment Rate	10	24	27
Number of Institutions	1 (0.0%)	0 (0.0%)	5 (0.1%)

SAIF Supervisory Subgroups*

	A	B	C
Well Capitalized:			
Assessment Rate	0	3	17
Number of Institutions	1,113 (90.6%)	82 (6.7%)	18 (1.5%)
Adequately Capitalized:			
Assessment Rate	3	10	24
Number of Institutions	7(0.6%)	4 (0.3%)	4 (0.3%)
Undercapitalized:			
Assessment Rate	10	24	27
Number of Institutions	0 (0.0%)	0 (0.0%)	1 (0.1%)

* BIF data exclude SAIF-member "Oakar" institutions that hold BIF-insured deposits. The assessment rate reflects the rate for BIF-assessable deposits, which remained the same throughout 2002.

* SAIF data exclude BIF-member "Oakar" institutions that hold SAIF-insured deposits. The assessment rate reflects the rate for SAIF-assessable deposits, which remained the same throughout 2002.

Corporate Budgeting

The FDIC has restructured its budget for 2003 to include separate Operating and Investment Budgets. The Operating Budget includes funding for both ongoing operations of the Corporation and receivership operations. The new Investment Budget approved by the Board of Directors is a composite of individual budgets for major investment projects.

The Board approved a 2003 Corporate Operating Budget of \$1,070.5 million and a multi-year Investment Budget of \$70.4 million. Total estimated spending for 2003 will be approximately \$1.1 billion, seven percent lower than 2002 spending. Almost two-thirds of projected 2003 spending will fund personnel and related costs.

Capital Investment Review Committee

During 2002, the FDIC began managing its capital investments from a new vantage point. The FDIC created a Capital Investment Review Committee (CIRC), dedicated to reviewing and overseeing all major information technology (IT) and non-IT investment initiatives with estimated capital outlays of more than \$3 million, as well as certain other projects that cost less but are considered mission-critical to the FDIC.

The purpose of the CIRC is to implement a systematic management review process that supports budgeting for the FDIC's capital investments and ensures the regular monitoring and proper management of these investments, once funded. The CIRC is responsible for reviewing the major capital investment initiatives funded in the new Investment Budget as well as significant enhancements and maintenance costs associated with the FDIC's current initiatives. The investments reviewed by the CIRC include major computer purchases, software application developments, and office buildings. The CIRC determines whether the business case supporting the proposed investment is sound, well-justified and appropriate for funding consideration by the FDIC's Board of Directors. The CIRC will also continue to monitor and report on the status of approved investment projects to the Board of Directors.