I. Management's Discussion and Analysis

The Year in Review

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

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

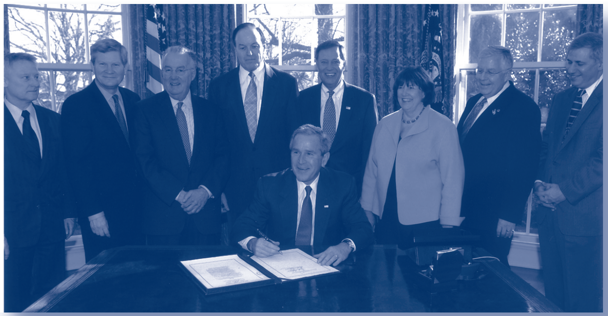
Insurance

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

Deposit Insurance Reform

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

- Merges the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into the new Deposit Insurance Fund (DIF).
- Permits the FDIC's Board of Directors to price deposit insurance according to risk for all insured institutions, regardless of the level of the reserve ratio.
- Grants a one-time initial assessment credit of approximately $4.7 billion to recognize institutions' past contributions to the combined fund.
- Establishes a range for the Designated Reserve Ratio (DRR) of 1.15 percent to 1.50 percent, and allows the FDIC to manage the reserve ratio within this range. Also requires that, if the reserve ratio falls below 1.15 percent or is expected to do so within six months, the FDIC must adopt a restoration plan that provides that the DIF will return the reserve ratio to 1.15 percent within five years.
- Generally mandates dividends to the industry of one-half of any amount above the 1.35 percent level and of all amounts in the fund above the 1.50 percent level.
- Increases the coverage limit for certain retirement accounts to $250,000 but leaves the basic insurance limit for other deposits at $100,000.
- Indexes both coverage limits for inflation, and allows the FDIC (in conjunction with the National Credit Union Administration) to increase the limits every five years beginning January 1, 2011, if warranted.



President George W. Bush in the Oval Office, signs the Federal Deposit Insurance Reform Act of 2005. Signing ceremony participants (l to r): Rep. Spencer Bachus, Sen. Tim Johnson, Sen. Paul Sarbanes, Sen. Richard Shelby, Rep. Mike Oxley, Rep. Darlene Hooley, Sen. Mike Enzi, and Martin Gruenberg, Vice Chairman – FDIC.

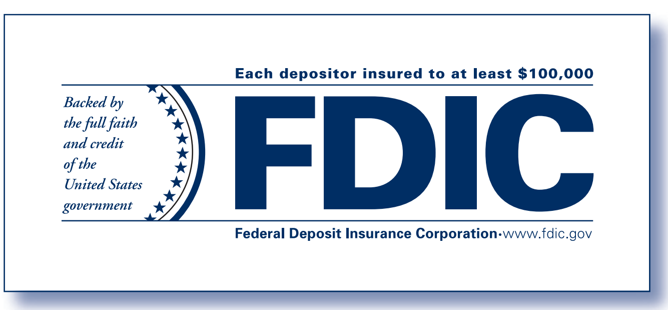
Implementation of deposit insurance reform was a major initiative for the FDIC in 2006. On March 14, 2006, the Board adopted an interim final rule implementing the substantive changes to the FDIC's insurance coverage rules, effective April 1, 2006. (A final rule was adopted on September 5, 2006.) In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

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

On November 2, 2006, after considering comments on an NPR published in July 2006, the Board adopted a final rule setting the DRR at 1.25 percent. The Board also adopted two final rules governing assessments after considering comments on NPRs published in May and July 2006. One of these rules makes operational changes to the assessment system. Under that rule, assessments will be determined and collected after the end of each quarter, which will permit consideration of more current supervisory information and capital data. Among its other provisions, the rule requires larger institutions to use average daily deposit balances as the basis for assessments.

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

In addition to the extensive rulemaking required in conjunction with the implementation of deposit insurance reform, fundamental changes were made in the FDIC's business functions including modification to major application systems such as the Risk-Related Premium System, Electronic Deposit Insurance Estimator, the Corporate Business Information System and the Assessment Information Management System. As part of the implementation, the FDIC also made available online new tools such as the One-Time Assessment Credit Search Tool and the Assessment Rate Calculator for insured institutions. System changes in support of deposit insurance reform will continue in 2007.



The new FDIC official teller sign reflects changes from deposit insurance reform.

Risk-Related Premiums

The accompanying table shows the number and percentage of institutions insured by the Deposit Insurance Fund (DIF) as of September 30, 2006, according to risk classifications effective for the second semi-annual assessment period of 2006. Each institution is categorized based on its capital group (1, 2, or 3) and supervisory subgroup (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.

Risk-Related Premiums

	Supervisory Risk Subgroup		
Capital Group	**A**	**B**	**C**
1. Well Capitalized:			
Assessment Rate	0	3	17
Number of Institutions	8,324 (95.1%)	345 (4.0%)	38 (0.4%)
2. Adequately Capitalized:			
Assessment Rate	3	10	24
Number of Institutions	39 (0.5%)	3 (0.0%)	1 (0.0%)
3. Undercapitalized:			
Assessment Rate	10	24	27
Number of Institutions	2 (0.0%)	0 (0.0%)	3 (0.0%)

Capital Standards

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

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

The findings of the fourth quantitative impact study (QIS-4), which were completed in 2005, suggested that, without modification, the Basel II framework could result in a significant decline in minimum risk-based capital requirements. As a result, several safeguards were incorporated into the Basel II NPR to protect against a significant decline in minimum risk-based capital requirements. These safeguards included a one-year delay in the targeted effective date of the regulation, a longer transition period, limitations on the amount that risk-based capital at individual banks could decline during the transition period, the retention of the U.S. leverage ratio and Prompt Corrective Action requirements, and a 10 percent downward limit on the aggregate reduction in minimum risk-based capital that could result from the implementation of Basel II. Through continuing on-site and off-site reviews of all FDIC-supervised institutions that have indicated possible plans to operate under the new Basel Capital Accord, the Corporation has confirmed that those institutions are making satisfactory progress towards meeting the expected requirements.

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

Regulatory Burden Reduction

Pursuant to Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), federal banking regulators are required to review existing regulations to identify and eliminate those that are outdated, unnecessary or unduly burdensome on insured depository institutions. An interagency EGRPRA work group completed a comprehensive three-year review in 2006, analyzing the comments received on the last sets of regulations and publishing a summary of those comments. The interagency working group also prepared a report to Congress, which identified significant issues raised during the public comment period.

The Financial Services Regulatory Relief Act of 2006 was enacted into law in October 2006. This Act requires the SEC and FRB to jointly issue a rule to implement the exceptions to the definition of *broker* in accordance with section 3(a)(4)(F) of the Securities Exchange Act of 1934, permits the Federal Reserve to pay interest on balances kept at the Federal Reserve Banks, increases the Federal Reserve Board's flexibility in setting certain reserve requirements, reduces some redundant bank filing requirements and makes numerous changes designed to enhance banking agency efficiency and effectiveness. The new law also expands eligibility for inclusion in the 18-month safety and soundness examination cycle to insured institutions with CAMELS[1] "1" ratings with up to $500 million in assets (an increase from the previous threshold of $250 million). Congress subsequently enacted legislation expanding eligibility for the 18-month examination cycle to insured institutions with CAMELS "2" ratings up to $500 million in assets.

Center for Financial Research

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

In addition to these conferences, the CFR and Harvard University jointly sponsored a brainstorming symposium to advance research on consumer finance in October 2006. Individuals from academia, businesses, public policy, consumer advocacy and philanthropy groups discussed and proposed a research agenda in the field of consumer finance.

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

Central Data Repository

The FDIC continued to leverage its investment in the Federal Financial Institutions Examination Council's (FFIEC) Central Data Repository (CDR). The CDR streamlines the collection, validation and publication of financial institutions' Call Report data. The CDR was used to successfully collect Call Report data from approximately 8,000 reporting institutions for each quarter of 2006. The FFIEC also began work during 2006 on enhancing the CDR to publish data to the public and produce bank performance reports, and an interagency team began work on modifications that will increase the flexibility of the CDR to process additional data series.

The FDIC also continued to lead in the promulgation of the CDR's underlying financial reporting standard, XBRL (eXtensible Business Reporting Language), to increase financial transparency. Early in 2006, the FDIC formed an XBRL Advisory Group to build upon the success of the CDR program. Leveraging the FDIC's demonstrated expertise and

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

leadership in the field, the group will expand the use of XBRL technologies and promote their use among other FDIC business partners. Internal and external collaboration Web sites were established to allow the exchange of information and to disseminate lessons learned.

Risk Analysis Center

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

Other Risk Identification Activities

During 2006, the FDIC continued to research and analyze trends in the banking sector, financial markets, and the overall economy to identify emerging risks to the banking industry and the DIF. The identified risks were highlighted throughout the year in presentations and written reports. The FDIC prepared summary analyses semiannually on the condition of large insured financial institutions, mainly based on information provided by FDIC examiners and these institutions' primary federal regulators. Institution-specific concerns were directed to FDIC regional offices for appropriate action. Additionally, the FDIC continued to analyze the regional economies adversely affected by hurricanes Katrina and Rita throughout the year.

The FDIC published a variety of studies in quarterly *FDIC Outlook* issues and periodic *FYI* reports that addressed a range of current topics in the banking sector, financial markets and the economy. In addition, quarterly *FDIC State Profiles* were released for each state during 2006. The FDIC also published the *Quarterly Banking Profile*, which discusses current conditions, trends and changes in the performance of insured institutions, and *Supervisory Insights*, which discusses implementation of regulatory policy, shares best practices and communicates emerging issues in bank supervision.

Throughout the year, the FDIC conducted numerous outreach activities addressing economic and banking risk analysis. Presentations were made to financial institutions and related trade groups, bank directors' colleges, community groups, foreign visitors and other regulators. The FDIC also sponsored a roundtable discussion that addressed possible scenarios for the next recession.

Supervision and Consumer Protection

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

Examination Program

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

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

FDIC Examinations 2004-2006

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

As of December 31, 2006, there were 51 insured institutions with total assets of $8.5 billion designated as problem institutions for safety and soundness purposes (defined as those institutions having a composite CAMELS[3] rating of "4" or "5"), compared to the same number of problem institutions with total assets of $6.6 billion on December 31, 2005. This constituted a 28.7 percent year-over-year increase in the total assets in problem institutions. During 2006, 38 institutions with aggregate assets of $4.7 billion were removed from the list of problem financial institutions, while 38 institutions with aggregate assets of $7.8 billion were added to the list of problem financial institutions. The FDIC is the primary federal regulator for 27 of the 51 problem institutions.

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

As of December 31, 2006, four FDIC-supervised institutions were assigned a "4" rating for compliance; no institutions were assigned a "5" rating. All of the "4"-rated institutions were examined in 2006, and Memoranda of Understanding are currently being finalized to address the FDIC's examination findings.

In addition, the FDIC developed and began using new screening tools in 2006 to identify those FDIC-supervised institutions with mortgage lending disparities, based upon "higher rate" pricing information supplied by these institutions under the Home Mortgage Disclosure Act (HMDA), and to assess whether the disparities in loan pricing and denial rates resulted from discriminatory lending or reflected other factors, such as creditworthiness, underwriting or other non-discriminatory criteria.[4] Compliance examinations were scheduled for all of the institutions with identified lending disparities to determine

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

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

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

whether those disparities were the result of discriminatory lending. Although those examinations indicated that the majority of the institutions were not engaging in discriminatory lending, a small number of institutions were referred to the U.S. Department of Justice for engaging in an apparent pattern and practice of discriminatory lending.

Large Complex Financial Institution Program

The FDIC's Large Bank Program was established to address the unique challenges associated with supervising and insuring the deposits of large and complex institutions. A significant share of the assets and insured deposits of the banking industry are today held in a small number of large institutions. The Program ensures a consistent approach to large bank supervision and risk analysis on a national basis by compiling key data and performing analyses of large-bank operations for use by various FDIC divisions and offices and by providing specialists to support supervisory activities for large banks. In 2006, guidelines were developed to enhance the FDIC's risk-monitoring program for large banks with assets greater than $50 billion. Monitoring and assessment activities also continued in 2006 to ensure internal and industry preparedness for the implementation of Basel II. Training on credit and operational risk was conducted for regional and interagency personnel, and numerous "supervisory working group" meetings were held with foreign regulatory authorities to address Basel II home-host and cross-border issues.

Sandra Thompson, John Bovenzi, and Douglas Jones at an ILC hearing.

Industrial Loan Companies

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

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

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

Promoting Economic Inclusion

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

Advisory Committee on Economic Inclusion

On November 2, 2006, the FDIC announced the establishment of an Advisory Committee on Economic Inclusion. The Committee will provide the FDIC with advice and recommendations on important initiatives focused on expanding access to banking services by underserved populations. It will also explore ways to encourage the banking industry to adopt suitable products and marketing strategies to compete with alternative high-cost providers. The Committee members will represent a cross section of interests from the banking industry, state regulatory authorities, government, academia, consumer or public advocacy organizations, community-based groups and others impacted by banking-related practices.

Alliance for Economic Inclusion

In 2006, the FDIC created the Alliance for Economic Inclusion (AEI), a broad-based coalition of banks, community organizations, foundations, educators, and local, state, and federal agencies in each of the FDIC's six regions. The goal of the AEI initiative is to work with financial institutions and other partners to bring those currently unbanked and underserved into the financial mainstream. The AEI will focus on expanding banking services in all underserved markets, including low- and moderate-income neighborhoods, minority communities and rural areas.

Affordable Small-Dollar Loan Guidelines

To help meet consumer demand for affordable small-dollar loans, the FDIC issued a draft of its *Affordable Small-Dollar Loan Guidelines*, targeted to the banking industry, for public comment on December 4, 2006. Many consumers with bank accounts turn to high-cost payday or other non-bank lenders because they are accessible and can quickly provide small loans to cover unforeseen circumstances. The draft guidelines suggest ways the banking industry can make affordable short-term loan products more accessible to these customers, helping to build long-term, profitable multiple-account relationships. The guidelines focus on product development and underwriting, and include information on tools such as consumer financial education and savings that may address longer term financial issues. The FDIC expects to finalize the guidelines in early 2007.

Military Bank Initiative

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

The FDIC hosted a conference with these banks in December 2006 in Washington, DC, to provide information and share ideas on successful product and marketing strategies for consumers in the military. Approximately 60 banks and more than 150 other participants – including press, bankers, trade associations and representatives of the Department of Defense – attended the conference on "Affordable, Responsible Loans for the Military: Programs and Prototypes." The program was organized with the assistance of the AMBA and featured Congressman Barney Frank and Kelvin Boston, host of PBS' *Moneywise*. The main focus of the event was the discussion of loan products targeted to or that have features that would benefit military borrowers. Following a discussion of regulatory issues, the participants attended workshops aimed at developing an affordable loan template. The FDIC intends to distribute this template to FDIC-supervised institutions in 2007 for use as a possible prototype in developing their own affordable loan programs.

Nontraditional Mortgage Products

In 2006, the FDIC became increasingly concerned with the expansion of nontraditional mortgage products and the potential risk posed by these products to the DIF. While these products, which are also referred to as "alternative" or "exotic" mortgage loans, have been available for many years, the number of institutions offering them has expanded rapidly in recent years. To address these concerns, the FDIC implemented certain enhancements to the supervisory oversight of nontraditional mortgage banking activities and, with the other financial institution regulatory agencies, developed and issued guidance to address the growing risks associated with these loan products. The agencies are concerned that some borrowers may not fully understand the risks of these products. The agencies are also concerned about the lack of principal amortization and the potential for negative amortization. Moreover, institutions are increasingly combining these loans with other features that may compound risk.

The guidance covers three primary areas: loan terms and underwriting standards, portfolio and risk management practices, and consumer protection issues. It focuses on qualification standards for borrowers, and portfolio management and communication with consumers and makes clear that the FDIC and the other regulatory agencies expect institutions to effectively assess and manage the risks posed by nontraditional mortgage products.

Erica Bovenzi and Sandra Thompson at a community bank forum in New Orleans.

The guidance recommends that promotional materials and other product descriptions provide consumers with full and balanced information about the costs, terms, features and risks – particularly payment shock and negative amortization – of nontraditional mortgage products. To help consumers shop wisely and decide whether such a product is right for them, the FDIC also published information about nontraditional mortgages in its quarterly *FDIC Consumer News* and joined the other regulatory agencies in publishing a consumer handbook on interest-only and payment-option mortgages.

Guidance on Concentrations in Commercial Real Estate Lending

The federal banking regulatory agencies (agencies) recognized that financial institutions serve a vital role in their communities by supplying credit for business and real estate development. However, the agencies have observed that commercial real estate (CRE) concentrations have been rising over the past several years and may expose institutions to earnings and capital volatility in the event of economic downturn. To address these concerns, the agencies published for comment the proposed interagency *Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices (CRE Guidance)* on January 10, 2006. After carefully reviewing over 4,400 comment letters, the agencies issued the final *CRE Guidance* on December 12, 2006. The *CRE Guidance* reminded institutions that strong underwriting standards, portfolio management practices, and capital levels are important elements of a sound CRE lending program.

Hurricane Recovery Assistance

Since the Gulf Coast hurricanes of 2005, the FDIC has worked with other federal and state regulatory agencies to address policy issues that arose due to the severity and

Vice Chairman Gruenberg at a Gulf Coast forum in New Orleans.

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

In October 2006, the FDIC and NeighborWorks® America jointly released a new homeownership and financial counseling guide called *Navigating the Road to Housing Recovery in the Gulf Coast*. The guide is designed for evacuees who are now beginning to receive federal and state financial assistance to rebuild or relocate. It was a focal point of two conferences held in late 2006, the "Gulf Coast Housing Summit–Strategies for Redeveloping Communities and Rebuilding Lives," jointly sponsored by the FDIC and NeighborWorks® America in New Orleans, LA, and another housing conference sponsored by Back Bay Mission in Biloxi, MS. More than 400 bankers, housing experts, homeownership counselors and others attended the two conferences to discuss local issues, match development resources with needs, and learn more about the "just-in-time" counseling program.

The FDIC, in cooperation with NeighborWorks® and an array of local partners, will schedule train-the-trainer sessions through early 2007 to develop 300 potential homeownership counselors. Counselor trainees will be drawn from banks, churches, government agencies, employers, nonprofits and other groups working with hurricane evacuees. This comprehensive counseling program will assist individuals to plan carefully and make informed decisions to avoid costly mistakes at this difficult time in their lives. The FDIC envisions that the counseling program will become a template for consumers to "navigate the road to housing recovery" in other areas of the country following major natural disasters or other catastrophic events.

Minority Depository Institutions

The FDIC has long recognized the importance of minority depository institutions in promoting the economic viability of minority and underserved communities. As a reflection of the FDIC's commitment to minority depository institutions, the FDIC issued a "Policy Statement Regarding Minority Depository Institutions" on April 9, 2002. The policy statement implements an outreach program designed to preserve and encourage minority ownership of financial institutions.

Since the adoption of that policy statement, the FDIC has maintained contact with various minority depository institution trade associations; met periodically with the other federal banking regulators to discuss initiatives underway at the FDIC and identify opportunities for the federal banking agencies to work together to assist minority institutions; held regional outreach meetings and five Minority Bankers Roundtables; and extended offers to each FDIC-supervised minority depository institution to meet and discuss issues of interest.

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

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

Homeland Security

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

Bank Secrecy Act

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

The FDIC continued in 2006 to play a critical role in the international fight against money laundering and terrorist financing. Its efforts included the following:

- With the other federal banking agencies, negotiated and signed an information-sharing memorandum of understanding (MOU) with the Office of Foreign Assets Control (OFAC) in April 2006.
- Conducted AML/Counter-Financing of Terrorism (CFT) training for 20 central bank representatives from Afghanistan, Iraq, Kenya, South Africa, and Yemen in September 2006.
- Provided guidance and resources for the international AML/CFT financial system assessments and training. The FDIC participated in reviews of South Africa's existing AML policies and Paraguay draft AML legislation; provided technical assistance in Bosnia to evaluate AML controls and existing legislation; delivered a presentation at the Eurasian Group (Financial Action Task Force-style regional body) seminar in Russia; and provided guidance to the Russian central bank, financial intelligence unit, and legislature regarding amendments to Russia's AML law.

- Continued to enhance the skills of its BSA/AML subject-matter experts, with 34 BSA/AML subject-matter experts attaining certification during 2006 under the Association of Certified Anti-Money Laundering Specialist certification program.
- Conducted AML examination training courses for representatives from the Albanian financial intelligence unit, the Indian financial intelligence unit, and Malaysian government officials.

Cyber Fraud and Financial Crimes

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

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

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

Office of International Affairs

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

Consumer Complaints and Inquiries

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

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

Deposit Insurance Education

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

Following enactment of deposit insurance reform legislation, the FDIC initiated a multi-pronged effort to inform the public and banking industry about the increase in coverage for retirement savings. As part of this effort, the FDIC updated its numerous publications and educational tools for consumers and bankers on FDIC insurance coverage, including updated editions of *Insuring Your Deposits*, the FDIC's basic deposit insurance brochure for consumers; *Your Insured Deposit*, the FDIC's comprehensive deposit insurance guide; and the Electronic Deposit Insurance Estimator (EDIE), the FDIC's user-friendly Internet application that helps bank customers calculate insurance coverage on their deposit accounts at FDIC-insured institutions. The FDIC also published other promotional materials, including a special edition of the *FDIC Consumer News* that included information on the new coverage limits, and worked with the banking industry, national consumer organizations and the media to publicize the availability of this information. More than 8,200 bankers participated in a series of national teleconferences on the new coverage limits conducted by the FDIC during the summer of 2006. In addition, the FDIC used a variety of formats to conduct 28 seminars for financial institution employees and consumer organizations on changes to deposit insurance coverage rules that were effective on April 1, 2006.

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

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

Financial Education and Community Development

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

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

Receivership Management

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

Resolving Financial Institution Failures

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

Liquidation Highlights 2004-2006

Dollars in billions (except where noted)

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

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

Large Bank Contingency Planning

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

Claims Modernization Project

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

The Corporation is also seeking cooperation from the largest insured institutions to assist in the insurance determination process in the event of failure. During 2006, the FDIC reviewed 28 comment letters received in response to an advance notice of proposed rulemaking (ANPR) published in December 2005, requesting input on three options that could be applied to the largest 145 insured institutions. Based on this review, a new ANPR was published in December 2006, seeking comment on a new option and strategy for this purpose. The FDIC is currently awaiting comments on this revised proposal.

Receivership Management

The FDIC, as receiver, manages failed banks and their subsidiaries with the goal of expeditiously winding up their affairs. The oversight and prompt termination of receiverships help to preserve value for the uninsured depositors and other creditors by reducing overhead and other holding costs. Once the assets of a failed institution have been sold and all impediments to termination have been resolved, the FDIC makes the final distribution of any proceeds and terminates the receivership estate. In 2006, the number of receiverships under management was reduced by 15.4 percent (from 65 to 55), while the book value of assets under management was reduced by 20.2 percent (from $441 million to $352 million). The ten receiverships terminated in 2006 were all terminated within 90 days of the resolution of all impediments.

Professional Liability Recoveries

The FDIC works to identify potential claims against directors and officers, accountants, appraisers, attorneys and other professionals who may have contributed to the failure of an insured financial institution. Once a claim is deemed viable and cost-effective to pursue, the FDIC initiates legal action against the appropriate parties. The FDIC strives to make a decision to close or pursue 80 percent of all potential claims within 18 months of the failure date.[5]

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

Protecting Insured Depositors

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

Effective Management of Strategic Resources

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

[5] This performance target did not apply in 2006, because no failures occurred during the 18-month period prior to the start of the year.

Human Capital Management

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

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

During 2006, the FDIC completed the last of its currently-planned workforce restructuring activities. Through the strategic use of voluntary early retirement authority and voluntary separation incentive payments, most of the remaining restructuring was accomplished voluntarily. The Corporation also completed a very successful internal placement process that reassigned remaining surplus staff to vacancies in other FDIC organizations.

Corporate Employee Program

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

Employee Learning and Growth

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

Corporate University expanded its support of external certificate programs to provide staff the opportunity to build skills as well as earn professional credentials. The FDIC now pays exam fees and preparation class fees for eligible students pursuing the following external certificate programs:

- Certified Anti-Money Laundering Specialist (CAMS);
- Certified Fraud Examiner (CFE);
- Certified Information Systems Auditor® (CISA®);
- Certified Regulatory Compliance Manager (CRCM);
- Chartered Financial Analyst® (CFA®); and
- Financial Risk Manager® (FRM®).

Succession Management

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

Pay-for-Performance

In January 2006, the FDIC began implementation of the new 2006-2009 Compensation Agreement that had been negotiated with its employee union during 2005. This included a revised pay-for-performance (PFP) system that provides for graduated base pay increases and potential lump sum bonuses based exclusively on assessments of total employee performance. The PFP system is entirely performance-based; only those employees who meet all of their performance standards are eligible for pay increases.

Employee Engagement

The FDIC's human capital programs and strategies are continually evaluated to ensure that the FDIC remains an employer of choice and that all employees feel engaged and aligned with the Corporation's mission critical functions. To help assess workload alignment and employee engagement, all FDIC employees were encouraged to participate in the 2006 Federal Human Capital Survey administered by the Office of Personnel Management. This survey provides relative measures of employee satisfaction and engagement on a number of dimensions. In 2007, the FDIC will analyze the results and implement action plans to address any potential issues that employees identify as inhibitors to strong employee engagement.

Management of Financial Resources

The FDIC's operational expenses are largely paid from the DIF, and the Corporation seeks to operate in a consistently efficient and cost effective manner in order to fulfill its fiduciary responsibilities. To that end, the Corporation engages annually in a rigorous planning and budgeting process that is designed to ensure that budgeted resources are properly aligned with projected workload and business priorities. In 2006, the FDIC continued to enhance the cost management information available to managers in conjunction with the implementation of the New Financial Environment, its new accounting system. In 2007, the FDIC will continue to explore how best to utilize this enhanced cost management data to promote good stewardship of the Corporation's resources.

Managing Facility-Related Costs

In the first quarter of 2006, the Corporation completed construction of its Virginia Square Phase II facility in Arlington, VA. The project was completed on time and under budget. Approximately 800 employees in three leased facilities in Washington, DC, were relocated to the expanded facility in Arlington. Successful completion of this initiative to build and relocate staff to owned space will save the Corporation an estimated $89 million (net present value) over 20 years, compared to the projected cost of extending the previous leasing agreements.

Information Technology Management

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

IT Transformation

For the past several years, the Corporation has been engaged in a major effort to transform and improve its IT program. In 2006, the IT program continued to evolve as it continued to implement key elements of its transformation plan:

- The organization fully adopted the Rational Unified Process® as its new system development life cycle methodology and customized it to meet the FDIC's unique IT project environment.
- The Division of Information Technology (DIT) adopted a new internal control framework based upon the international standard known as CobiT (Control Objectives for Information and Related Technology).

- DIT continued implementing a new sourcing strategy in which it partnered with the private sector and other federal agencies to provide IT support services using performance-based, results-driven contracts.

E-Exam Programs

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

E-Government

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

Central Data Repository

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

Enhanced Information Security Program

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

Corporate Privacy Program

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

- Developing an overarching privacy directive.
- Developing a strategy for the protection of PII processed, stored, transmitted or accessed by FDIC contractors, and ensuring appropriate assessment of the security of data.
- Continuing the review and remediation of PII in FDIC application systems.
- Identifying all contracts that process or use PII or other sensitive information, ensuring that updated privacy and nondisclosure clauses are included.
- Continuing to participate in the Office of Management and Budget Privacy Work Group.

Emergency Preparedness Program

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