Operations of the Corporation

At year-end 1998, the FDIC was the primary federal regulator of 5,321 state-chartered banks that are not members of the Federal Reserve System and 544 state-chartered savings banks. The FDIC also had back-up examination and enforcement authority for the remaining 4,596 federally insured state member banks, national banks and savings associations.

The Division of Supervision (DOS) leads the FDIC's supervisory efforts through on-site examinations and off-site analyses. When DOS identifies an institution that operates in a weakened or an unsafe and unsound condition, or encounters practices that might lead to future difficulties, it employs various corrective methods or enforcement actions to curtail activities that might otherwise result in significant losses to the insurance funds. DOS also works with other divisions to identify emerging risks and to develop timely policies and procedures to help examiners assess each bank's ability to identify, measure, monitor, and control those risks.

Taking the opportunity provided by the continued good health of the banking industry in 1998, the FDIC addressed several challenges and provided a more dynamic approach to its mission. The FDIC continued to address Year 2000 challenges, refine examination and risk assessment procedures, streamline or consolidate regulations, initiate outreach programs for bankers and other regulators, manage enforcement actions and applications, and otherwise prepare for the future. These actions illustrate the FDIC's continued commitment to improve efficiency throughout the organization and to reduce regulatory burden on the industry.

Addressing Year 2000 Challenges

During 1998, DOS spearheaded the agency's efforts to address potential supervisory-related problems associated with the Year 2000 date change.

DOS worked with the other Federal Financial Institutions Examination Council (FFIEC) agencies to issue industry guidance on the Year 2000 issue and to train examiners. During 1998, examiners completed the first round of comprehensive on-site assessments for FDIC-supervised institutions. At year-end, 97 percent of institutions were satisfactorily addressing the Year 2000 issue. For the remaining institutions, the FDIC implemented supervisory action to ensure that those institutions take corrective action.

The FDIC will continue to work closely with banks during the coming year on this enormous task. During 1999, examiners will complete a second phase of on-site examinations focusing on the critical steps of systems testing and contingency planning. By June 30, 1999, insured institutions should be using computer programs that have been fixed and tested to deal with Year 2000 challenges.

For more information on the challenges faced by the Year 2000 date change, see Pages 13–15.

Refining Examination and Risk-Assessment Procedures

The FDIC implemented several programs in 1998 that improved the agency's risk-assessment capabilities and streamlined examinations and other supervisory functions.

On October 19, the FDIC launched the General Examination System (GENESYS), a software application that automates the preparation of the entire examination report. GENESYS improves the examination process by integrating information from other automated systems, including the Automated Loan Examination Review Tool (ALERT). The GENESYS software features a more comprehensive database of financial and examination information than previous systems, which enhances the risk-focused examination process. GENESYS also includes advanced data-query and analysis tools that allow examiners to perform a significant portion of their analysis off-site, thereby minimizing time spent in a financial institution.

W.W. Reid

Kari Walter (l), Chief of the Division of Supervision's (DOS) International Branch, and DOS Assistant Director Jesse Snyder handle numerous requests from foreign government agencies asking the FDIC to share its expertise.

FDIC Examinations 1996-1998

	1998	1997	1996
Safety and Soundness:			
State Nonmember Banks	2,170	2,515	2,789
Savings Banks	221	224	297
National Banks	1	6	11
State Member Banks	6	0	2
Savings Associations	1	4	7
Subtotal	2,399	2,749	3,106
Compliance/CRA	1,989	1,990	2,033
Trust Departments	542	552	637
Data Processing Facilities	1,335	1,514	1,681
Total	6,265	6,805	7,457

DOS worked closely with the Federal Reserve Board (FRB) and the Conference of State Bank Supervisors (CSBS) to develop GENESYS. This cooperation promoted consistency among the agencies and reduced regulatory burden on state banks. During 1998, the FDIC, the FRB and the CSBS also formed a steering committee to better coordinate risk-focused examination procedures among the agencies and to oversee ongoing enhancements to the supporting software.

The FDIC also developed other automation tools that make examinations and off-site analyses more productive, efficient and risk-focused. For instance, DOS worked with the FDIC's Division of Research and Statistics (DRS) to develop the Statistical Camels Offsite Rating (SCOR) program. SCOR is an "early warning" application that uses statistical measures to identify institutions that are likely to receive a downgrade at the next examination in their Uniform Financial Institution Rating.

Additional automation projects completed during 1998 that improve the examination process included:

- The Division of Insurance's (DOI) Regional Economic Conditions Report for Examiners (RECON), which provides timely, comprehensive regional economic data to examiners and other staff members through the FDIC's internal computer network;

- A commercial real estate database that provides recent sales information and assists FDIC staff in the assessment of large, complicated real estate loans or other real estate; and

- A new CD-ROM that provides examiners with commonly used reference materials in an electronic format.

During 1998, DOS implemented new examination procedures for securities and derivatives activities at institutions. The new procedures place primary emphasis on management's ability to identify, measure, monitor and control the risks of investment activities. The new procedures also require examiners to evaluate whether an institution's management understands the risks in securities activities, both prior to purchases and on an ongoing basis.

The FDIC has taken a leading role in recognizing and responding to electronic banking developments, which present unique risks and supervisory issues to the financial system. During 1998, DOS developed streamlined examination procedures for telephone banking activities and enhanced the risk-focused examination modules to reflect recent changes in the electronic banking industry. DOS also implemented an electronic banking data-entry system that collects key data from examinations and improves off-site risk monitoring capabilities. To address the growing complexity of electronic banking activities, DOS appointed nearly 200 electronic banking specialists and trained these specialists in technical examination procedures that evaluate the safety of various operating systems and firewalls.

The FDIC Safety and Soundness Examination Questionnaire, implemented in 1995, solicits quarterly opinions and suggestions from bankers on how to improve the quality and efficiency of the examination process. The FDIC received more than 1,300 responses to the questionnaire in 1998. The responses show that institutions continue to submit positive reviews of the examination process, teams, reports and other examination activities.

Identifying and Addressing Emerging Risks

During 1998, the FDIC identified several emerging risks and developed timely guidelines to address those risks. DOS, together with DOI, identified the expansion of loans to "subprime" borrowers (those presenting higher risk of default characteristics than most others). Faced with strong competition and shrinking margins on loans to high-quality borrowers, some lenders extended their risk selection standards to include these higher-rate, higher-risk loans. Because of the relatively high default rates on such loans, subprime lending requires institutions to have strong internal controls and risk management practices. As a result of this trend, DOS worked with DOI and other regulatory agencies to develop interagency guidance to ensure that institutions both understand the risks inherent in subprime lending and manage those risks in a safe and sound manner.

The quarterly *Report on Underwriting Practices* is another primary early warning mechanism for detecting emerging risks in the banking system. While underwriting practices remained sound overall in 1998, the underwriting surveys that examiners completed indicated an easing of standards for commercial real estate as well as acquisition, development, and construction lending. In addition, various studies by DOI detected early indicators of potential imbalances in a number of real estate markets. As a result of these studies, the FDIC issued guidance to bankers reminding them of the regulatory guidelines for underwriting real estate loans.

The FDIC also is addressing the potential outcomes that may result from continued industry consolidation. As the industry stratifies into large multi-tiered organizations and small community banks, the FDIC is working to preserve the "dual banking system" of national and state banks by allowing small, state-chartered banking organizations to remain competitive in an interstate banking environment. For example, DOS is evaluating the merits of establishing a separate capital framework for nationwide and multinational banks. DOS also is working closely with DOI, DRS, and DRR (Division of Resolutions and Receiverships) to simulate the impact that the failure of one or more of the nation's largest financial institutions may have on the deposit insurance funds. These studies will enable the FDIC to prepare for future events and continue to serve as a source of stability to the nation's banking system in a changing environment.

During 1998, the FDIC also was faced with the challenge of supervising an increasingly global industry. Foreign banking organizations operating in the U.S. control nearly one-fifth of the U.S. banking industry's asset base. The international branch of DOS monitors the activities of U.S. banks operating abroad and foreign banks operating in the U.S. The international branch also completes risk profiles of various countries whose banking systems are of potential interest to the FDIC. The continued deterioration in global economies, particularly in Asia and among emerging economies, was probably the most significant international issue the FDIC monitored during 1998. **For more information on international banking, see Pages 16–17.**

Reducing Regulatory Burden

The FDIC continued to streamline its regulations and policies as mandated by the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI). Throughout 1998, FDIC staff worked to develop and implement recommendations that originally called for the rescission or revision of 85 of the 120 FDIC and interagency regulations and policy statements.

Perhaps the most important accomplishment resulting from the 1998 CDRI reviews was the implementation of a final rule governing the FDIC's application process. The revised rule (Part 303) allows well-managed and well-capitalized institutions to take advantage of expedited applications processing for deposit insurance, mergers, branches, trust powers, stock buy-backs and certain international activities. More than 90 percent of all FDIC-supervised banks currently meet the eligibility standards for the expedited processing, so the new applications procedures will significantly reduce regulatory burden for the banking industry.

The FDIC also adopted a final rule (Part 362) that consolidated into a single regulation what previously were several regulations governing activities and investments of FDIC-supervised institutions. The consolidated regulation both simplifies existing limitations applicable to certain real estate and securities activities and streamlines the application process. Because the FDIC retains the ability to place restrictions on an activity or prohibit a particular institution from engaging in the activity, the final rule relieves regulatory burden significantly without affecting safety and soundness.

Other significant actions taken in 1998 as a result of the CDRI review included:

- Revising and consolidating three different groups of rules and regulations governing international banking;
- Removing inconsistencies or outdated procedures in policy statements involving applications and bank merger transactions;
- Simplifying deposit insurance rules; and
- Revising and consolidating two policy statements concerning participation in the conduct of the affairs of an institution by persons who have been convicted of certain crimes or who entered pretrial diversions for such offenses.

Maintaining Open Communication

The FDIC also established and maintained open lines of communication regarding supervisory matters with the financial services industry and other regulators. FDIC representatives routinely attended or participated in events sponsored by trade associations and foreign and domestic regulatory agencies (including FDIC-sponsored outreach meetings). The FDIC also serves as a chief source of public information on banking industry supervision through a variety of publications and an extensive Internet site (www.fdic.gov). For example, quarterly publications of DOI's *Regional Outlook* and *Bank Trends* provide in-depth analyses of trends that affect the financial services industry from national and regional perspectives.

J.W.Devine

Examiner Brian Looft from the Division of Supervision's Kansas City office answers bankers' Y2K questions at the FutureBank '98 exhibit in Kansas City sponsored by the Community Bankers Associations of Kansas and Minnesota.

Additional communication efforts in 1998 include:

- The FDIC's International Deposit Insurance Conference, which was held in Washington, DC, in September. The conference primarily addressed the role of deposit insurance in maintaining public confidence and was attended by top government officials from 62 countries. **For more details, see Pages 5 and 17.**

- A Year 2000 summit, which was held in Washington, DC, in December. The FDIC and the Federal Reserve Board hosted this summit for financial institutions and members of the utilities and telecommunications industries. The forum focused on the participants' progress in addressing the Year 2000 computer challenge.

- FDIC-sponsored seminars, in cooperation with the Independent Bankers Association of America and the American Bankers Association, on nondeposit investment products, securities activities, interest rate risk and trust activities. Nearly 1,000 bankers attended these seminars.

FDIC Applications 1996-1998

	1998	1997	1996
Deposit Insurance	**296**	**238**	**192**
Approved	296	238	192
Denied	0	0	0
New Branches	**1,450**	**1,436**	**2,054**
Approved	1,450	1,435	2,054
Branches	1,450	1,435	1,352
Remote Service Facilities●	NA	NA	702
Denied	0	1	0
Mergers	**390**	**419**	**392**
Approved	390	419	392
Denied	0	0	0
Requests for Consent to Serve■	**304**	**261**	**873**
Approved		258	873
Section 19	145	76	77
Section 32	154	182	796
Denied		3	0
Section 19	3	2	0
Section 32	2	1	0
Notices of Change in Control	**34**	**28**	**46**
Letters of Intent Not to Disapprove	34	28	46
Disapproved	0	0	0
Conversions of Insurance Coverage▲	**0**	**0**	**0**
Approved	0	0	2
Denied	0	0	0
Brokered Deposit Waivers	**10**	**17**	**15**
Approved	9	17	15
Denied	1	0	0
Savings Association Activities	**0**	**2**	**2**
Approved	0	2	2
Denied	0	0	0
State Bank Activities/Investments▼	**23**	**46**	**167**
Approved	23	46	164
Denied	0	0	3
Conversions of Mutual Institutions	**30**	**15**	**26**
Non-Objection	30	15	26
Objection	0	0	0

● Effective September 30, 1996, the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) excluded remote service facilities from the definition of a domestic branch under Section 3 (o) of the FDI Act.

■ Under Section 19 of the Federal Deposit Insurance Act, an insured institution must receive FDIC approval before employing a person convicted of dishonesty or breach of trust. Under Section 32, the FDIC must approve any change of directors or senior executive officers at a state nonmember bank that is not in compliance with capital requirements or is otherwise in troubled condition.

▲ Applications to convert from the SAIF to the BIF or vice versa.

▼ Section 24 of the FDI Act, in general, precludes an insured state bank from engaging in an activity not permissible for a national bank and requires notices be filed with the FDIC.

Managing Enforcement Actions and Applications

DOS works closely with the Legal Division to initiate supervisory enforcement actions against FDIC-supervised institutions and their employees. The FDIC initiated 143 enforcement actions in 1998, representing a continued decline from the 338 actions initiated just six years ago. These figures indicate the continued health of the banking industry.

The trends of continued health and further consolidation of the industry are also evident in both the number and types of applications that the FDIC processed. New bank applications increased significantly for the sixth consecutive year, as record profits attracted new entrants to the marketplace. Nevertheless, merger applications continued to outnumber new entrants as the industry consolidates. Several revisions to regulations governing the FDIC's applications procedures will further reduce regulatory burden and likely result in a decline in future applications.

Compliance, Enforcement and Other Related Legal Actions 1996-1998

	1998	1997	1996
Total Number of Actions Initiated by the FDIC	**143**	127	186
Termination of Insurance			
Involuntary Termination			
Sec. 8a For Violations, Unsafe/Unsound Practices or Condition	**0**	0	1
Voluntary Termination			
Sec.8a By Order Upon Request	**0**	0	0
Sec.8p No Deposits	**5**	6	3
Sec.8q Deposits Assumed	**4**	7	17
Sec. 8b Cease-and-Desist Actions			
Notices of Charges Issued	**2**	3	3
Consent Orders	**21**	15	16
Sec. 8e Removal/Prohibition of Director or Officer			
Notices of Intention to Remove/Prohibit	**2**	11	7
Consent Orders	**15**	33	60
Sec. 8g Suspension/Removal When Charged With Crime	**0**	1	1
Civil Money Penalties Issued			
Sec.7a Call Report Penalties	**41**	24	19
Sec.8i Civil Money Penalties	**35**	10	19
Sec. 10c Orders of Investigation	**6**	6	11
Sec. 19 Denials of Service After Criminal Conviction	**3**	1	1
Sec. 32 Notices Disapproving Officer or Director	**0**	0	0
Truth in Lending Act Reimbursement Actions			
Denials of Requests for Relief	**1**	3	6
Grants of Relief	**0**	0	0
Banks Making Reimbursement •	**161**	139	162
Criminal Referrals Involving Open Institutions •	**5,786**	12,689	8,201
Other Actions Not Listed	**8**	7	22

• These actions do not constitute the initiation of a formal enforcement action and, therefore, are not included in the total number of actions initiated.

The FDIC has the unique mission to protect depositors of insured banks and savings associations. No depositor has ever experienced a loss of insured funds in an FDIC-insured institution due to a failure. The FDIC protects depositors by managing the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). The FDIC also manages the remaining assets and liabilities of the former Federal Savings and Loan Insurance Corporation (FSLIC) and the former Resolution Trust Corporation (RTC) through the FSLIC Resolution Fund (FRF).

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 Division of Resolutions and Receiverships (DRR) staff gathers data about the troubled institution, estimates the potential loss from a liquidation, solicits and evaluates bids from potential acquirers, and recommends the least costly resolution to the FDIC's Board of Directors.

Protecting Insured Depositors

Although the focus of the FDIC 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 deposits in 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 DRR in an orderly manner and the proceeds are used to pay creditors, including depositors whose accounts exceeded the insured $100,000 limit, as well as the FDIC for repayment to the insurance fund.

During 1998, the FDIC resolved three BIF-insured institutions that failed. OmniBank, River Rouge, MI, with a total of $38 million in assets, was closed on April 9. The majority of the bank's assets and all of the deposits were acquired under a "loss-share agreement" (explained in the next section). BestBank, Boulder, CO, with total assets of $318 million, was closed on July 23. Its insured deposits and certain assets were acquired by an assuming bank. Q Bank, Fort Benton, MT, with total assets of $14 million, was closed on August 7. The failed bank's insured deposits and some assets were acquired by an assuming bank.

Asset Disposition

To keep as many of a failed institution's assets in the private sector as possible (as opposed to being in a liquidation mode if left behind in receivership), the FDIC developed several new procedures and concepts. One such concept included opening the competition to bidders who might want to buy the troubled institution's loans, but not its branches. The expansion of potential acquirers was designed to decrease the cost of failures through increased competition.

In addition, previously used resolution tools and methods were reintroduced. Typically used in larger transactions, the FDIC utilized the loss-sharing agreement with the OmniBank resolution. The loss-share transaction allows flexibility for the potential acquirers of failing banks. The structure provides for the FDIC and the acquirer to share future losses and recoveries on specified assets within a limited time from the failure—generally two years for loss-sharing, with recovery-sharing extending an additional year.

Assets not sold at the time of resolution are retained by the FDIC for later sale, workout or other disposition. During the year, the FDIC had reduced the book value of the combined FDIC/RTC assets

Sally Kearney

Regulators and former regulators, bankers and members of the academic community joined in a wide-ranging discussion at the April 29 FDIC-sponsored symposium "Managing the Crisis: The FDIC and RTC Experience."

Liquidation Highlights 1996-1998

Dollars in billions

	1998	1997	1996
Total Failed Banks	3	1	5
Assets of Failed Banks	$ .37	$ .03	$ .18
Total Failed Savings Associations	0	0	1
Assets of Failed Savings Associations	$ 0	$ 0	$ .04
Net Collections from Assets in Liquidation	$ 3.55	$ 3.57	$ 5.94
Total Assets in Liquidation •	$ 2.38	$ 4.12	$ 8.71
Net Collections from Assets Not in Liquidation •	$ .38	$ .48	$ .65
Total Assets Not in Liquidation (year-end) •	$ 6.71	$ 8.17	$ 13.31

• Also includes assets from thrifts resolved by the former Federal Savings and Loan Insurance Corporation (FSLIC) and the Resolution Trust Corporation (RTC). These assets are serviced by the FDIC as well as by asset management contractors and national servicers.

in liquidation from $4.1 billion to $2.4 billion, a reduction of 42 percent. In addition to the $2.4 billion in assets in liquidation, the FDIC was also managing $6.7 billion in assets not in liquidation, consisting of cash, securitization reserves and residuals. During the year, 806 real estate properties were sold for a total of $148.7 million, which yielded a recovery of 88.9 percent of their average appraised value as determined by independent appraisers. Also, 6,545 loans and other assets were sold for a total of $203.8 million.

Receivership Management Activities

Once the assets of the failed institutions have been sold and the final distribution of any proceeds made, the FDIC terminates the receivership estates. During 1998, the FDIC terminated 274 receiverships. Of these, 155 were RTC pass-through receiverships (where assets and liabilities are passed to an acquirer while certain claims were retained by the RTC as receiver), 14 were FRF receiverships (commonly referred to as "Southwest Plan" institutions), and the remaining 105 were BIF or FRF/RTC receiverships. A total of 140 receiverships are currently in termination status, which means that expenses are no longer charged to the receiverships in anticipation of their termination.

The FDIC in 1998 created a new team approach to administering receiverships. The Receivership Management Oversight program is designed to increase efficiency and reduce receivership costs. Each receivership created from a failed institution was assigned a team of experts to oversee the liquidation of the assets, manage the costs charged to the receivership and facilitate the receivership's timely termination. These experts created a business plan for the receivership that broadly defined the anticipated life cycle of the receivership.

The FDIC has also targeted specific older receiverships to be terminated by a streamlined process intended to resolve receiverships sooner. This streamlining was fully explored during the fourth quarter of 1998 and will be in place for 1999.

Historical Studies

During 1998, the FDIC continued its studies on the banking crisis of the late 1980s and early 1990s. In August 1998, DRR issued a publication entitled *Managing The Crisis — The FDIC and RTC Experience.* Virtually every division of the FDIC contributed to the study. This book provides a historical summary of the policies and procedures used by the FDIC and RTC in resolving the large volume of banks and thrifts that failed during the crisis. It studies the various asset disposition and bank resolution methods used and the lessons learned by both the FDIC and the RTC. This publication complements a previous study completed by the FDIC in 1997 entitled *History of the Eighties—Lessons for the Future: An Examination of the Banking Crises of the 1980s and Early 1990s.* The 1998 publication, which has been widely distributed, is accessible through the Internet and numerous libraries. The information from this study was the centerpiece of an FDIC-sponsored public symposium in April 1998.

A second book, entitled *Resolutions Handbook*, was also published in 1998 by the same FDIC groups that completed *Managing the Crisis*. This 90-page book focuses on the resolution process of bank failures. It relates the historical efforts and experience of the FDIC and RTC and is an aid for the many foreign governments that have requested the FDIC's assistance. Numerous FDIC seminars involving participants from foreign countries have used or are expected to use this book as their reference guide.

These three publications establish permanent resource documents of the nation's most troubled financial crisis since the Great Depression. In addition, as the United States is now being called upon to provide international fiscal guidance, these publications will aid countries that are now struggling through their own banking difficulties.

FSLIC Resolution Fund

The FRF was established by law in 1989 to assume the remaining assets and obligations of the former FSLIC arising from thrift failures before January 1, 1989. Congress placed this new fund under FDIC management on August 9, 1989, when the FSLIC was abolished. On January 1, 1996, the FRF also assumed the RTC's residual assets and obligations.

Today, the FRF consists of two distinct pools of assets and liabilities: one from the former FSLIC (FRF-FSLIC) transferred on August 9, 1989, and the other from the former RTC (FRF-RTC) transferred to the FRF on January 1, 1996. The assets of one pool are not available to satisfy obligations of the other.

At year-end 1998, the FRF-FSLIC had resolution equity of $2.1 billion, and the FRF-RTC had resolution equity of $8.2 billion. The FRF will continue to exist until all of its assets are sold or liquidated and all of its liabilities are satisfied. Any funds remaining in the FRF-FSLIC will be paid to the U.S. Treasury. Any remaining funds of the FRF-RTC will be distributed to the U.S. Treasury to repay RTC Completion Act appropriations and to the REFCORP to pay the interest on the REFCORP bonds.

Professional Liability Recoveries

The FDIC's Legal Division and DRR work together to identify claims against directors and officers, accountants, appraisers, attorneys and other professionals who may have contributed to the failure of an insured financial institution. During the year, the FDIC recovered more than $186.5 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 more than $17 million in criminal restitution and asset forfeiture during the year.

The Corporation also investigates the circumstances surrounding the failure of every institution and, where appropriate, sends suspicious activity reports to the Justice Department. In recent years, 6,434 such reports have been issued regarding failures. The FDIC's caseload at the end of 1998 included investigations, lawsuits and ongoing settlement collections involving 141 institutions, down from 180 at the beginning of 1998. This caseload includes RTC cases that the FDIC assumed on January 1, 1996.

The FDIC has a significant consumer protection responsibility. The agency enforces compliance with consumer protection laws, including the Community Reinvestment Act (CRA) and fair lending laws. It also educates insured depository institutions and consumers in areas such as fair lending, community reinvestment and deposit insurance. The FDIC's Division of Compliance and Consumer Affairs (DCA) primarily carries out the Corporation's consumer protection activities, with support from other divisions and offices.

Community Reinvestment Act

The FDIC continued working with the other federal banking agencies, financial institutions and community organizations to better implement the CRA regulations. The CRA is a law that encourages FDIC-insured lenders to help meet their communities' credit needs.

One option for CRA compliance—the "strategic plan"—offers banks both flexibility and certainty, regardless of their asset size or product mix. The plan allows an institution to tailor its CRA goals and objectives to address its community's needs, consistent with the institution's business strategy, operational focus, capacity and constraints. Once an institution has proposed specific goals, the FDIC will work with the institution to determine the goals' appropriateness and reasonableness. If the goals meet the criteria for either a satisfactory or outstanding rating, the FDIC will approve the goals and the institution will know its CRA performance rating provided it achieves those goals.

The FDIC's *Guidelines for Strategic Plan Submissions*, issued in March 1998, presents existing FDIC policy guidance in a more user-friendly format. Since the CRA strategic plan became an alternative CRA assessment method in January 1996, relatively few banks have exercised the option. This publication encourages institutions to consider the strategic plan method by providing "how-to" guidance for developing a workable strategic plan. It also includes references to help with data-gathering and analysis over the Internet.

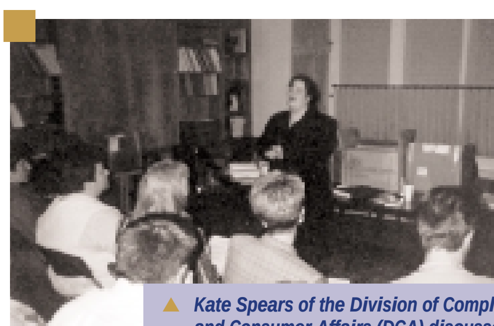
Also during 1998, the FDIC, the Office of the Comptroller of the Currency, and the Federal Reserve Board initiated a three-part project to promote consistency in the CRA examination process for "large" banks. The project included eight joint interagency examinations, a review of sample CRA performance evaluations from each agency, and an interagency-sponsored CRA forum in October to address ways for improving examination consistency. The agencies will review the project results and consider recommendations for developing more consistent application of CRA examination procedures.

Compliance Examinations

DCA examines FDIC-supervised banks for compliance with consumer protection, fair lending, and community reinvestment laws and regulations. During 1998, the FDIC initiated 1,989 examinations. At year-end, 96 percent of FDIC-supervised banks were rated satisfactory or outstanding for compliance with consumer protection and fair lending laws, while 99 percent were rated satisfactory or outstanding for compliance with the CRA. These percentages were fairly similar to 1997 levels.

During 1998, a total of 161 FDIC-supervised banks were required to reimburse over $1 million to 31,222 consumers for violations of the Truth in Lending Act, which requires accurate disclosures of interest rates and finance charges. The reimbursements ordered in 1998 stem from compliance examinations conducted in 1998 and in previous years.

To improve risk management, DCA increased the focus of the examination process on areas of highest risk to the public, financial institutions and the FDIC. This "scoping" policy ensures an on-site presence in all FDIC-supervised institutions every three years.



Michael A. Frias

Kate Spears of the Division of Compliance and Consumer Affairs (DCA) discusses deposit insurance with bank employees during one of the many educational outreach seminars conducted by DCA around the country.

Another risk-management effort is relying more on an institution's internal and external audit programs, which promote self-regulation. For example, under the Community Reinvestment Act, institutions are not required to perform any internal assessment of their CRA performance. However, if in the normal course of business, an institution conducted an analysis of its lending, service or investment activity, assessment area, community development lending, or other activities reviewed for CRA purposes, an examiner might request that information to review and use for the CRA examination. This would, in effect, reduce or limit CRA examination procedures.

Also, new interagency procedures were issued in August 1998 to assist compliance examiners when reviewing an interstate branch that has been operating for more than one year. Section 109 of the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994 prohibits banks from establishing or acquiring interstate branches primarily for deposit production.

To ensure quality and efficiency in the FDIC's fair lending examination program, the Corporation in 1998 helped create interagency fair lending examination procedures and conducted new training and development programs for its compliance examiners.

The goal of the new fair lending examination procedures was to give examiners guidance in taking an efficient risk-based approach to examining for compliance with the Fair Housing Act and the Equal Credit Opportunity Act. The procedures also are a blueprint for financial institutions wishing to conduct a thorough self-assessment.

Two new training and development programs were created for compliance examiners in 1998. One gave examiners practical knowledge of existing fair lending examination methodologies, familiarized them with the new interagency fair lending examination procedures and identified emerging issues. The other program sharpened senior compliance examiners' fair lending expertise.

Electronic Banking

Financial institutions are continuing to use the Internet as an alternative delivery channel for offering an increasing number of consumer products and services online, such as deposit account applications, bill payment, and funds transfers. At year-end 1998, more than 950 FDIC-supervised institutions operated on the Internet. Over 200 were "transactional" sites that provided customers the ability to pay bills, transfer funds and open accounts—an increase of 500 percent over 1997. The FDIC responded to emerging electronic banking issues in areas such as consumer protection and fair lending laws and regulations, consumer privacy concerns, and bank fraud on the Internet.

The FDIC and other members of the Federal Financial Institutions Examination Council issued interagency guidance on the applicability of federal consumer protection and fair lending laws and regulations. The same guidance stressed the importance of a compliance review of electronic banking operations. During 1998, DCA also trained its compliance examiners nationwide on electronic banking systems, risks, and compliance examination guidelines.

Changes in the financial services industry, such as industry consolidation, new business affiliations with brokerage and insurance firms, and increasing use of technology, have renewed consumers' concern about the privacy of personal information. Of particular concern to the public is financial institutions' participation in the rapid growth of electronic commerce online, primarily over the Internet. In 1998, the FDIC issued guidance to financial institutions to raise awareness about consumer privacy concerns. Institutions were encouraged to take voluntary actions to provide consumers with privacy protections in the online environment. The FDIC also issued its own privacy policy statement to demonstrate its commitment to maintain the privacy of information. That policy statement has been posted on the FDIC's Web site.

During 1998, the FDIC launched a "Suspicious Internet Banking" Web site, allowing the public to check whether an online institution is chartered by a legitimate regulatory authority and insured by the FDIC before transacting business with it. The site also allows the public to report any Internet banking sites they believe may be fraudulent.

Educating Consumers and Bankers

The FDIC offers a wide range of information and assistance to thousands of consumers and depository institution employees each year in areas ranging from federal deposit insurance to banking industry practices. DCA coordinates the agency's efforts to educate consumers and bankers on these important topics.

Since 1980, the FDIC's primary means of disseminating information to the public and banking community has been its toll-free Consumer Affairs Call Center (1-800-934-3342 or 1-800-925-4618 for the hearing impaired). Beginning in 1997, the FDIC increased public awareness of its Call Center and, as a result, the Call Center received more than 90,000 calls from consumers and bankers in 1998, approximately 30 percent more than in 1997. DCA regional offices received another 13,500 calls from consumers and bankers during the year.

DCA also received 2,300 written inquiries from consumers and 267 written inquiries from bankers in 1998, over one-third more than in 1997. The increase is attributed primarily to the success of DCA's efforts to raise public awareness of the FDIC's educational services. Another 2,399 inquiries were referred to other state and federal agencies.

To make it faster and easier for consumers and depository institution employees to obtain information from the FDIC, consumers and bankers can send questions and requests to the agency electronically at consumer@fdic.gov and receive a quick response via electronic mail. More than 1,000 of the inquiries received were submitted by electronic mail to the FDIC's "consumer mailbox" in 1998, compared to 555 in 1997 and 120 in 1996.

Most consumer inquiries received by DCA—whether by telephone, electronic mail or traditional mail—involved requests to verify whether specific financial institutions are insured by the FDIC or questions about FDIC deposit insurance coverage. Other common inquiries were requests for copies of FDIC consumer publications, questions about banking practices and consumers' rights under federal consumer protection laws, and requests for guidance on filing a consumer complaint against a financial institution. Most inquiries from financial institutions concerned the deposit insurance rules, requests for FDIC publications and consumer brochures, and questions about regulatory matters, including requests for guidance on the fair lending, community reinvestment, and consumer protection laws.

The FDIC develops educational tools designed to promote consumer and banker understanding of federal deposit insurance, banking, and federal consumer protection laws. An example is the recently developed Electronic Deposit Insurance Estimator, known as "EDIE." EDIE is a user-friendly Internet application that consumers and bankers can use to calculate the amount of insurance coverage for deposit accounts at FDIC-insured financial institutions. EDIE can be found on the FDIC's Web site at www2.fdic.gov/edie.

The FDIC also initiated a public awareness campaign regarding the Year 2000 challenge. During 1998, the FDIC published a brochure and a "statement stuffer" to help bankers educate their customers about the Year 2000 computer issue and what is being done to assure that the banking industry is ready for the new millennium. The FDIC also devoted an entire issue of its quarterly *FDIC Consumer News* to the Year 2000. **More information on these and other efforts to educate consumers and bankers on Y2K can be found on Pages 13–15.**

Responses to Consumer Complaints

The FDIC investigates complaints it receives from consumers about FDIC-supervised financial institutions. It also tracks the volume and nature of these complaints to monitor trends and identify emerging issues that may raise consumer protection concerns. In 1998, the FDIC received almost 3,900 written consumer complaints against state-chartered nonmember banks. Nearly two-thirds of these complaints concerned consumer credit card accounts issued by FDIC-supervised credit card banks. The most common complaints about credit card banks in 1998 involved billing disputes and account errors, disclosure of reasons for denying credit requests, misdirected credit card applications, reporting consumers' credit history, and credit card fees and service charges.

To improve consumer awareness and understanding of credit card issues, DCA:

- Centralized credit card complaints and inquiries to ensure greater consistency in its responses, and stepped up analysis and monitoring of specific issues.
- Prepared a brochure that describes what consumers need to know when applying for credit cards. This brochure will be used at outreach events, mailed to major consumer organizations and placed on the FDIC's Web site.
- Included articles about emerging credit card issues in *FDIC Consumer News.*

Community Affairs and Outreach

The FDIC frequently meets with community and consumer groups, financial institution representatives and government officials to exchange views or provide information about community reinvestment, community and economic development, and fair lending issues. In 1998, the FDIC's Community Affairs Program sponsored or participated in over 200 such events across the country. The activities were primarily of two types—those focusing on educating and those fostering partnerships between financial institutions and community-based organizations to promote community and economic development in low- and moderate-income communities.

The educational activities focused largely on encouraging insured depository institutions' understanding of and compliance with CRA. They often were conducted in cooperation with state banking associations.

The FDIC also held several meetings and conferences to promote CRA compliance. Their size and purpose ranged from small meetings on the bank examination process with community-based organizations to co-sponsoring conferences in Miami and Las Vegas attended by more than 250 financial institutions, real estate developers, community-based organizations and others involved in community development. The FDIC reached more than 6,000 financial institution representatives through these initiatives.

The Corporation also made major strides in fostering ongoing communication between banks and community organizations. These efforts are expected to result in new partnerships, strengthen existing alliances, increase lending activities, improve lending performance or develop strategies to help meet identified credit needs. For the first time, the FDIC co-sponsored a national conference that focused on community and economic development. The theme of the conference co-sponsored with the American Bankers Association was "Revitalization and Development: Joining Forces for Healthy Communities." Attended by more than 250 financial institution representatives, community based-organizations and government representatives, the conference confirmed the FDIC's strong commitment to helping the financial institutions it supervises further community development.

Two other 1998 events demonstrate the success of the FDIC's partnership-building efforts and show the FDIC's commitment to using a variety of techniques to address the needs of the communities of FDIC-supervised institutions. One event was a regional conference in Chattanooga, TN, which the FDIC co-sponsored with the Appalachian Regional Commission. The conference was designed to bring attention to the needs of the communities located within the Appalachian Region. Cooperating in the effort were the Tennessee Valley Authority, the Small Business Administration, the Department of Agriculture, and various development districts and government officials throughout the region. The second event was a hands-on effort to form a "micro-loan" program for small businesses in the Greater Humboldt Park area of Chicago, IL. A micro-loan pool involving eight financial institutions and an intermediary to serve small businesses was established in this predominantly low-income Hispanic community.

Matters in litigation covered a broad spectrum including issues relating to the supervision of insured institutions, the resolution of failed banks and savings associations, the liquidation of assets, and the pursuit of liability claims against failed institution officers, directors and professionals. The FDIC's litigation caseload declined 50 percent, from about 8,550 matters at year-end 1997 to approximately 4,280 at year-end 1998. That decline was due primarily to the resolution of cases from the bank and thrift crisis of the late 1980s and early 1990s, the decrease in new bank failures, and the ending of litigation caused by asset sales in the liquidation process. Noteworthy developments in 1998 are described below.

Professional Liability and Criminal Recoveries

The Legal Division and the Division of Resolutions and Receiverships recovered $186.5 million during 1998 from professional liability settlements or judgments. At year-end, the FDIC's professional liability caseload included investigations, lawsuits and settlement collections involving 141 institutions, a decrease of 39 institutions from the prior year.

The FDIC also collected more than $11.4 million from criminal restitution payments and $5.6 million in asset forfeitures ordered by the Courts as part of the judgments against defendants in criminal cases brought by the U.S. Department of Justice.

Statutes of Limitation Defenses

In professional liability matters, the applicable "statutes of limitation" (the state laws that determine the period during which an action against directors, officers or others who contributed to the failure of federally insured depository institutions may be brought) continued to be a hotly contested issue in 1998. The FDIC argues that when wrongdoers dominated the board of a failed institution, the agency should get additional time to file suit against them because these controlling board members would not have sued themselves, and no one else could sue them while they were in power. For many years the FDIC successfully asserted this doctrine of "adverse domination" as a matter of federal common law, until the U.S. Supreme Court's decision in *O'Melveny & Myers v. FDIC* in 1994. As a result of the *O'Melveny* decision, these issues are now determined by state laws, which vary widely.

For example, in Texas, the 1993 decision in *Dawson v. FDIC* by the U.S. Court of Appeals for the Fifth Circuit in New Orleans, and subsequent decisions interpreting it, limit the FDIC's use of the doctrine of adverse domination to cases where the defendants engaged in intentional misconduct or fraud, as opposed to gross negligence. In 1998, in a variation on this issue, the Fifth Circuit rejected the FDIC's argument in a Louisiana case, *FDIC v. Abraham*, that 15 former directors of a failed savings institution should be held accountable under a 10-year statute of limitation for claims of breach of fiduciary duty instead of a one-year statute of limitation for claims of gross negligence. The Fifth Circuit concluded that a claim for breach of fiduciary duty, and thus application of the 10-year statute of limitation, requires a showing of fraud, self-dealing, bad faith, breach of trust, or other "ill acts." It rejected the FDIC's position, and a recent Louisiana appellate court decision, that grossly negligent conduct is sufficient for a claim of breach of fiduciary duty. The *Abraham* ruling caused the FDIC to lose approximately $54 million in dismissed claims in four Louisiana suits.

The statute of limitation precedents are not uniform in all circuits. For example, in 1998 the U.S. Court of Appeals for the Ninth Circuit in San Francisco held in *FDIC v. Jackson* that an Arizona statute of limitation is tolled (that is, extended) during the time that grossly negligent directors adversely dominate an institution. Thus, in Arizona (unlike Texas), fraudulent or intentional concealment of facts is not necessary in order to toll the statute of limitation. As a result of the significant differences in state laws regarding statutes of limitation, as well as differing interpretations of such statutes by the courts, this area will likely continue to be hotly contested for years to come.

Directors' and Officers' Liability

The case of *FDIC v. Jackson* mentioned previously dates back to 1992, when the FDIC brought a professional liability lawsuit against the former directors of Century Bank, a failed Arizona bank. The suit involved claims that the former directors negligently approved improper loans that later went into default. In October 1992, the U. S. District Court for the District of Arizona ruled against the FDIC on claims for negligence, gross negligence and breach of fiduciary duty brought against the former directors. The FDIC appealed the case, and on January 5, 1998, the U.S. Court of Appeals for the Ninth Circuit issued a mostly favorable decision in *FDIC v. Jackson*.

The Ninth Circuit determined that the district court had improperly dismissed all of the FDIC's claims for simple negligence without regard to whether they fell within the Arizona law on "business judgment" (i.e., a rule that corporate officers and directors acting in good faith are not liable for errors in judgment unless they engage in unauthorized or illegal acts). The appellate court found that under Arizona law, bank directors should be held to a gross negligence standard of liability when the business judgment rule applies, but a simple negligence standard when the alleged wrongful acts fall outside the scope of the business judgment rule. The Ninth Circuit also concluded that a long-time bank director's greater knowledge and historical perspective regarding regulatory problems may be considered in determining whether a director had acted negligently in approving a loan.

In its decision, the Court also addressed when the statute of limitation started to run on the FDIC's claims. It determined that under Arizona law, the earliest that the claims could have been brought against the former directors was when the improper loans were made or approved, not, as the FDIC had argued, at the later time when the loans actually went into default. This ruling by the Court did not bar the FDIC's claims, however, because the Court also found that the doctrine of adverse domination (described previously in this chapter) applied to the FDIC's claims.

The Ninth Circuit's analysis of these significant issues—the standard of care for bank directors, the business judgment rule and adverse domination—provides favorable precedent for the FDIC's future professional liability cases.

Goodwill Litigation

As a result of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the Office of Thrift Supervision (OTS) in 1990 changed the regulations governing the capital requirements for thrift institutions to make them conform to those for commercial banks. Consequently, certain forms of intangible capital, such as supervisory goodwill, were no longer allowed to be counted as part of a thrift's capital. Acquirers of thrift institutions sued the government, alleging that they had purchased failed or failing thrifts prior to the passage of FIRREA based on a promise from the Federal Savings and Loan Insurance Corporation (FSLIC) that they could count such intangibles toward their capital requirements. Plaintiffs allege that FIRREA's changes resulted in a breach of contract or a taking of their property without just compensation.

In July 1996, in *Winstar Corporation v. United States (Winstar)*, the U.S. Supreme Court ruled in three consolidated goodwill cases (*Winstar, Statesman* and *Glendale*) that the United States is liable for a breach of contract based on FIRREA's change in capital standards and remanded those cases for a trial on damages. More than 120 goodwill cases were pending in the U.S. Court of Federal Claims as of year-end 1998. The major issues include breach of contract liability in many cases and the appropriate legal standards for the recovery of damages (the recovery of future lost profits being the most controversial issue). Four cases were settled, in whole or in part, during 1998 (*Statesman, Union, Winstar* and *Dollar*). Twelve "priority" cases are scheduled to go to trial in 1999. Upon completion of the priority cases, the remaining cases are expected to go to trial at a rate of 12 or 15 per year. In addition, five cases, known as the Guarini cases, involve challenges to legislation passed after FIRREA that changed the method for computing certain tax benefits given to acquirers of failed or failing thrifts.

The FDIC, as successor to the rights of failed institutions with potential goodwill claims against the United States, is a co-plaintiff or plaintiff in more than 40 goodwill cases. The FDIC, as successor to the FSLIC, is providing support to the Department of Justice in its defense of the United States. Appropriate "fire walls" have been established within the FDIC to keep the two groups of employees supporting these different roles separate and apart in order to preserve confidentiality and avoid conflicts of interest.

In October 1998, Congress passed legislation appropriating necessary sums to pay judgments and settlements arising out of goodwill litigation. Pursuant to a Memorandum of Understanding between the FDIC and the Department of Justice, the litigation expenses incurred by the United States are to be funded separately by the FDIC from other resources. That portion of the FSLIC Resolution Fund that contains the assets and liabilities of the former FSLIC shall be the funding source for goodwill litigation expenses.

On April 10, 1999, the United States Court of Federal Claims ruled that the federal government must pay Glendale Federal Bank $908.9 million for breaching a contract that allowed the thrift to count goodwill toward regulatory capital. Both the plaintiffs and the Department of Justice are expected to appeal the decision. Additionally, on April 16, 1999, in a similar case, another judge of the U.S. Court of Federal Claims, using a different analysis than the one used by the judge in the Glendale case, awarded California Federal Bank $23 million. California Federal Bank was seeking more than $1.5 billion in damages and is expected to appeal the decision. The analyses of the damage issues in the two cases appear to be irreconcilable. Due to the anticipated appeals and the conflicting analyses in the two cases, the ultimate outcome is uncertain.

Tax Penalties

FIRREA precludes state and local governments from imposing any taxes, fees or penalties on real property owned by the FDIC except for real property taxes based on value. The statute was in part a codification of the well-settled doctrine announced by the Supreme Court in 1819 in *McCulloch v. Maryland* that the national government is generally immune from taxes by state and local governments. To enforce this statute and the related FDIC policy, the FDIC as receiver of various failed financial institutions and as manager of the FRF filed suit in 1998 against 28 California counties to recover in excess of $5 million in overpaid property tax penalties paid in violation of FIRREA. These cases are significant both because they concern a challenge to the FDIC's express statutory immunity from state and local taxes and because they raise the issue of whether the Tax Injunction Act of 1948 or the 11th Amendment to the Constitution preclude federal courts from enforcing that immunity.

Bank Holding Company Litigation

In the case of *Branch v. FDIC*, the bankruptcy trustee for a bank holding company in 1992 alleged that it was due $2.1 billion as a result of money and assets the company "downstreamed" to its subsidiary banks (including the Bank of New England) when the parent company was insolvent. The plaintiff cited the Bankruptcy Code, which allows a trustee to avoid transfers of a debtor's property made when the debtor was insolvent, without regard to the motives of the parties involved, if the debtor did not receive reasonably equivalent value in exchange. The case highlighted an inherent conflict between the bank regulatory and statutory systems (which require holding companies to provide financial support to their subsidiary banks) and the Bankruptcy Code (which focuses exclusively on recovering the debtor's property regardless of the legitimacy of the reasons transfers were made). The FDIC argued that it could not be held liable for transfers under the Bankruptcy Code's fraudulent transfer section (or a corresponding state law) when the transfer was made pursuant to a valid regulatory directive. The district court in 1993 rejected this argument, made in a motion to dismiss in 1993, and allowed the plaintiff to proceed to trial on the merits.

In 1998 the FDIC prevailed on its motion to dismiss plaintiff's largest claim for more than $1.6 billion in federal funds from two of the subsidiary banks. These efforts reduced the claims to be tried to about $400 million. After engaging in mediation, the FDIC in 1998 settled the remaining claims by paying $140 million.

Insurance Assessments

In 1996, the FDIC revised the assessment schedule for the Savings Association Insurance Fund (SAIF) for the fourth quarter of 1996 because a special assessment authorized by Congress had recapitalized the insurance fund. The revised assessment schedule resulted in a refund of most of the SAIF assessments previously collected for the fourth quarter but not the money collected at the same time to service bonds of the Financing Corporation (FICO). America's Community Bankers (ACB), an industry trade association, sued the FDIC to have the FICO assessment refunded. ACB argued that since the SAIF had been recapitalized in the fourth quarter, the FDIC was precluded from collecting the FICO assessment that quarter.

In November 1998, the District Court for the District of Columbia rejected the ACB's challenge. It found that the FDIC's interpretation of the statute was entitled to deference and was reasonable in light of the statute's conflicting goals and the broad discretion afforded the FDIC in setting assessments. The court also concluded that because the FICO assessment had already been transferred to the FICO prior to enactment of the SAIF special assessment, the FICO funds did not belong to the FDIC and therefore an award of money damages was precluded by the Administrative Procedure Act. In early 1999, ACB announced its intention to appeal the court's decision.

D'Oench Duhme

The *D'Oench* doctrine, which is traced to a 1942 Supreme Court ruling, protects the FDIC against any arrangements, including oral or secret agreements, that are likely to mislead bank examiners in the review of a bank's records. On May 8, 1996, the U.S. Court of Appeals for the Eleventh Circuit in Atlanta, sitting *en banc* (with all active judges participating), held in *Motorcity of Jacksonville v. Southeast Bank* that the *D'Oench* doctrine survives the passage of FIRREA and remains a viable protection for the FDIC. However, that decision disagreed with a 1995 opinion by the U.S. Court of Appeals for the District of Columbia. On February 28, 1997, the FDIC issued its operative Statement of Policy on *D'Oench* to deal with the concerns raised in the courts as to the *D'Oench* doctrine's continuing viability after FIRREA. The FDIC determined in the policy statement that agreements made pre-FIRREA will be governed by *D'Oench*; FIRREA will not be applied retroactively to agreements entered into before the enactment of FIRREA on August 9, 1989. In addition, the FDIC determined that agreements made after the enactment of FIRREA will be governed by sections of FIRREA barring claims against the FDIC that do not meet specific recording requirements set forth in the statute.

The plaintiff in *Motorcity* also had appealed to the U.S. Supreme Court, arguing that the "split" between the two circuits needed to be resolved. In January 1997, the U.S. Supreme Court instructed the Eleventh Circuit to reconsider its decision and determine whether a previous U.S. Supreme Court case involving federal common law (*Atherton v. FDIC*) affected the outcome. In August 1997, the Eleventh Circuit held that nothing in Atherton altered the outcome of its earlier decision and, consequently, it was not necessary to address the FDIC's policy statement. The *Motorcity* plaintiff filed its second appeal to the U.S. Supreme Court on December 18, 1997. On April 27, 1998, the Supreme Court denied the plaintiff's petition, bringing an end to this litigation. Although the Eleventh Circuit's favorable decision stands, the FDIC will continue to apply the provisions of the 1997 policy statement in determining whether to apply the *D'Oench* doctrine.

FIRREA's Anti-Injunction Provision

When Congress enacted FIRREA in 1989, it gave the FDIC broad powers to resolve failed financial institutions efficiently and expeditiously. One of these powers was an anti-injunction statute that enables the FDIC, in its capacity as receiver or conservator for a failed bank, to operate quickly and without interference. In particular, the statute prohibits judicial action that would "restrain or affect the exercise of powers or functions" of the FDIC.

In 1994, five former shareholders of Meritor Savings Bank sued the FDIC and the Pennsylvania Secretary of Banking, challenging the 1992 closure of the bank and the appointment of the FDIC as receiver. In this case (*Hindes v. FDIC*), the plaintiffs argued that the FDIC had wrongfully issued advance "notification" of its intent to terminate Meritor's deposit insurance in order to provide the Pennsylvania banking supervisor with a pretext for seizing the institution. On February 19, 1998, the U.S. Court of Appeals for the Third Circuit in Philadelphia, upheld a district court ruling dismissing the shareholders' action because a review of the FDIC's "notification" was barred by the anti-injunction statute. In addition, the Court stated that even if the anti-injunction provision did not apply, the agency's issuance of the notification was not subject to judicial review because it was not a final action that could be reviewed by the Court.

This case is significant because the Third Circuit determined that the shareholders' failure to timely challenge the FDIC's appointment as receiver under state procedures precluded them from later seeking to remove the FDIC. In addition, it is the first court of appeals decision to hold that shareholders could not assert a claim under FIRREA against the FDIC challenging the appropriateness of the receivership accounting.

Building on the groundwork laid in previous years, the FDIC continued to focus on improving the operational efficiency and effectiveness of the Corporation in 1998. A strong banking industry and the small number of institution failures resulted in a continued decline in the FDIC's resolutions and liquidation workload. This led to more office closings and further staff reductions at the FDIC in 1998. At the same time, the Corporation allocated additional resources to ensure that insured institutions were effectively addressing Year 2000 technology issues, and to identify and analyze other potential emerging risks to the insurance funds. Here is an overview of the most significant activities in these areas in 1998.

Focusing on Planning and Efficiency

The FDIC Strategic Plan provides a framework for accomplishing the Corporation's mission. The plan sets a course for the organization and guides decisions on the use of Corporation resources. In 1998, the FDIC revised its Strategic Plan to emphasize the results to be achieved and to realign the Corporation's activities around three major program areas: insurance, supervision and receivership management. A section was added to address the FDIC's management of its human, technological and information resources and internal controls.

The corporate-level strategic plan is augmented by three additional strategic plans that address information technology, corporate diversity and the activities of the Office of Inspector General (OIG). In accordance with the Government Performance and Results Act of 1993, the FDIC's annual budget is linked to the FDIC Strategic Plan.

Regular performance reports allow management to evaluate actual performance and to adjust strategic goals and the allocation of resources as needed. They also provide important information for future planning efforts.

The FDIC developed new tools during 1998 to integrate its planning activities with established management functions. For example, a new Business Planning System facilitates budget development, provides a link to the FDIC Strategic and Annual Plans, and enables improved cost management by furnishing FDIC managers with information not previously available. Another new tool, the Business Planning Information Application, enables quicker access to expense information, which allows the Corporation to make more timely, informed decisions that can help control costs.

Controlling Expenses and Reducing Costs

The FDIC's budget is the culmination of the Corporation's annual planning process. The largest component of the annual budget is staffing-related costs. Staffing estimates are developed by each division and office, and are based on corporate-wide workload assumptions and division and office annual performance plans. Additional resource needs are also identified during the budget process.

In 1998, the FDIC continued to contain expenses and reduce costs. Actual expenditures for 1998 were \$1.2 billion, or 12.7 percent less than 1997 spending and 12 percent below the approved 1998 budget. Actual 1998 spending was below budgeted levels primarily due to lower costs for asset liquidation-related contracting and the hiring of fewer Division of Supervision (DOS) examiners than initially planned.

Downsizing and Consolidation

The Corporation continued to reduce the size of its workforce in 1998 to levels consistent with its declining resolutions and liquidation workload. Total FDIC staffing decreased to 7,359 at year-end 1998, down 5.7 percent from year-end 1997. Staffing reductions were primarily due to further declines in the inventory of assets in liquidation and related workload. They were accomplished largely through the expiration of non-permanent appointments and by consolidating field operations.

W.W. Reid

Members of the FDIC's information management staff test the Corporation's internal software systems for Y2K compliance.

Number of Officials and Employees of the FDIC 1997-1998 (year-end)

	Total		Washington		Regional/Field	
	1998	1997	1998	1997	1998	1997
Executive Offices•	110	127	110	127	0	0
Division of Supervision	2,655	2,550	197	191	2,458	2,359
Division of Compliance and Consumer Affairs	646	618	59	56	587	562
Division of Resolutions and Receiverships	795	1,093	134	153	661	940
Legal Division	907	1,035	482	472	425	563
Division of Finance	570	606	298	307	272	299
Division of Information Resources Management	505	502	429	421	76	81
Division of Research and Statistics	94	94	94	94	0	0
Division of Insurance	69	56	36	32	33	24
Division of Administration	687	758	417	429	270	329
Office of Inspector General	218	216	145	147	73	69
Office of Diversity and Economic Opportunity	45	63	33	45	12	18
Office of the Ombudsman	37	57	15	23	22	34
Office of Internal Control Management	21	18	21	18	0	0
Total	**7,359**	**7,793**	**2,470**	**2,515**	**4,889**	**5,278**

• Includes the Offices of the Chairman, Vice Chairman, Director (Appointive), Chief Operating Officer, Chief Financial Officer, Chief Information Officer, Executive Secretary, Corporate Communications, Legislative Affairs, and Policy Development.

In accordance with a 1996 plan for a phased consolidation of its field operations, the Division of Resolutions and Receiverships (DRR) in 1998 closed field offices in Irvine, CA; Jersey City, NJ; and Boston, MA; and consolidated the residual workload from those sites into the Dallas and Washington offices. Only the Hartford, CT, office remains to be closed under DRR's 1996 field consolidation plan. In December 1998, the FDIC Board of Directors delayed the Hartford office's projected closing date until June 30, 2000. This will allow the Corporation to retain a large number of experienced staff as part of a contingent workforce ready to respond to any unexpected increase in bank failures in early 2000 due to Y2K technical issues. The Division of Supervision also continued to streamline its field office structure in 1998 by closing small field offices in Bath, OH; Cincinnati, OH; Macon, GA; and Fort Wayne, IN.

Throughout 1998, the Corporation continued to provide job placement and training opportunities to employees affected by downsizing. Approximately 350 employees in closing offices (including 150 employees with permanent appointments) left the Corporation during the year, and another 150 permanent employees in these offices were placed in other positions within the Corporation. Many employees took advantage of the FDIC's Career Transition and Outplacement Program, which provides job search assistance and resources to employees affected by downsizing. To further cushion the impact of downsizing, the Corporation also made new buyout and early retirement opportunities available to selected employees in overstaffed divisions and offices. The Corporation will continue many of these initiatives in 1999 as it continues to pursue further downsizing and realignment of the Corporation's workforce.

Ensuring a Diverse and Productive Workforce Into the Future

The Corporation took steps in 1998 to ensure that it maintains a capable, productive, diverse and motivated workforce into the future.

The FDIC is strongly committed to maintaining a workplace that is fair and inclusive. An executive-level Diversity Steering Committee was created during the year to help ensure that the FDIC benefits from the dedication, experience and diversity of its employees. This committee will promote among employees an environment of mutual respect, an appreciation of differing perspectives and talents, and an opportunity to work cooperatively together to achieve their full potential pursuing the Corporation's mission. The Steering Committee will unveil the Corporation's first diversity strategic plan in 1999.

As part of this diversity effort, a corporate-wide mentoring program was developed that will encourage senior managers to share their knowledge, skills and organizational insights with participating employees to help them realize their full potential. Another element of the diversity effort is the Corporation's career management program, to be started on a pilot basis in 1999. It will provide career planning, counseling, reference tools and other resources to help employees better manage their careers.

The FDIC's external recruitment efforts are designed to attract a well-qualified and diverse pool of applicants. In 1998, about 200 new examiners were hired from outside the Corporation for positions in DOS and the Division of Compliance and Consumer Affairs (DCA). While the Corporation had made substantial progress in downsizing its liquidation staff, it still had a large number of bank examiner vacancies in DOS and DCA at the beginning of the year. About 300 employees from other divisions undergoing downsizing had been retrained in recent years to fill examiner positions, but these transfers were not sufficient to fill the growing number of examiner vacancies. To ensure that the Corporation could adequately fulfill its supervisory responsibilities, the FDIC began in early 1998 to recruit new examiners from outside the Corporation for the first time in six years.

Compensation and Benefits

The FDIC's compensation and benefits program underwent significant changes in 1998 as a result of a 1997 agreement between the FDIC and the National Treasury Employees Union.

Compensation changes included eliminating a 19-step pay system and replacing it with minimum and maximum salary ranges for each grade. Beginning in January 1999, FDIC employees will no longer receive automatic, across-the-board salary increases. Instead, pay raises will be based upon performance.

Special legislation was also passed in 1998 to convert health insurance coverage for FDIC employees and retirees to the Federal Employees Health Benefits (FEHB) program. Beginning in 1999, the FDIC will terminate its separate corporate-sponsored health insurance program. This will result in long-term savings for the Corporation.

Audits, Investigations and Reviews

The FDIC Office of Inspector General performed numerous independent audits, investigations and other reviews related to corporate programs and operations in 1998. The OIG's mission is to promote economy and efficiency and to detect and prevent fraud and abuse. The Inspector General keeps the FDIC Board of Directors and the Congress fully informed about possible problems and deficiencies in corporate activities.

For the 12-month period ending September 30, 1998 (the OIG's reporting period to the Congress), the office issued 103 audit and evaluation reports with questioned costs totaling nearly $22 million and recommendations for putting more than $1 million to better use. These reports also included 129 non-monetary recommendations to improve corporate programs and operations. OIG investigations resulted in nearly $30 million in fines, restitutions and recoveries. Indictments and criminal charges were brought against 26 individuals, two of whom were FDIC employees. Over the same period, 21 individuals were convicted, including one employee and one former employee.

During the year, the OIG assisted management in closing out over 400 former Resolution Trust Corporation (RTC) contracts that transitioned to the FDIC at year-end 1995. During the 12-month period, OIG efforts resulted in questioned costs of over $2.8 million for these RTC contracts. Since 1996, the FDIC has disallowed $94.6 million in contractor fees and expenses and agreed to seek recovery of an additional $28.8 million as a result of the OIG's work.

The OIG manages a hotline (1-800-964-FDIC) for employees, contractors and others to report incidents of fraud, waste, abuse and mismanagement that could threaten the effectiveness and efficiency of corporate programs and operations. The OIG continues to review all draft corporate policy and procedural directives, and proposed legislation and regulations before they are finalized.

For additional information about the OIG's activities, please refer to its two Semiannual Reports to the Congress dated April 30,1998, and October 30,1998.

Internal Controls

During 1998, the FDIC significantly strengthened its internal controls program. The Office of Internal Control Management (OICM) developed a manual with guidance on corporate-wide internal control policies and risk-management procedures. OICM also issued an employee brochure to enhance employees' understanding of risk management and how internal controls play an integral part in their daily on-the-job activities.

At internal conferences and workshops, OICM provided training to over 700 managers, supervisors and professional employees. In December 1998, OICM hosted a Best Practices Conference and apprised FDIC senior managers and internal review staff of new and innovative approaches to managing risk. OICM also participated in a number of internal control reviews to better understand the operations of selected divisions and offices.

Internal Year 2000 Challenges

The FDIC is committed to ensuring that its computer hardware, software and communications infrastructure will continue to function appropriately in the Year 2000, when many current computer systems may have difficulty distinguishing the numbers 2000 and 1900. The Corporation is adhering to timeframes established by the U.S. Office of Management and Budget and the U.S. General Accounting Office for completing each of the five stages of Year 2000 project management: awareness, assessment, renovation, validation and implementation. The FDIC completed the renovation stage in August 1998, and was on schedule at year-end to complete the validation and implementation stages within established timeframes. The FDIC's rigorous, centralized strategy should result in a smooth transition of its automated systems in the Year 2000. **For more information on the Year 2000 issue, see Pages 13–15.**