

Federal  
Deposit  
Insurance  
Corporation  
  
**Annual  
Report  
1998**

**Maintaining  
public confidence  
in the  
banking system**

Each Depositor Insured to \$100,000



FEDERAL DEPOSIT INSURANCE CORPORATION



### **The Federal Deposit Insurance Corporation**

**(FDIC)** is the independent deposit insurance agency created by Congress to maintain stability and public confidence in the nation's banking system.

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

The **FDIC** promotes public understanding and sound public policies by providing financial and economic information and analyses. It minimizes disruptive effects from the failure of banks and savings associations. It assures fairness in the sale of financial products and the provision of financial services.

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



F e d e r a l   D e p o s i t   I n s u r a n c e   C o r p o r a t i o n

# **FDIC**

**Federal Deposit Insurance Corporation**

Washington, DC 20429-9990

Office of the Chairman

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August 5, 1999

Sirs,

In accordance with the provisions of section 17 (a) of the Federal Deposit Insurance Act, the Federal Deposit Insurance Corporation is pleased to submit its Annual Report for the calendar year 1998.

Sincerely,



Donna Tanoue  
**Chairman**

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The President of the U.S. Senate  
The Speaker of the U.S. House of Representatives

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## Overview





In terms of earnings, 1998 was an extraordinary year for banking. Despite declines in net income in the third and fourth quarters, commercial banks earned a record \$61.9 billion for the year as a whole. Return on assets—or ROA, a basic yardstick for profitability—was 1.19 percent. Savings institutions' earnings reached a record \$10.2 billion in 1998—\$1.4 billion above the previous record set in 1997. That \$10.2 billion translated into a 1.01 percent ROA—the highest annual ROA for savings institutions since 1946.

The Bank Insurance Fund grew 4.7 percent during the year to \$29.6 billion, and the Savings Association Insurance Fund grew 5 percent to \$9.8 billion. The funds are strong—in fact, they are at record levels.

Having strong deposit insurance funds is important to everyone. In effect, deposit insurance makes a bank failure a nonevent for an average household customer. Because the government provides an absolute guarantee, people do not have to worry about the safety of their savings, and because they do not have to worry, they do not feel compelled to rush to the bank to get their money out in response to the news—or rumor—that their institution is troubled financially. In the 1980s and early 1990s, nine percent of the banks in the United States—nearly one-out-of-10—either failed altogether or received FDIC financial assistance to stay open, and nearly 1,300 savings and loan associations also failed. Because of federal deposit insurance, there was no widespread panic or bank runs.

Deposit insurance protects depositors. But just as important—perhaps even more important—is the fact that, in preventing banking panics, deposit insurance keeps the payments system operating.

In recent years, we've seen financial crises in Asia and Latin America—crises that, in part, have led 21 countries to institute explicit deposit insurance programs since May of 1995. Today, 68 countries have such systems. Clearly, the benefits of deposit insurance are appreciated worldwide.

Deposit insurance, however, doesn't alone ensure stability in the financial marketplace. It addresses only one potential problem, albeit a problem that can cripple, or even bring down, a financial system: the evaporation of public confidence in banking. Stability also requires both effective economic policy and effective prudential supervision.

When the three contributors—effective economic policy, effective prudential supervision, and deposit insurance—are present, experience has shown that stability in the financial marketplace can be achieved and maintained.

The conditions in the industry—and the strength of our insurance funds—in 1998 gave the FDIC opportunity to focus on three corporate priorities—Year 2000

readiness; emerging risks facing insured institutions, and, therefore, the insurance funds; and diversity in our workforce. Each in its way contributed to our efforts to ensure that the FDIC remains the world's leading deposit insurance authority.

### Year 2000

The Year 2000, or Y2K, computer challenge was the FDIC's highest safety-and-soundness priority during the year. Examiners visited all FDIC-supervised institutions at least once by May 31 to assess progress toward Y2K readiness, and thereafter began a second round of on-site assessments. To maintain communication with the banking industry on the issue, the FDIC—along with the Federal Financial Institutions Examination Council and industry trade associations—conducted an extensive nationwide outreach program for bankers. The FDIC participated in more than 130 seminars attended by more than 11,000 bankers.



David Hathcox

▲ **Chairman Donna Tanoue**

The FDIC also addressed consumer awareness and concerns on the Y2K issue with two publications. The first was a brochure, *The Year 2000 Date Change*, which answers basic consumer questions. All FDIC-insured institutions were provided with camera-ready versions of the brochure, in both English and Spanish, so they could reproduce copies for their customers. More than 10 million copies of the brochure were distributed in 1998. The second was a special issue of the quarterly *FDIC Consumer News*, which was devoted entirely to Y2K, and included features on the efforts of federal banking regulators to protect bank customers and a list of steps that consumers can take to help protect themselves. We arranged to distribute this issue of the *FDIC Consumer News* through the federal Consumer Information Center in Pueblo, CO, as well as through insured financial institutions.

As the year drew to a close, it became more apparent that maintaining public confidence in banking was an important element in the Y2K challenge. If the conventional wisdom during 1999 were for people to take sensible precautions, most would likely take sensible precautions. If the conventional wisdom were for people to take extreme measures, many would take extreme measures. To promote sensible conventional wisdom, the FDIC followed a simple communications strategy: The more people know about Y2K and banking—and about the efforts of both the industry and the regulators—the more comfortable they would be. Public confidence will be strengthened by regular, consistent and clear communications.

During 1998, we told a three-part story on banking and Y2K. One, bankers have been working aggressively to meet the Y2K challenge. Two, regulators are aggressively supervising the banks' preparations to become Y2K-ready. While no one could say there won't be glitches, we have a great deal of confidence that the banking industry will be ready. (In fact, by summer 1999, virtually all banks and savings institutions had satisfactory Y2K ratings.) And three, money in an FDIC-insured account is safe—the Year 2000 will not affect our guarantee.

As the year ended, the Corporation began to refine and expand the information we would communicate on Y2K and banking to meet ever-shifting public concerns.

Lastly, along with the Federal Reserve, the FDIC in December hosted a Year 2000 summit on behalf of the President's Council on Year 2000 Conversion for financial institutions and members of the utilities and telecommunications industries. The forum focused on the participants' progress in addressing the Y2K computer challenge.

### Emerging Risks

As a risk to the banking industry, the Y2K challenge is unique, but FDIC-insured institutions face other emerging risks as well.

By most measures of prosperity, this is the best economy in a generation. Inflation and unemployment are at levels not seen since the 1960s. Consumer spending and business investment are propelling growth even at this late stage of the expansion. The recent performance of the U.S. economy is a triumph of technology, as well as of U.S. fiscal and monetary policy.

It is also uncharted territory, so this is no time for complacency.

Moreover, our economy has become linked to the health of—and events in—foreign economies. This linkage has increased the potential for sudden adverse economic and financial events.

During the third quarter of 1998, for example, a default in Russian debt and the resultant difficulties with hedge funds, such as those experienced by Long Term Capital Management, LP, showed how interconnected the world had become and how quickly and dramatically events can affect world markets. That makes our job of watching the horizon all the more important.

Strong competition in the financial marketplace has placed pressure on banks to look for ways to maintain market share and increase profitability—and these pressures may also be forcing institutions to compromise their underwriting standards. The market currently rewards high-performing banks to an unprecedented degree, giving some lenders incentive to take increased risk.

For example, we are seeing a proliferation of non-traditional consumer lending that is currently highly profitable—subprime and high loan-to-value home equity lending. These “new frontiers” in consumer lending are pushing institutions into riskier territory where some are having problems, even though times are good.

Responding to risks on the horizon is a challenge, but the FDIC also must respond to the long-term changes in the banking industry that will ultimately shape the way we do our jobs. Among these trends are the growing concentration of the FDIC's exposure in the largest banks we insure; expansion of business activities conducted by banks and their affiliates; globalization of banking and increasing affiliations with non-bank financial companies; electronic banking; and the growing segmentation of the industry into a few large banks, and many small ones. The changes underway make it more challenging—and more important—for the FDIC to understand the risks being underwritten by the deposit insurance funds.

In light of globalization, the Corporation in September hosted an international conference on deposit insurance—the first of its kind. The conference brought together senior government authorities from 62 countries. Discussions focused on the role of deposit insurance in maintaining public confidence in the world's banking systems.

The widespread response to our invitation reflected global interest in deposit insurance issues—and their importance. Deposit insurance is becoming a frequent condition of international funding agreements, and there is substantial international demand for the FDIC's assistance—and leadership—in this area.

During the conference it became clear that the FDIC has expertise and leadership to offer by designing and publishing best practices for deposit insurance systems around the world. It also became clear that the FDIC should take advantage of opportunities, such as gatherings of international bankers, to describe our best practices concepts. The FDIC was also asked to consider investigating the creation of an international consortium for sharing information on deposit insurance.

### Diversity

As the year drew to a close, we created an executive-level Diversity Steering Committee to ensure an inclusive workplace at the FDIC. Diversity is a business imperative for the Corporation for three reasons. The first is that trends and events in the financial-services industry and in society at large affect the FDIC—we do not operate in a vacuum. In that regard, the composition of the national employee pool is dramatically changing as a result of the increasing diversity of our society. The second reason is that one out of every six employees in the FDIC is eligible to retire in the next five years. As a result, we will need to conserve and replenish our institutional knowledge and expertise. For the Corporation to continue to be successful, we must retain and recruit the most qualified and most motivated employees that we can. We must maintain and enhance our reputation as a place where people want to work. We must continue to be an employer of choice. The third reason is that the increasing diversity of our society directly affects the depositors we insure and the customers and employees of financial institutions. We need to understand their needs.

I would like to end on a personal note. Since becoming FDIC Chairman, I have been reminded every day that the men and women of the FDIC are extraordinarily dedicated and talented. It is a privilege to work with them. The Corporation has challenges ahead of it—challenges from a changing financial industry and a changing America. But the FDIC will rise to meet those challenges because of the men and women who stand behind it and who, day in and day out, maintain the FDIC seal as a symbol of confidence. Because of the work they have done, the FDIC has a proud history, but because of who they are, the Corporation's best years are yet to come.

Sincerely,



**Donna Tanoue**  
Chairman

## March 12

The FDIC reported that insured commercial banks earned record annual profits for 1997, reaching \$59.2 billion, up \$6.8 billion from 1996 results. Strong growth in loans and other interest-earning assets was responsible for the earnings rise. In 1998, bank earnings set a new record for the seventh consecutive year at \$61.9 billion (**see Pages 10–11**).

## April 4

FDIC Board member Eugene A. Ludwig's tenure on the Board ended with the expiration of his five-year term as Comptroller of the Currency. On December 8, John D. Hawke, Jr., was sworn in as the 28th Comptroller of the Currency, filling the FDIC Board seat vacated by Mr. Ludwig. In the interim, Julie L. Williams, as Acting Comptroller, served on the FDIC Board (**see Page 21**).

## April 9

Omnibank, River Rouge, Michigan, was the first FDIC-insured bank to fail since November 1997. Two more banks failed during 1998. All three banks were insured by the Bank Insurance Fund (**see Page 31**).

## April 28

The FDIC Board voted to simplify the deposit insurance rules, making them easier to understand and less burdensome without reducing the consumer protections or safety-and-soundness standards for institutions (**see Pages 28, 50**).

## April 29

At a two-day symposium, "Managing the Crisis: The FDIC and RTC Experience," current and former FDIC and Resolution Trust Corporation (RTC) executives discussed the strategies they used to resolve troubled banks and thrifts during the financial crisis of the 1980s and '90s. Between 1980 and 1994, a total of 1,617 banks and 1,295 thrifts failed (**see Page 32**).

A new Internet service was launched giving the public quick and easy access to Community Reinvestment Act evaluations for banks and thrifts supervised by the FDIC. The FDIC's ratings and evaluations can be accessed from the agency's Web site (**see Page 127**).

## May 26

Donna Tanoue was sworn in as the 17th Chairman of the FDIC. Andrew C. Hove, Jr., who had served as Acting Chairman since June 1997, resumed his position as the agency's Vice Chairman (**see Pages 20–21**).

## May 31

FDIC examiners had completed at least one on-site review at each institution the FDIC regulates to assess efforts to address Year 2000 issues. At year-end 1998, 97 percent of the institutions were making satisfactory progress toward achieving Year 2000 readiness (**see Pages 14–15, 25**).

## June 18

The FDIC announced its "Suspicious Internet Banking" Web site designed to help detect potentially fraudulent Internet banking activity. The site provides the public and the industry with a "user-friendly" vehicle for reporting entities on the Internet that may be misrepresenting themselves as legitimately chartered or federally insured depository institutions (**see Pages 35, 127**).

## July 7

The FDIC Board voted to expedite the processing of applications filed by well-managed, well-capitalized institutions. More than 90 percent of all FDIC-supervised banks meet the eligibility standards (**see Pages 27, 51**).



## August 17

With the rapid growth of electronic commerce and the increased collection of consumers' personal information over the Internet, the FDIC alerted bankers to the issue of online privacy. The FDIC encouraged institutions to maintain an awareness of consumers' online privacy concerns, while taking voluntary, specific actions to address them (see Page 35).

## September 9

Top government officials from 62 countries, including the leaders of deposit insurance agencies in more than 20 nations, met in Washington, DC, for a three-day FDIC-sponsored conference to discuss the role of deposit insurance in sustaining public confidence in the world's banking systems (see Pages 3, 17, 29).

## September 28

The FDIC unveiled a new Internet service allowing the public easy access to a listing of banks' pending applications that are subject to public comment (see Page 127).

### Selected Statistics

Dollars in millions

For the year ended December 31

1998 1997 1996

#### Bank Insurance Fund

##### Financial Results

|  |           |           |           |
|--|-----------|-----------|-----------|
| Revenue                                  | \$ 2,000  | \$ 1,616  | \$ 1,655  |
| Operating Expenses                       | \$ 698    | \$ 605    | \$ 505    |
| Insurance Losses and Expenses            | \$ (6)    | \$ (428)  | \$ (251)  |
| Net Income                               | \$ 1,309  | \$ 1,438  | \$ 1,401  |
| Insurance Fund Balance                   | \$ 29,612 | \$ 28,293 | \$ 26,854 |
| Fund as a Percentage of Insured Deposits | 1.38%     | 1.38%     | 1.34%     |

##### Selected Statistics

|   |          |          |          |
|---|----------|----------|----------|
| Total BIF-Member Institutions •                   | 9,031    | 9,403    | 9,822    |
| Problem Institutions                              | 68       | 73       | 86       |
| Total Assets of Problem Institutions              | \$ 5,000 | \$ 5,000 | \$ 7,000 |
| Institution Failures                              | 3        | 1        | 5        |
| Total Assets of Failed Institutions               | \$ 370   | \$ 26    | \$ 183   |
| Number of Active Failed Institution Receiverships | 219      | 302      | 408      |

#### Savings Association Insurance Fund

##### Financial Results

|  |          |          |          |
|--|----------|----------|----------|
| Revenue                                  | \$ 584   | \$ 550   | \$ 5,502 |
| Operating Expenses                       | \$ 85    | \$ 72    | \$ 63    |
| Insurance Losses and Expenses            | \$ 32    | \$ (2)   | \$ (92)  |
| Net Income                               | \$ 467   | \$ 480   | \$ 5,531 |
| Insurance Fund Balance                   | \$ 9,840 | \$ 9,368 | \$ 8,888 |
| Fund as a Percentage of Insured Deposits | 1.39%    | 1.36%    | 1.30%    |

##### Selected Statistics

|   |          |          |          |
|---|----------|----------|----------|
| Total SAIF-Member Institutions ▪                  | 1,430    | 1,519    | 1,630    |
| Problem Institutions                              | 16       | 19       | 31       |
| Total Assets of Problem Institutions              | \$ 6,000 | \$ 2,000 | \$ 6,000 |
| Institution Failures                              | 0        | 0        | 1        |
| Total Assets of Failed Institutions               | \$ 0     | \$ 0     | \$ 35    |
| Number of Active Failed Institution Receiverships | 2        | 2        | 2        |

- Commercial banks and savings institutions. Does not include U.S. branches of foreign banks.
- Savings institutions and commercial banks.

## September 30

Joseph H. Neely resigned as a member of the FDIC's Board of Directors. He had served since January 29, 1996.

A "user-friendly" electronic deposit insurance estimator called "EDIE" became available on the FDIC's Web site. The service enables consumers and financial institution employees to quickly check whether a depositor with multiple accounts at the same institution has exceeded the \$100,000 statutory limit for deposit insurance coverage (see Pages 19, 36, 127).

## December 18

The FDIC Board approved a 1999 budget of \$1.218 billion, an 11 percent decrease (\$148 million) from the \$1.366 billion authorized for 1998. The budget will allow the agency to pursue its supervisory plans to ensure the safety and soundness of insured financial institutions and the industry's Year 2000 compliance (see Page 42).



▲ Donna Tanoue at her April 22nd Senate confirmation hearing. She was accompanied to the hearing by both of Hawaii's senators—Daniel K. Inouye (top) and Daniel K. Akaka (below).

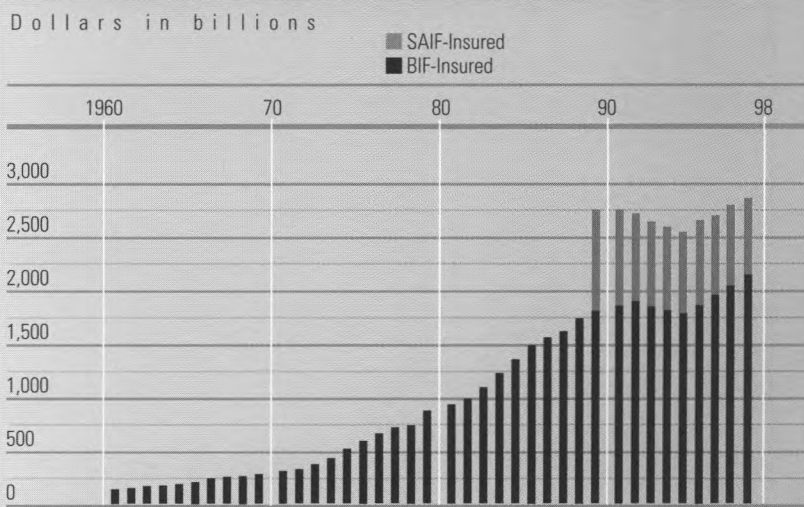


The FDIC administers two deposit insurance funds, the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). The agency also manages a third fund fulfilling the obligations of the former Federal Savings and Loan Insurance Corporation (FSLIC), called the FSLIC Resolution Fund (FRF). On January 1, 1996, the FRF assumed responsibility for the assets and obligations of the Resolution Trust Corporation (RTC).

The economic environment in 1998 remained favorable for the banking and thrift industries, resulting in relatively few problem institutions, high profitability and increased capitalization. During the third quarter, a default in Russian debt and the resulting difficulties with hedge funds, such as those experienced by Long Term Capital Management, LP, illustrated the speed with which financial market volatility and foreign sector developments can affect insured institutions. During 1998, some insured institutions continued to increase their exposures to an economic downturn through higher-risk lending and other practices. This is suggested by evidence of weakening underwriting standards, narrower interest-rate spreads, and increased concentrations in higher-risk loans. The potential effect of these trends on the deposit insurance funds depends on the nature of any national or regional economic downturns.

An overview of the funds' performance during 1998 follows. **(Full details about the funds appear in the financial statements that begin on Page 57.)**

## FDIC-Insured Deposits (as of December 31, 1998)



Source: Commercial Bank Call Reports and Thrift Financial Reports  
Note: For more details, see pages 57 (BIF) and 75 (SAIF).

## Bank Insurance Fund

With banks experiencing another highly profitable year and only three bank failures, 1998 was another positive year for the BIF, despite adverse trends in the global economic picture. The BIF has grown steadily from a negative fund balance of \$7 billion at year-end 1991 to \$29.6 billion at year-end 1998. The 1998 fund balance represents a 4.7 percent increase over the 1997 balance of \$28.3 billion. BIF-insured deposits grew by 4.1 percent in 1998, yielding a reserve ratio of 1.38 percent of insured deposits at year-end 1998, unchanged from year-end 1997.

Deposit insurance assessment rates in 1998 were unchanged from 1997. For both semiannual assessment periods in 1998, the Board voted to retain rates ranging from 0 to 27 cents annually per \$100 of assessable deposits. Under these rates, 95.1 percent of BIF-member institutions, or 8,808 institutions, were in the lowest-risk assessment rate category and

paid no deposit-insurance assessments for the second semiannual assessment period of 1998. This rate schedule resulted in an average 1998 BIF rate of 0.08 cents per \$100 of assessable deposits.

As in 1997, interest earned on U.S. Treasury investments (\$1.7 billion) exceeded assessment revenue (\$22 million) and was the primary source of revenue for the BIF in 1998. This was a result of minimal insurance losses and receivership activity, the continued low assessment rate schedule and the concentration of institutions in the lowest-risk category.

Bank failures continued to be minimal in 1998. Only three BIF-member institutions, with assets totaling \$370 million, failed during the year. In 1997, one BIF-member institution with assets of \$25.9 million failed. Estimated insurance losses of the banks that failed in 1998 were \$179 million, compared to \$4 million in estimated losses for the one failure in 1997.

## Risk-Related Premiums

The following tables show the number and percentage of institutions insured by the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF), according to risk classifications effective for the second semiannual assessment period of 1998. Each institution is categorized based on its capitalization and a supervisory subgroup rating (A, B, or C), which is generally determined by on-site examinations. Assessment rates are basis points, cents per \$100 of assessable deposits, per year.

### BIF Supervisory Subgroups\*

|                                | A             | B          | C         |
|--------------------------------|---------------|------------|-----------|
| <b>Well Capitalized:</b>       |               |            |           |
| Assessment Rate                | 0             | 3          | 17        |
| Number of Institutions         | 8,808 (95.1%) | 248 (2.7%) | 33 (0.4%) |
| <b>Adequately Capitalized:</b> |               |            |           |
| Assessment Rate                | 3             | 10         | 24        |
| Number of Institutions         | 132 (1.4%)    | 18 (0.2%)  | 15 (0.2%) |
| <b>Undercapitalized:</b>       |               |            |           |
| Assessment Rate                | 10            | 24         | 27        |
| Number of Institutions         | 4 (0.0%)      | 0 (0.0%)   | 7 (0.1%)  |

### SAIF Supervisory Subgroups\*

|                                |               |           |          |
|--------------------------------|---------------|-----------|----------|
| <b>Well Capitalized:</b>       |               |           |          |
| Assessment Rate                | 0             | 3         | 17       |
| Number of Institutions         | 1,354 (91.9%) | 83 (5.6%) | 9 (0.6%) |
| <b>Adequately Capitalized:</b> |               |           |          |
| Assessment Rate                | 3             | 10        | 24       |
| Number of Institutions         | 14 (0.9%)     | 7 (0.5%)  | 5 (0.3%) |
| <b>Undercapitalized:</b>       |               |           |          |
| Assessment Rate                | 10            | 24        | 27       |
| Number of Institutions         | 1 (0.1%)      | 0 (0.0%)  | 1 (0.1%) |

- BIF data exclude 111 SAIF-member "Oakar" institutions that hold BIF-insured deposits. The assessment rate reflects the rate for BIF-assessable deposits, which remained the same throughout 1998.
- SAIF data exclude 760 BIF-member "Oakar" institutions that hold SAIF-insured deposits. The assessment rate reflects the rate for SAIF-assessable deposits, which remained the same throughout 1998.

For the BIF in 1998, investments in U.S. Treasury obligations continued to be the main component of total assets, at 94.4 percent, compared to 93.8 percent in 1997. The financial position of the BIF continued to improve as cash and investments at year-end were 92 times total liabilities, up from 85.6 times the total liabilities in 1997. In 1998, the BIF had operating expenses of \$697.6 million and net income of \$1.3 billion, compared to operating expenses of \$605 million and net income of \$1.4 billion in 1997.

### Savings Association Insurance Fund

The SAIF ended 1998 with a fund balance of \$9.8 billion, a 5.0 percent increase over the year-end 1997 balance of \$9.4 billion. Estimated insured deposits increased by 2.8 percent in 1998. During the year, the reserve ratio of the SAIF grew from 1.36 percent of insured deposits to 1.39 percent.

For both semiannual assessment periods of 1998, the Board retained the rate schedule in effect for 1997, a range of 0 to 27 cents annually per \$100 of assessable deposits. Under this schedule, the percentage of SAIF-member institutions that paid no assessments increased from 90.9 percent in the first semiannual assessment period to 91.9 percent in the second half of the year, as more institutions qualified for the lowest-risk assessment rate category. This rate schedule resulted in an average 1998 SAIF rate of 0.21 cents per \$100 of assessable deposits.

The SAIF earned \$15 million in assessment income in 1998, compared to \$563 million in interest income. In 1998, the SAIF had operating expenses of \$85 million and net income of \$467 million, compared to operating expenses of \$72 million and net income of \$480 million in 1997. For the second consecutive year, no SAIF-member institution failed in 1998.

Under the Deposit Insurance Funds Act of 1996, the FDIC must set aside all SAIF funds above the statutorily required Designated Reserve Ratio (DRR) of 1.25 percent of insured deposits in a Special Reserve on January 1, 1999. No assessment credits, refunds or other payments can be made from the Special Reserve unless the SAIF reserve ratio falls below 50 percent of the DRR and is expected to remain below 50 percent for the following four quarters. Effective January 1, 1999, the Special Reserve was funded with \$978 million, reducing the SAIF unrestricted fund balance to \$8.9 billion and the SAIF reserve ratio to 1.25 percent.

The SAIF Special Reserve was mandated by Congress in the Deposit Insurance Funds Act. It was not proposed in order to address any deposit-insurance issues. However, by eliminating any cushion above the DRR, the creation of the Special Reserve on January 1, 1999, increases the likelihood of the SAIF dropping below the DRR. This, in turn, increases the possibility that the FDIC would be required to raise SAIF assessment rates sooner or higher than BIF assessment rates, resulting in an assessment rate disparity between the SAIF and the BIF. In 1998, legislation that would have eliminated the Special Reserve was introduced in the Congress but did not pass.

### **FSLIC Resolution Fund**

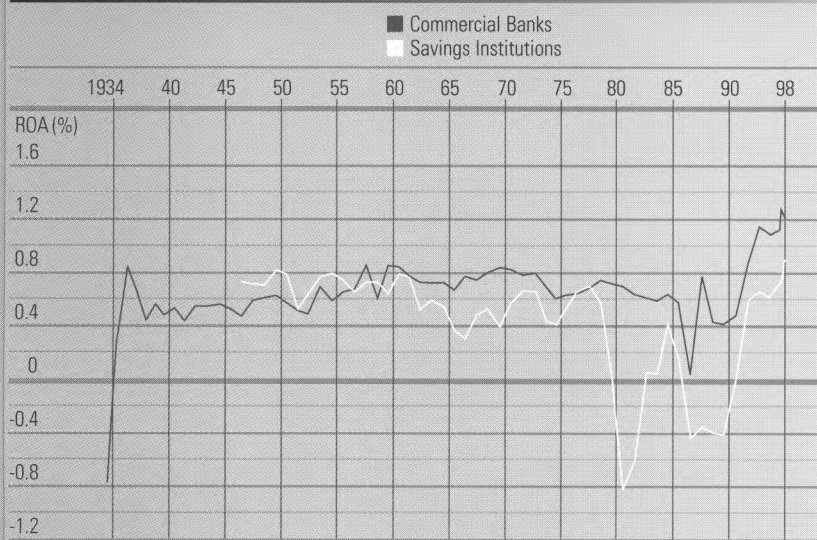
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The FRF was established by law in 1989 to assume the remaining assets and obligations of the former FSLIC arising from thrift failures before January 1, 1989. Congress placed this new fund under FDIC management on August 9, 1989, when FSLIC was abolished. 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 pool, composed of the assets and liabilities of the FSLIC, transferred to the FRF upon the dissolution of the FSLIC on August 9, 1989 (FRF-FSLIC). The other pool, composed of the RTC's assets and liabilities, transferred to the FRF on January 1, 1996 (FRF-RTC). The assets of one pool are not available to satisfy obligations of the other. The FRF-FSLIC had resolution equity of \$2.098 billion as of December 31, 1998, and the FRF-RTC had resolution equity of \$8.224 billion as of that date.



## Annual Return on Assets (ROA) FDIC-Insured Institutions 1934-1998



Note:  
Savings institution data not available prior to 1947.

The economic environment remained largely favorable for commercial banks and savings institutions in 1998. These favorable conditions were reflected in record earnings for both industries. Commercial bank earnings set a new record for the seventh consecutive year, surpassing \$60 billion for the first time, while savings institutions enjoyed their second consecutive year of record profits, passing \$10 billion for the first time. Never before had both industries registered a return on average assets (ROA) above one percent. They overcame declining net interest margins and higher expenses related to mergers and restructuring charges with the help of strong growth in assets and fee income, and relatively low expenses for credit-quality problems. Only three commercial banks failed during the year and, for the second consecutive year, no insured savings institution failed. The following is an overview of conditions in these two industries.

### Commercial Banks

Insured commercial banks posted record earnings of \$61.9 billion in 1998, an increase of \$2.8 billion (4.7 percent) from 1997 results. Commercial bank performance benefited from strong asset growth and a continued rise in fee income. Industry assets rose by \$425 billion (8.5 percent) during the year, led by a \$264 billion (9.1 percent) increase in loans. The growth in interest-earning assets helped lift net interest income by \$8.3 billion (4.7 percent) above the 1997 level. Noninterest income was \$19.2 billion higher than in 1997, reflecting very strong growth in fee income. In addition to these positive factors, banks earned \$1.3 billion more from sales of securities in 1998 than in 1997.

The improvement in earnings was limited by a \$24.1 billion increase in noninterest expense, a \$2.4 billion increase in loan-loss provisioning, and a 14-basis point decline in the average net interest margin. Restructuring charges related to mergers at several large institutions accounted for much of the rise in noninterest expenses. The higher provisions for credit losses mirrored an increase in charge-offs and noncurrent loans. The decline in the industry's net interest margin—the difference between the average yield on interest-bearing assets and the average cost of funding those assets—was caused by a combination of declining asset yields and rising funding costs. The year marked the sixth consecutive time that the industry's margin declined, and the 14-basis point drop was the steepest year-to-year decline since 1974-75, when it fell by 30 basis points.

The average ROA fell to 1.19 percent in 1998 from 1.23 percent in 1997. Despite the decline, 1998 was the sixth consecutive year that the industry's ROA had been above one percent, a level first achieved by the industry in 1993. Almost two out of every three banks (63.2 percent) registered an ROA of one percent or better in 1998. Almost as many (61.8 percent) reported higher earnings than in 1997.

Business loan growth was especially strong in 1998. Loans to commercial and industrial borrowers increased by \$103 billion (12.9 percent), while real estate loans secured by commercial properties grew by \$30 billion (8.9 percent) and construction and land development loans rose by

\$18 billion (20.9 percent). In addition to the growth in direct loans, banks' holdings of mortgage-backed securities increased by \$86 billion (22.4 percent). Banks continued to expand their credit card lending, but the amount of credit card loans on banks' balance sheets declined by \$2 billion during 1998 because of an increase in securitization activity. The amount of credit card loans securitized and sold by banks rose by \$63 billion in 1998 to \$254 billion at year-end. These securitized receivables now exceed the amount of credit card loans remaining on banks' balance sheets.

A fourth-quarter surge helped deposits register their largest annual percent increase since 1986. Total deposits increased by \$260 billion (7.6 percent) during 1998. Nevertheless, deposit growth failed to keep pace with growth in total assets, and the share of commercial bank assets that are funded by deposits declined for the seventh consecutive year. As recently as 1991, deposits funded 78.3 percent of commercial bank assets. At the end of 1998, deposits funded slightly more than two out of every three dollars of assets (67.7 percent). The shortfall in deposit funding was covered by growth in nondeposit borrowings and equity capital.

Asset quality deteriorated slightly in 1998, as both credit losses and noncurrent loans increased. Banks charged off \$20.7 billion in loans in 1998, an increase of \$2.4 billion (13.0 percent) over 1997. Noncurrent loans increased for the first year since 1990, rising by \$2.7 billion. For the fourth time in as many years, credit card loans comprised more than half of all loans charged off by commercial banks. Net charge-offs of credit

card loans totaled \$11.5 billion in 1998, or 55.4 percent of all loan charge-offs. The increase in noncurrent loans was led by a \$2.2 billion rise in noncurrent commercial and industrial loans. Despite the growth in noncurrent loans, the percentage of loans that were noncurrent at year-end (0.96 percent) was unchanged from a year earlier because of growth in banks' loan portfolios. This noncurrent rate is only slightly above the record low level of 0.94 percent, reached at the end of the second and third quarters of 1998.

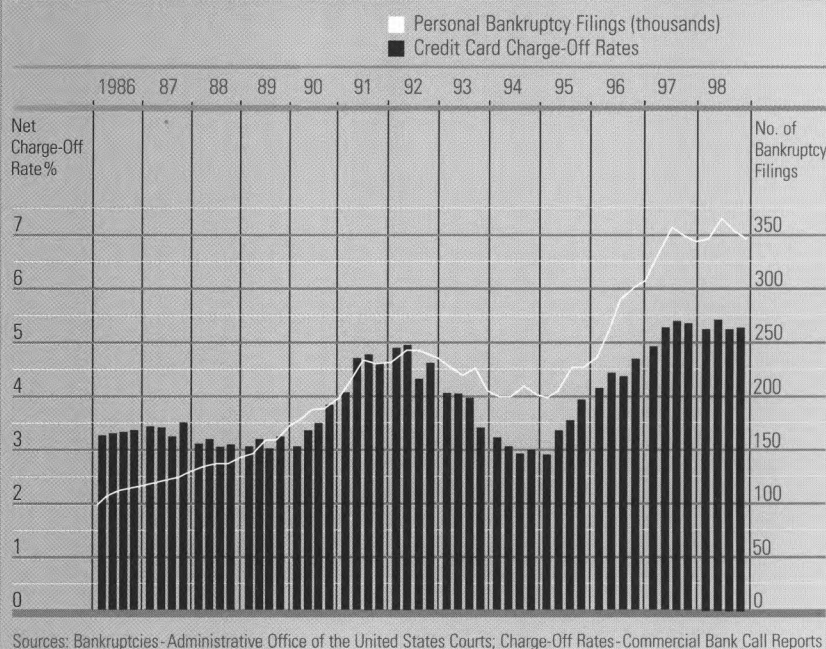
The number of insured commercial banks declined for the 14th year in a row. At year-end 1998, there were 8,774 commercial banks reporting financial results, a decline of 368 banks during the year. Mergers absorbed 557 banks, and three banks failed, while there were 190 new banks chartered and two noninsured institutions

became insured. At year-end 1998, there were 5,708 fewer insured commercial banks than at the end of 1984, a decline of 39.4 percent. The number of commercial banks on the FDIC's "Problem List" declined from 71 institutions to 69 (with \$5.4 billion in assets) during the year.

### Savings Institutions

Insured savings institutions earned \$10.2 billion in 1998, an increase of \$1.4 billion (15.6 percent) from 1997. Noninterest income was \$2.2 billion (30.9 percent) higher than in 1997, and gains from sales of securities and other assets were \$1.2 billion (95.0 percent) higher. Earnings also received a boost from increased net interest income

### Credit Card Losses and Personal Bankruptcy Filings 1986-1998 (by quarter)



Sources: Bankruptcies - Administrative Office of the United States Courts; Charge-Off Rates - Commercial Bank Call Reports

(up \$554 million, or 1.9 percent) and lower credit-loss provisions (down \$413 million, or 18.9 percent). These improvements were partially offset by a \$2.5 billion (11.7 percent) rise in noninterest expenses. The industry's ROA rose to 1.01 percent in 1998 from 0.93 percent in 1997. For the first year since 1946, federally insured thrifts posted an ROA above one percent. Unlike the commercial banking industry, high profitability was not as widespread among insured savings institutions. Fewer than one in three thrifts (30.5 percent) had an ROA of one percent or higher in 1998, but this group included many of the largest savings institutions. Smaller thrifts were generally less profitable than their larger counterparts.

As with commercial banks, insured savings institutions experienced a sharp decline in net interest margins in 1998. For the year, the thrift industry's net interest margin was 3.10 percent, down from 3.23 percent in 1997. The modest improvement in net interest income in 1998 was entirely the result of strong asset growth. Assets of savings institutions increased by over \$61 billion (6.0 percent) during 1998, the largest increase in industry assets in 10 years.

The increase in thrift industry assets in 1998 consisted primarily of assets other than loans. In an environment of low interest rates, most residential mortgage loan demand was for fixed-rate loans; a considerable share of mortgage lending in 1998 represented refinancing of higher-rate, fixed-rate mortgages and adjustable-rate mortgages. Lenders preferred not to retain these long-term, fixed-rate assets, opting instead

to securitize and sell many new mortgage loans. While thrifts' 1-to-4 family residential mortgage loans increased by \$11 billion (2.2 percent) in 1998, their holdings of mortgage-backed securities grew by \$26 billion (14.6 percent).

Deposit growth at savings institutions in 1998 was negligible. Total deposits increased by only \$395 million (0.1 percent). Funding for asset growth came from nondeposit borrowings, including Federal Home Loan Bank advances. Equity capital increased by over \$5 billion (5.7 percent) in 1998, but the industry's equity-to-assets ratio fell slightly, from 8.71 percent at year-end 1997 to 8.68 percent at year-end 1998.

The number of insured savings institutions declined by 93 institutions in 1998. Mergers absorbed 114 thrifts, while 28 new savings institutions were chartered—the largest number since 1990. Thrifts converting to commercial bank charters accounted for most of the remaining reduction in thrift numbers. For the second consecutive year, no insured savings institutions failed. The number of insured thrifts on the FDIC's "Problem List" fell from 21 to 15 during 1998. Assets of "problem" thrifts totaled \$5.9 billion at year-end.



The Year 2000 date change presents challenges for the financial services industry and its regulators. If this issue is not addressed, computers may be unable to record and process information accurately.

The Year 2000 challenge was the FDIC's highest safety-and-soundness priority in 1998. The Corporation took aggressive action during the year to address the Year 2000 date change, including issuing guidance to financial institutions, performing outreach activities, conducting comprehensive on-site assessments at banks, training staff and preparing contingency plans. The FDIC also addressed the effects of the Year 2000 date change on its own automated systems.

The FDIC, in partnership with the other agencies of the Federal Financial Institutions Examination Council (FFIEC), issued substantial guidance to the industry in 1998 on how to address certain Year 2000-related issues. The guidance states that banks should ensure the involvement of the board of directors and management in Year 2000 efforts, adopt written project plans, renovate mission-critical systems, complete tests of the renovated systems by specific deadlines, plan for contingencies, appropriately manage Year 2000 risk posed by customers and develop Year 2000 customer awareness programs. Milestone dates by which financial institutions should accomplish certain Year 2000-related responsibilities are prescribed in the guidance.

To maintain open communication with the banking industry about Year 2000 issues, the FDIC and the FFIEC conducted an extensive nationwide banker outreach program in conjunction with industry trade

organizations in 1998. The FDIC took part in more than 130 one-day seminars addressing regulatory expectations in the areas of testing and contingency planning. More than 11,000 bankers attended these sessions. Other Year 2000 outreach activities in 1998 included co-sponsoring a summit meeting on behalf of the President's Council on Year 2000 Conversion Financial Institution Sector Group; and monthly publication of an FDIC Year 2000 newsletter, which discusses important current issues and reminds bankers of regulatory expectations.

### Customer Awareness

The FFIEC guidance requiring all FDIC-insured financial institutions to establish Year 2000 customer awareness programs underscores the FFIEC's belief that institutions have a responsibility to inform bank customers about the Year 2000 issue and the steps they are taking to minimize the potential for glitches. To help insured financial institutions comply with the FFIEC's guidance, the FDIC developed several publications in 1998 that bankers can use to educate their customers about the Year 2000 issue.

The first was a consumer brochure, *The Year 2000 Date Change*, which answers basic consumer questions about the Year 2000 issue. The brochure, developed by the FDIC in conjunction with the FFIEC, has a two-pronged message: first, that the FDIC and other federal banking agencies are taking strong action to assure the banking industry is ready for the new millennium; and second, that depositors' funds will continue to be protected by FDIC insurance. The FDIC provided all FDIC-insured institutions with camera-ready versions of the brochure, in both English and Spanish, so they could reproduce copies of the brochure for their customers. The brochure has been well-received by consumers and financial institutions alike, and more than 10 million copies were distributed to consumers in 1998. The brochure is also posted on the FDIC's Web site.



Mattox Photography

▲ The FDIC's Year 2000 project managers meet frequently to discuss the banking industry's progress in achieving Y2K readiness.

# The Year 2000 Date Change

What the  
Year 2000 Date Change  
Means to **You** and **Your**  
Financial Institution



▲ The Year 2000 Date Change brochure for banking customers highlights the efforts of financial institutions and the Federal Financial Institutions Examination Council (FFIEC) to address the potential effects of the Year 2000 date change.

To help insured financial institutions get the FDIC's Year 2000 message across to an even larger audience, the FDIC developed a "statement stuffer" that institutions can conveniently include in customer account mailings. The FDIC's Year 2000 statement stuffer, which briefly emphasizes the two main messages in the consumer brochure, was sent to all insured financial institutions in late 1998. The statement stuffer is expected to be even more popular than the brochure.

In another major initiative to educate the public on the Year 2000 issue, the FDIC has devoted substantial coverage to the topic in its quarterly *FDIC Consumer News*. Three of four issues of the newsletter published in 1998 included articles on the Year 2000 challenge. The fall issue was devoted entirely to Year 2000—related topics of interest to consumers, including features on the efforts of federal banking regulators and banking institutions to protect bank customers, a list of steps consumers can take to help protect themselves, and an interview with Chairman Tanoue. *FDIC Consumer News* has a regular distribution to more than 50,000 homes, banks, consumer organizations, and other readers. To assure that this special Year 2000 edition reaches as broad an audience as possible, the FDIC also arranged to make the publication available through insured financial institutions and the federal Consumer Information Center in Pueblo, CO. *FDIC Consumer News* is also posted on the FDIC's Web site.

Along with these highly visible efforts, the FDIC took action to assure that its staff who answer consumer inquiries are trained on the Year 2000 issue. The volume of Year 2000 consumer inquiries

was relatively small in 1998—with only 38 inquiries for the year. However, consumer inquiries are expected to increase in 1999, and the FDIC has taken steps to ensure it is ready to handle consumer questions appropriately. In early 1999, the FDIC established a toll-free Year 2000 Call Center to answer the public's calls about Y2K.

## On-Site Assessments

By May 31, 1998, the FDIC's bank examiners, with assistance from state bank regulators, completed the first round of on-site Year 2000 assessments for FDIC-supervised institutions. FDIC examiners also completed on-site assessments of all data service providers and vendors that the FDIC is responsible for examining. In these on-site assessments, examiners determined whether the board and senior management were actively involved in their institution's Year 2000 projects, whether their Year 2000 programs were comprehensive, and whether they understood regulatory requirements. Examiners also assessed whether institutions properly identified the scope of the Year 2000 issue and the resources that would be required to address technical problems.

The results indicated that the vast majority of financial institutions, as well as their service providers and software vendors, recognize the risk of the Year 2000 date change and are acting to address the issue. At year-end 1998, approximately 97 percent of FDIC-supervised institutions were making satisfactory progress toward achieving Year 2000 readiness. During 1999, examiners will continue to follow up on weaknesses detected in the first round of on-site examinations and, by March 31, will complete a second round that began in the latter half of 1998.


### Internal Compliance

The FDIC has a rigorous, centralized strategy to address internal Y2K issues that should result in a smooth transition of its automated systems in the Year 2000.

The Corporation is adhering to timeframes established in guidance from the U.S. Office of Management and Budget (OMB) and the U.S. General Accounting Office for five stages of Year 2000 project management: awareness, assessment, renovation, validation, and implementation. The FDIC completed the renovation phase at the end of August 1998 in accordance with the OMB schedule, and at year-end was on schedule to continue meeting the other timeframes in the guidance.

The FDIC's strong management efforts should enable the Corporation to continue business as usual after January 1, 2000.

Special Report  
on the Year 2000



# Consumer News

Fall 1998

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The Year 2000, Your Bank and You

**The government and the banking industry are working to keep the Y2K computer bug from affecting bank customers. Here's an FDIC guide to what you need to know and do to be ready.**

The scenario for the "Year 2000" situation may seem like something created by Hollywood. Computer experts warn that systems worldwide could go haywire when midnight strikes on January 1, 2000. The news touches off a global rescue effort—a race against the clock—to ensure that our most basic services,

from water and electricity to medical care and banking, will continue with little or no interruption.

In the movies, the "good guys" usually have just seconds or minutes to solve the problem. But in the real-world story of the Year 2000 (also known as

continued on next page

▲ **The fall 1998 issue of the FDIC Consumer News was devoted entirely to Year 2000 topics, including government efforts to protect bank customers and steps consumers can take to help protect themselves.**

The FDIC faced the challenge of supervising an increasingly global banking industry during 1998. In that role, the Corporation took a number of steps in the international arena, such as monitoring foreign economies, supervising international banking activities, providing technical assistance to foreign supervisors and deposit insurers, and promoting cooperation and coordination among foreign bank supervisors.

## Monitoring Foreign Economies

By monitoring foreign economies, the agency was able to assess the risks of current and emerging international issues to the FDIC's deposit insurance funds. 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. In many countries throughout the world, the economic turmoil contributed to deterioration in the international banking sector's capital levels, asset quality and profitability. As a result, bank failures in some countries increased and worldwide confidence in the global economic system declined.

During 1998, the FDIC took appropriate actions to minimize any adverse impact on its deposit insurance funds resulting from deterioration in foreign economies. For instance, FDIC economists from the Division of Research and Statistics and Division of Insurance studied the indirect risks to U.S. banks of international lending resulting from the increased linkages of world economies. These linkages have become stronger

in recent years due to increased international trade and increased capital flows to and from emerging economies around the world, particularly East Asia, Eastern Europe and Latin America. Greater economic linkages among world economies increase the likelihood that one country's economic woes will adversely affect other countries. In an attempt to quantify the effects of indirect risks caused by trade fluctuations, FDIC economists are developing statistical models to measure the degree of international linkages and risks among world financial markets. These models will better enable the FDIC to determine the degree of risk to the insurance funds that may result from the international activities of FDIC-insured institutions.

## Supervising International Banking Activities

The FDIC Division of Supervision's (DOS) on-site and off-site supervisory programs continued to focus on the increasing globalization of banking during 1998. DOS staff conducted quarterly reviews of foreign banking operations (FBOs) that have insured operating subsidiaries or branches in the U.S. These quarterly FBO reviews included detailed analyses of parent institutions, financial issues and current developments in home countries. The FDIC also closely reviewed U.S. banking organizations'

cross-border exposures, which result from their issuance of debt or off-balance sheet contracts to international entities. Along with the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, the FDIC is a member of the Interagency Country Exposure Review Committee (ICERC), which assesses transfer risk (the risk that a foreign debtor will not be able to obtain dollars to repay U.S. creditors) in those countries to which U.S. banks have cross-border exposures. The FDIC chaired the ICERC during 1998.

## Sharing Expertise With Other Countries

Over its 65-year history, the FDIC has accumulated a wealth of knowledge and experience that it shares with bank supervisors and deposit insurers around the world. Of particular interest is the FDIC's success in resolving the banking crisis that occurred in the 1980s and early 1990s, without a single loss to an insured depositor. The FDIC's success in resolving failing institutions enabled the nation to maintain confidence in the U.S. banking system.



▲ **Vijay Deshpande (l), Director of FDIC's Office of Internal Control Management, talks with Central Bank officials from Sri Lanka (center) and Malaysia at the FDIC-sponsored international conference on deposit insurance in September.**

W.W.Reid



The FDIC shared its expertise by providing technical advice to foreign supervisory authorities and deposit insurers. Technical advice is a relatively low-cost method of helping to improve the operations of foreign supervisory authorities and deposit insurers. It may contribute to the stability of foreign markets and reduce any adverse impact that international events may have on the FDIC's deposit insurance funds. During 1998, the FDIC met with representatives from Japan, Korea, Nigeria, Kenya, Croatia, Malaysia, Lithuania, England, Thailand, Slovakia, the Philippines, and other countries. The FDIC addressed a number of the foreign representatives' concerns, including how to liquidate failed-bank asset portfolios without damaging market or investor confidence.

The FDIC also provided training to supervisory personnel of foreign banking authorities. In conjunction with the Association of Banking Supervisory Authorities of Latin America and the Caribbean, the Corporation established a training curriculum on internal routines and controls, and the resolution process for failing institutions. The FDIC, through DOS, also participates in an ongoing effort with the Asian-Pacific Economic Cooperation Forum (APEC) to improve bank supervisory training in APEC-member countries. Further, the FDIC provided foreign supervisory authorities with the opportunity to gain hands-on experience in U.S. bank examinations. Throughout 1998, a number of foreign bank supervisors observed on-site examinations of banks to learn more about how the FDIC supervises U.S. institutions.

### **Promoting Cooperation Among Foreign Bank Supervisors**

The FDIC consistently promotes cooperation and coordination among international supervisory authorities, resulting in stronger and more consistent supervisory standards. This, in turn, decreases risk to the FDIC's deposit insurance funds.

During 1998, the FDIC participated in a number of international efforts that promoted cooperation and coordination among bank supervisors around the world. The FDIC is a member of the Basle Committee on Banking Supervision, which formulates broad standards and guidelines for each of the member countries. The FDIC is an active participant in many facets of the Basle Committee's work, including subgroups and task forces that focus on such issues as capital, risk management and the Year 2000. During 1998, the FDIC provided extensive input on a number of important supervisory topics, including managing risks associated with electronic banking, improving public disclosure of international banking organizations and implementing strong internal control systems. Throughout 1998, DOS staff also worked with the U.S. Department of the Treasury on projects mandated by the Group of Seven (G-7) countries and the Group of Twenty-Two (G-22) countries. The G-7 and G-22 projects focused on strengthening international financial systems, including banking systems, improving information-sharing between domestic and foreign regulators and improving disclosure by banking organizations.

In September 1998, the FDIC hosted the International Deposit Insurance Conference in Washington, DC. The conference was the first of its kind to bring together deposit insurance authorities from around the world. Top government officials from 62 countries, including leaders of deposit insurance agencies from more than 20 nations, attended the conference. Keynote speakers included FDIC Chairman Donna Tanoue; Deputy Secretary of the Treasury Lawrence H. Summers; First Deputy Managing Director, International Monetary Fund, Stanley Fisher; and former FDIC Chairman Ricki Helfer. Discussion focused on the role of deposit insurance in maintaining public confidence in the world's banking systems. Other topics addressed were past strategies used to restore stability to various financial sectors, and the strategies' applicability in addressing problems that may arise in the international arena in the future.

Supervising an increasingly global banking industry will likely continue to be one of the FDIC's primary challenges in the future. The Corporation will remain diligent in its efforts to respond to international issues in order to maintain the stability of the FDIC's deposit insurance funds and further strengthen public confidence in the U.S. banking system.

Since 1933, the FDIC has contributed to the stability of the U.S. banking system. The FDIC's insurance program is designed to achieve three goals: provide insured depositors timely access to their funds in the event of a bank failure; ensure the viability of the insurance funds as risks and economic conditions change; and promote bank customers' understanding of the deposit insurance rules.

In 1998, the FDIC gave much attention to the scope and nature of deposit insurance in light of several ongoing trends. One was financial modernization, or the actual or proposed expansion of banking organizations into additional lines of business. Another was the changing nature of the global marketplace, where larger and more complex banks are taking on new businesses and risks. These and other trends spurred the FDIC to undertake a variety of initiatives in the administration of its insurance program in 1998.

### Addressing Risks to the Funds

The ongoing debate over financial modernization raises fundamental questions with respect to the structure of banks and the role of deposit insurance. As continued innovations in technology and information services allow financial service providers to offer a full range of products, the distinction between banking and nonbanking organizations has become increasingly blurred. The challenge for policymakers is to provide a statutory and regulatory framework that allows the financial services industry to evolve while maintaining the safety and soundness of

individual insured institutions, the stability of the financial system and a level competitive playing field. The FDIC has supported initiatives that would expand the range of activities permissible for banking organizations, if the activity poses no significant safety-and-soundness concerns. Further, the FDIC has supported the ability of banking organizations to have the flexibility to choose the corporate or organizational structure that best suits their needs, provided adequate safeguards exist to protect the insurance funds and the taxpayer.

On January 29, 1998, the FDIC sponsored a symposium to promote a discussion of the role and nature of deposit insurance. The audience included bankers, regulators, consumer and trade group representatives, academics and congressional staff members. A wide range of opinions was expressed and a number of interesting ideas deserving further consideration were discussed. Among the issues covered were the use of additional information for determining risk-based insurance premiums; the appropriate reserve-ratio target and other matters relating to management of the deposit insurance funds; proper coverage levels and funding arrangements for small versus large institutions; and ways to enhance the FDIC's ability to identify, analyze and act on risks to the insurance funds and the banking industry.

In an effort to identify and respond to these risks more quickly and effectively, the FDIC continued to refine the examination process to emphasize an institution's risk-management systems and the risks each individual institution faces. Examiners look beyond the static condition of an institution to how well it can respond to changing market conditions.

In addition, analysts in the Division of Insurance (DOI) closely monitor trends in the financial services industry and the economy, and work closely with FDIC examiners to help assess emerging risk exposure for individual banks and groups of banks by providing comprehensive regional economic data and analysis. Articles in the 1998 issues of *Regional Outlook*, DOI's quarterly publication, addressed topics such as mergers and consolidations in the banking and thrift industries, lending concentrations in real estate, the Asian crisis, volatility in financial markets, and the Year 2000 issue. Another resource, "The Regional Economic Condition Report for Examiners," or RECON, is an Internet-based application introduced by the FDIC in 1998 to provide supervisory personnel quick and easy access to a wealth of local economic data.

The risk-related premium system is another means through which the FDIC can address risks in the banking industry. The Corporation is required to maintain a deposit insurance premium schedule that reflects the risks posed to the insurance funds by member institutions. While the current nine-category premium schedule is based primarily on capital ratios and examination ratings, the FDIC is authorized to consider other information when assigning institutions to particular risk categories.

Twice a year, the FDIC sets deposit insurance assessment rates for members of the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). These rate schedules are supported by analysis of the probable losses to the funds, failure-resolution expenditures and income, expected operating expenses, revenue needs of the insurance funds, the impact of assessments upon insured institutions, and any other factors that the Board deems relevant.



Throughout 1998, the FDIC and other banking agencies identified the possible build-up of risk in the banking system due to easing credit standards. Regulators observed that a growing number of institutions exhibited risky loan concentrations, poor underwriting practices, and weak internal controls. These signals were particularly troubling because they appeared against a backdrop of global instability, as the financial crisis in Asia deepened and economic shock waves from Russia jolted Brazil and other countries.

In light of these indications of increased risk at the same time that 95 percent of all insured institutions were classified into the lowest risk category of the premium schedule, the Corporation intensified its efforts to ensure that the risk-based premium system incorporates all relevant information regarding fund risk exposure. As 1998 ended, the FDIC was engaged in discussions with bankers and other banking regulators on ways to use additional information from the supervisory process, financial reports, and the market to enhance the risk classifications used for setting deposit insurance premiums.

### Efforts to Promote Public Understanding

In 1998, the FDIC employed a variety of methods to provide deposit insurance information to insured financial institutions and the public. The FDIC's primary means of answering questions from bankers and the public is through its toll-free Consumer Affairs Call Center (1-800-934-3342). During the year, more than half of the inquiries answered by the Call Center concerned FDIC deposit

insurance. The FDIC answered another 730 deposit insurance inquiries received through regular mail and electronic mail. The volume of deposit insurance inquiries increased approximately 50 percent in 1998, due largely to the FDIC's efforts to increase public awareness of its deposit insurance education program.

A major FDIC initiative during the year was developing the Electronic Deposit Insurance Estimator, or "EDIE," a user-friendly Internet application that consumers and bankers can use to calculate the amount of insurance coverage for deposit accounts at FDIC-insured institutions. EDIE is accessible to novice computer users with no prior knowledge of deposit insurance. EDIE also provides links to other FDIC Web sites that provide useful information for consumers. EDIE can be found on the FDIC's Web site at [www2.fdic.gov/edie](http://www2.fdic.gov/edie).

The FDIC maintains a number of consumer brochures and banker training guides on deposit insurance. These documents, which are published by the FDIC and disseminated widely by the agency and FDIC-insured institutions, are tailored to the specific needs of financial institution customers and employees. In 1998, the FDIC updated its most popular brochure for consumers, *Your Insured Deposit*, to reflect simplified amendments to the deposit insurance rules adopted by the FDIC during the

year. The FDIC distributed more than 10 million copies of *Your Insured Deposit* in 1998. Copies of all the FDIC consumer brochures and training materials for bankers are available on the FDIC's Web site.

The FDIC routinely publishes articles on deposit insurance topics of interest to consumers and bankers in quarterly editions of *FDIC Consumer News*, a free publication distributed to consumer organizations, individual consumer subscribers and bankers. *FDIC Consumer News* is also available on the FDIC's Web site.

Another facet of the FDIC's deposit insurance education program is training seminars for employees of FDIC-insured institutions. During 1998, the FDIC conducted 29 seminars on the deposit insurance rules. These seminars were held across the nation and attended by approximately 2,000 representatives from almost 700 FDIC-insured financial institution employees. Participants received an in-depth review of the deposit insurance regulations and interagency guidelines for the retail sale of mutual funds and other nondeposit investments by financial institutions.



▲ The FDIC's electronic deposit insurance estimator—"EDIE"—allows consumers and bankers to easily calculate the amount of insurance coverage for deposit accounts at FDIC-insured institutions. EDIE (and the onscreen helper, "Edie") appears on the FDIC's Web page.



▲ **FDIC Board of Directors:**  
(seated) Donna Tanoue,  
(standing, l-r) John D. Hawke, Jr.,  
Ellen S. Seidman, Andrew C. Hove, Jr.

## Donna Tanoue

Ms. Tanoue is the 17th Chairman of the Federal Deposit Insurance Corporation. Appointed Chairman by President William Clinton, she took office on May 26, 1998. Prior to her appointment, she was a partner in the Hawaii law firm of Goodsill Anderson Quinn & Stifel, where she specialized in banking, real estate finance and governmental affairs.

From 1983 to 1987, Ms. Tanoue was Commissioner of Financial Institutions for the State of Hawaii. As Commissioner, her responsibilities included the enforcement of state laws governing banks, savings and loan associations, trust companies, industrial loan companies and credit unions. She is noted for having provided the stewardship for the smooth conversion of industrial loan companies from private insurance coverage to FDIC membership after an unprecedented series of loan company failures shook the financial community.

Ms. Tanoue served as Special Deputy Attorney General to the Department of Commerce and Consumer Affairs for the State of Hawaii from 1981 to 1983, upon her return from the Georgetown University Law Center, where she received her Juris Doctor degree in 1981.

In 1995, Ms. Tanoue was appointed to serve as a member of the Board of Regents of the University of Hawaii, where she had received her undergraduate degree in 1977. She was elected Vice Chair of the Board of Regents in June 1997, serving until March 1998.

Ms. Tanoue held positions as an officer, director, or trustee for the following community organizations: the Aloha United Way, Palama Settlement, High Technology Development Corporation, Maximum Legal Services Corporation, Legal Aid Society of Hawaii, and Historic Hawaii Foundation. She also served as a community advisory board member for Time-Warner Communications of Hawaii, L.P., and Oceanic Cablevision.

### Andrew C. Hove, Jr.

Mr. Hove was appointed to his second term as Vice Chairman of the FDIC in 1994. His first term as Vice Chairman began in 1990. Since 1991, Mr. Hove has served as Acting Chairman of the FDIC three times, most recently from June 1, 1997, when Chairman Ricki Helfer resigned, to May 26, 1998, when Donna Tanoue was sworn in as the 17th Chairman. Before joining the FDIC, Mr. Hove was Chairman and Chief Executive Officer of the Minden Exchange Bank & Trust Company, Minden, Nebraska, where he served in every department during his 30 years with the bank.

Also involved in local government, Mr. Hove was Mayor of Minden from 1974 until 1982 and was Minden's Treasurer from 1962 until 1974.

Other civic activities included serving as President of the Minden Chamber of Commerce, President of the South Platte United Chambers of Commerce and positions associated with the University of Nebraska. Mr. Hove also was active in the Nebraska Bankers Association and the American Bankers Association.

Mr. Hove earned his B.S. degree at the University of Nebraska-Lincoln. He also is a graduate of the University of Wisconsin-Madison Graduate School of Banking. After serving as a U.S. naval officer and naval aviator from 1956 to 1960, Mr. Hove was in the Nebraska National Guard until 1963.

### Ellen S. Seidman

Ms. Seidman became Director of the Office of Thrift Supervision (OTS) on October 28, 1997. As OTS Director, Ms. Seidman is also an FDIC Board member.

Ms. Seidman joined the OTS from the White House, where from 1993 to 1997 she was Special Assistant to President Clinton for economic policy at the White House National Economic Council. She chaired the interagency working group on pensions and dealt with such issues as financial institutions, natural disaster insurance, bankruptcy and home ownership.

From 1987 to 1993, Ms. Seidman served in various positions at Fannie Mae, ending her career there as Senior Vice President for Regulation, Research and Economics. Other prior positions include Special Assistant to the Treasury Undersecretary for Finance from 1986 to 1987, and Deputy Assistant General Counsel at the Department of Transportation from 1979 to 1981. Ms. Seidman also practiced law for three years beginning in 1975 with Caplin & Drysdale, a Washington, DC, law firm specializing in tax, securities and bankruptcy issues.

Ms. Seidman received an A.B. degree in government from Radcliffe College, an M.B.A. from George Washington University and a J.D. from Georgetown University Law Center.

### John D. Hawke, Jr.

Mr. Hawke was sworn in as the 28th Comptroller of the Currency on December 8, 1998. As Comptroller, Mr. Hawke serves as an FDIC Board member.

Before his appointment as Comptroller, Mr. Hawke served for three-and-a-half years as Under Secretary of the Treasury for Domestic Finance. He oversaw the development of policy and legislation in the areas of financial institutions, debt management and capital markets.

Prior to joining the Treasury Department, Mr. Hawke was a senior partner at the Washington, DC, law firm of Arnold & Porter, which he first joined as an associate in 1962. At Arnold & Porter, he headed the financial institutions practice and, from 1987 to 1995, served as Chairman of the firm. In 1975, he left the firm to serve as General Counsel to the Board of Governors of the Federal Reserve System, but then returned in 1978.

From 1970 to 1987, Mr. Hawke taught courses on federal regulation of banking at the Georgetown University Law Center. He has also taught courses on bank acquisitions and financial regulation at the Morin Center for Banking Law Studies in Boston, where he continues to serve as Chairman of the Board of Advisors.

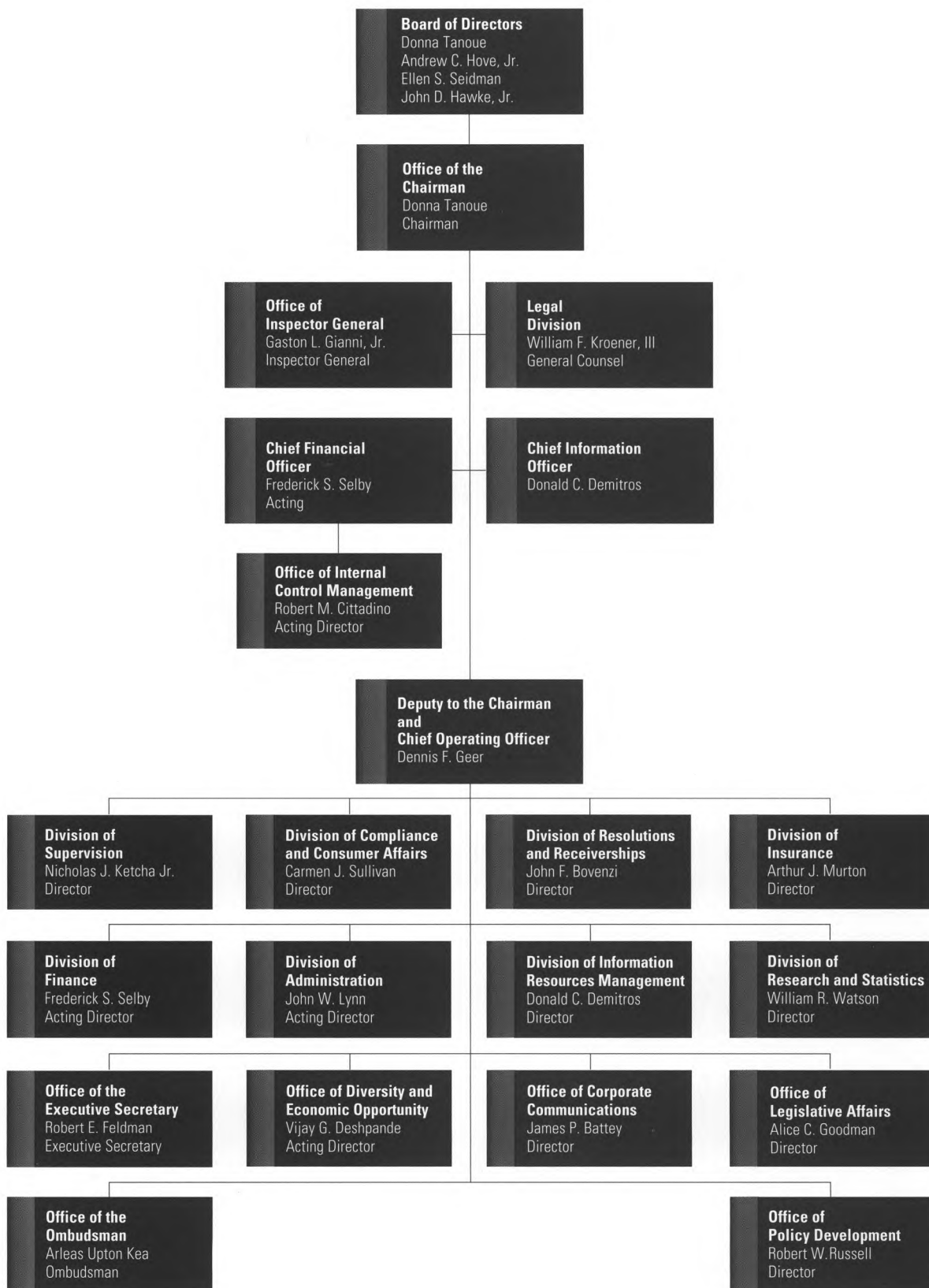
Mr. Hawke has written extensively on matters relating to the regulation of financial institutions, including the book *Commentaries on Banking Regulation* published in 1985. He received a B.A. in English from Yale University and is a graduate of the Columbia University School of Law, where he was Editor-in-Chief of the Columbia Law Review.

*Mr. Hawke succeeded Eugene A. Ludwig, whose five-year term as Comptroller of the Currency expired on April 4, 1998. Until Mr. Hawke's appointment, Julie L. Williams, Chief Counsel at the Office of the Comptroller of the Currency, was Acting Comptroller, also serving on the FDIC Board.*

# Organization Chart

as of December 31, 1998

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# 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.



▲ **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         |
|------------------------------|--------------|--------------|--------------|
| <b>Safety and Soundness:</b> |              |              |              |
| 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            |
| <b>Subtotal</b>              | <b>2,399</b> | <b>2,749</b> | <b>3,106</b> |
| Compliance/CRA               | 1,989        | 1,990        | 2,033        |
| Trust Departments            | 542          | 552          | 637          |
| Data Processing Facilities   | 1,335        | 1,514        | 1,681        |
| <b>Total</b>                 | <b>6,265</b> | <b>6,805</b> | <b>7,457</b> |

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](http://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.



▲ 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         |
|---|--------------|--------------|--------------|
| <b>Deposit Insurance</b>                  | <b>296</b>   | <b>238</b>   | <b>192</b>   |
| Approved                                  | 296          | 238          | 192          |
| Denied                                    | 0            | 0            | 0            |
| <b>New Branches</b>                       | <b>1,450</b> | <b>1,436</b> | <b>2,054</b> |
| Approved                                  | 1,450        | 1,435        | 2,054        |
| Branches                                  | 1,450        | 1,435        | 1,352        |
| Remote Service Facilities*                | NA           | NA           | 702          |
| Denied                                    | 0            | 1            | 0            |
| <b>Mergers</b>                            | <b>390</b>   | <b>419</b>   | <b>392</b>   |
| Approved                                  | 390          | 419          | 392          |
| Denied                                    | 0            | 0            | 0            |
| <b>Requests for Consent to Serve*</b>     | <b>304</b>   | <b>261</b>   | <b>873</b>   |
| 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            |
| <b>Notices of Change in Control</b>       | <b>34</b>    | <b>28</b>    | <b>46</b>    |
| Letters of Intent Not to Disapprove       | 34           | 28           | 46           |
| Disapproved                               | 0            | 0            | 0            |
| <b>Conversions of Insurance Coverage^</b> | <b>0</b>     | <b>0</b>     | <b>0</b>     |
| Approved                                  | 0            | 0            | 2            |
| Denied                                    | 0            | 0            | 0            |
| <b>Brokered Deposit Waivers</b>           | <b>10</b>    | <b>17</b>    | <b>15</b>    |
| Approved                                  | 9            | 17           | 15           |
| Denied                                    | 1            | 0            | 0            |
| <b>Savings Association Activities</b>     | <b>0</b>     | <b>2</b>     | <b>2</b>     |
| Approved                                  | 0            | 2            | 2            |
| Denied                                    | 0            | 0            | 0            |
| <b>State Bank Activities/Investments^</b> | <b>23</b>    | <b>46</b>    | <b>167</b>   |
| Approved                                  | 23           | 46           | 164          |
| Denied                                    | 0            | 0            | 3            |
| <b>Conversions of Mutual Institutions</b> | <b>30</b>    | <b>15</b>    | <b>26</b>    |
| 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  |
|---|--------------|--------|-------|
| <b>Total Number of Actions Initiated by the FDIC</b>              | <b>143</b>   | 127    | 186   |
| <b>Termination of Insurance</b>                                   |              |        |       |
| <b>Involuntary Termination</b>                                    |              |        |       |
| Sec. 8a For Violations, Unsafe/Unsound Practices or Condition     | 0            | 0      | 1     |
| <b>Voluntary Termination</b>                                      |              |        |       |
| Sec.8a By Order Upon Request                                      | 0            | 0      | 0     |
| Sec.8p No Deposits  | 5            | 6      | 3     |
| Sec.8q Deposits Assumed   | 4            | 7      | 17    |
| <b>Sec. 8b Cease-and-Desist Actions</b>                           |              |        |       |
| Notices of Charges Issued   | 2            | 3      | 3     |
| Consent Orders  | 21           | 15     | 16    |
| <b>Sec. 8e Removal/Prohibition of Director or Officer</b>         |              |        |       |
| Notices of Intention to Remove/Prohibit                           | 2            | 11     | 7     |
| Consent Orders  | 15           | 33     | 60    |
| <b>Sec. 8g Suspension/Removal When Charged With Crime</b>         | 0            | 1      | 1     |
| <b>Civil Money Penalties Issued</b>                               |              |        |       |
| Sec.7a Call Report Penalties                                      | 41           | 24     | 19    |
| Sec.8i Civil Money Penalties                                      | 35           | 10     | 19    |
| <b>Sec. 10c Orders of Investigation</b>                           | 6            | 6      | 11    |
| <b>Sec. 19 Denials of Service After Criminal Conviction</b>       | 3            | 1      | 1     |
| <b>Sec. 32 Notices Disapproving Officer or Director</b>           | 0            | 0      | 0     |
| <b>Truth in Lending Act Reimbursement Actions</b>                 |              |        |       |
| Denials of Requests for Relief                                    | 1            | 3      | 6     |
| Grants of Relief  | 0            | 0      | 0     |
| Banks Making Reimbursement <sup>•</sup>                           | 161          | 139    | 162   |
| <b>Criminal Referrals Involving Open Institutions<sup>•</sup></b> | <b>5,786</b> | 12,689 | 8,201 |
| <b>Other Actions Not Listed</b>                                   | <b>8</b>     | 7      | 22    |

- <sup>•</sup> 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. Frías

▲ **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](mailto: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](http://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.

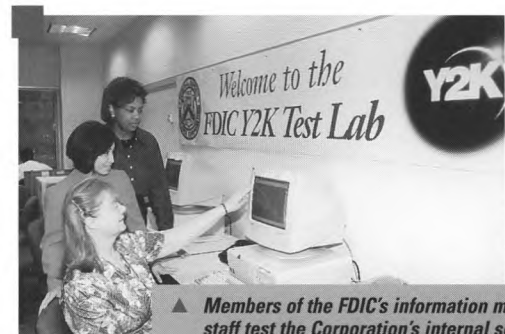
### Controlling Expenses and Reducing Costs

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.



▲ 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            |
| <b>Total</b>                                 | <b>7,359</b> | <b>7,793</b> | <b>2,470</b> | <b>2,515</b> | <b>4,889</b>   | <b>5,278</b> |

- \* 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**

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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**

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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.**



# Legislation and Regulations





Although Congress did not enact comprehensive banking legislation in 1998, lawmakers approved several measures directly affecting the FDIC or insured depository institutions. Among the topics addressed in laws enacted in 1998 were legislation on the Year 2000 computer issue, private mortgage insurance, and the termination of the Thrift Depositor Protection Oversight Board. Congress also appropriated funds for the FDIC Office of Inspector General and for judgments and settlements of "goodwill" lawsuits related to savings and loan association failures.

## The Year 2000 Computer Issue

The Examination Parity and Year 2000 Readiness for Financial Institutions Act (Public Law 105-164) was signed into law on March 20, 1998. The Act requires the FDIC, as well as the other federal banking agencies and the National Credit Union Administration (NCUA), to offer seminars to all institutions under its jurisdiction on the safety and soundness implications of the Year 2000 computer issue. The law also requires the agencies to give insured depository institutions model approaches to common Year 2000 challenges in such areas as project management, vendor contracts, testing regimes and business continuity planning. The Act also amends the Home Owners' Loan Act and the Federal Credit Union Act to give express authority to the Office of Thrift Supervision and the NCUA to examine and regulate service companies and third-party service providers such as data processing firms.

## Private Mortgage Insurance

The Homeowners Protection Act of 1998 (Public Law 105-216) was signed into law on July 29, 1998. The Act provides a statutory framework for canceling or automatically terminating private mortgage insurance (PMI). PMI is an insurance policy that protects the lender from losses when a mortgage with a low down payment is in default. In general, most PMI requirements in connection with a residential mortgage transaction entered into after July 29, 1999, will terminate when the mortgage is scheduled to reach 78 percent of the original value of the property. A mortgagor with a good payment history and who meets other requirements of the Act may request the cancellation when the mortgage balance reaches 80 percent of the property's value. The federal banking agencies, the NCUA, and the Farm Credit Administration are directed to enforce these requirements.

## Thrift Depositor Protection Oversight Board

Also as part of the Homeowners Protection Act, Congress abolished the Thrift Depositor Protection Oversight Board, which was created in 1991 to monitor the operations of the Resolution Trust Corporation. The Act transfers the Oversight Board's authority over the Resolution Funding Corporation—an entity created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 to provide funding for use in thrift resolutions—to the Secretary of the Treasury. The Act also amended provisions governing the frequency and location of the Affordable Housing Advisory Board's (AHAB) meetings. The AHAB, which terminated by law on September 30, 1998, advised the FDIC and the Oversight Board on policies and programs related to the provision on affordable housing.

## FDIC Employees' Health Insurance

The Federal Employees Health Care Protection Act of 1998 (Public Law 105-266) was signed into law on October 19, 1998. The Act includes provisions permitting FDIC retirees and employees who are within five years of retirement to participate in the Federal Employees Health Benefits Program during retirement.

## Appropriations

Congress provided funding for the FDIC Office of Inspector General as part of the Departments of Veterans Affairs, Housing and Urban Development and Independent Agencies Appropriations Act, 1999 (Public Law 105-276), enacted on October 21, 1998. The Act appropriates approximately \$34.6 million from the Bank Insurance Fund, the Savings Association Insurance Fund and the FSLIC Resolution Fund for necessary expenses of the Office of Inspector General in fiscal year 1999.

Also, Congress appropriated funds for payments of judgments and settlements related to the *Winstar* (goodwill) cases in the Omnibus Consolidated and Emergency Supplemental Appropriations Act for Fiscal Year 1999 (Public Law 105-277), enacted on October 21, 1998. **For more information about these cases, see Pages 39–40.**

## Regulations Adopted and Proposed

Publication date refers to the date published in the *Federal Register*.

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### Final Rules

#### **Interest on Deposits**

The FDIC amended Part 329 of its regulations relating to interest on deposits. The Federal Deposit Insurance Act requires that the FDIC prohibit insured nonmember banks and insured branches of foreign banks from paying interest or dividends on demand deposits. Under the amended rule, these institutions automatically become subject to exceptions to the prohibition adopted by the Federal Reserve Board for demand deposits in its member banks, regardless of whether the FDIC authorized the specific exception.

**Approved: February 10, 1998**

**Published: February 19, 1998**

#### **Determination of Economically Depressed Regions**

The FDIC amended Part 357 of its regulations used to determine whether an insured savings association is in an "economically depressed region" and therefore qualifies for financial assistance to prevent default. The FDIC changed the manner in which it defines geographic units as "economically depressed regions" for an institution to a case-by-case basis, rather than the previous statewide designation. After an institution's geographic market is defined, the FDIC will determine whether that market falls within an "economically depressed region." This revision to Part 357 will apply to cases where an institution's geographic market is limited to some portion of a state, or crosses two or more states.

**Approved: February 10, 1998**

**Published: March 3, 1998**

#### **Expanded Examination Cycle for Certain Small Insured Institutions**

The FDIC, along with the other bank and thrift regulatory agencies, amended Part 337 of its regulations to implement section 306 of the Riegle Community Development and Regulatory Improvement Act of 1994, and section 2221 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The amendment increases from \$100 million to \$250 million the asset size of certain financial institutions that may be examined once every 18 months instead of every 12 months, if certain other criteria are met. In effect, the amendment increases the number of institutions that are eligible for the 18-month examination schedule.

**Approved: March 24, 1998**

**Published: April 2, 1998**

#### **Disclosure of Information**

The FDIC amended Part 309 of its regulations regarding the public disclosure of information under changes in the Freedom of Information Act (FOIA) made by the Electronic Freedom of Information Act Amendments of 1996 (EFOIA). The amendment implements expedited and "multi-track" FOIA processing procedures and the processing deadlines and appeal rights created by electronic FOIA. The amendment also notes the expanded range of records available through the FDIC's Internet site.

**Approved: March 24, 1998**

**Published: April 3, 1998**

#### **Consolidation and Simplification of International Banking Regulations**

The FDIC amended Part 347 of its regulations to consolidate, update and streamline rules that apply to foreign banking operations. The FDIC's international rules, which had been in effect since 1979 without significant revision, were divided into three separate parts. Those rules were consolidated into a new Part 347. In particular, the amendment: reduces filing requirements for most banks wishing to open a foreign branch or make a foreign investment; defines permissible activities in which bank branches, foreign joint ventures and subsidiaries may engage, within specific dollar limits; eliminates a general limit on foreign investment of 25 per cent of capital; simplifies accounting for fees on international loans; and requires banks to either establish reserves to account for transfer risk in international assets, or use an alternate method consistent with generally accepted accounting principles (GAAP).

**Approved: March 24, 1998**

**Published: April 8, 1998**

#### **Deposit Insurance Simplification**

The FDIC clarified and simplified its deposit insurance regulations to benefit both consumers and bankers. The amended Part 330 of the FDIC's regulation now contains plainer, more understandable language as well as examples illustrating the rules that govern the most basic types of consumer accounts. The amendment also relaxed the FDIC's recordkeeping requirements for certain agency or fiduciary accounts, created a six-month grace period for the restructuring of accounts after a depositor's death, and clarified the insurance coverage of revocable trust accounts.

**Approved: April 28, 1998**

**Published: May 11, 1998**

## Final Rules

### Resolution and Receivership Rules

The FDIC amended Part 360 of its regulations regarding resolution and receivership rules. The amendment made only clarifying, technical modifications to the regulation, correcting an erroneous statutory reference and amending certain sections to achieve uniform language throughout the regulation.

**Approved: July 7, 1998**

**Published: July 14, 1998**

### Capital Treatment of Servicing Assets

The FDIC, along with the other bank and thrift regulatory agencies, amended Part 325 of its regulations regarding capital treatment of "servicing assets," which arise from contracts to service loans or other financial assets. The amendment relaxes the regulatory capital limitations on servicing assets and modifies certain terms used in the agencies' capital rules to be more consistent with accounting standards prescribed by the Financial Accounting Standards Board. Specifically, the final rule increases the amount of mortgage servicing assets recognized for regulatory capital purposes and, for the first time, recognizes limited amounts of nonmortgage servicing assets in regulatory capital calculations.

**Approved: July 7, 1998**

**Published: August 10, 1998**

### Applications, Filing Procedures and Delegations of Authority

The FDIC amended Part 303 of its regulations and related statements of policy regarding applications, notice and request procedures, and delegations of authority. The final rule provides qualifying well-capitalized and well-managed insured depository institutions expedited processing procedures for several types of filings, including deposit insurance, branch, and merger applications. For ease of reference, the amendment also centralizes within Part 303 substantially all filing procedures found throughout the FDIC's regulations.

**Approved: July 7, 1998**

**Published: August 20, 1998**

### Capital Treatment of Unrealized Gains on Available-for-Sale Equity Securities

The FDIC, along with the other bank and thrift regulatory agencies, amended Part 325 of its regulations regarding the treatment of unrealized gains on equity securities. The amendment permits institutions holding equity securities that have appreciated in value since the institution purchased them to include up to 45 percent of these gains as a component of Tier 2 capital. For the gains to be eligible for inclusion in Tier 2 capital, the equity securities must be available-for-sale and have readily determinable fair values in accordance with GAAP. If an institution holds equity securities meeting the rule's requirements, the institution's total risk-based capital ratio will improve as a result of this rule change.

**Approved: August 25, 1998**

**Published: September 1, 1998**

### Activities of Insured State Banks and Insured Savings Associations

The FDIC amended Part 362 of its regulations, which requires a state bank to obtain the FDIC's approval before engaging in an activity or making an equity investment that would not be authorized for a national bank. Several rules covering state bank and savings association activities were combined with Part 362, establishing greater consistency among the activities authorized under each rule and greater consistency among restrictions on conducting the activities. Part 362 now includes rules previously located in Part 303, requiring state savings associations to obtain the FDIC's approval before engaging in activities or equity investments that would not be authorized for a federal savings association, and rules previously located in Part 337, applicable to state nonmember banks that engage in securities underwriting, dealing, and public sale. The amendments also allow qualifying well-capitalized and well-managed state banks and savings associations to obtain the FDIC's approval to engage in some activities covered by the rules through an expedited notice process, if the institution conducts the activity in the manner spelled out in the rule.

**Approved: November 5, 1998**

**Published: December 1, 1998**



## Interim Rules

### **Extended Examination Cycle for U.S. Branches and Agencies of Foreign Banks**

The FDIC, along with the other bank and thrift agencies, issued an interim amendment to Part 347 of its regulations regarding examination cycles for U.S. branches and agencies of foreign banks. This interim rule reduces the regulatory burden on certain branches and agencies of foreign banks with total assets of \$250 million or less by making them eligible for an 18-month examination cycle, as opposed to a 12-month cycle. To be eligible, the branches or agencies must meet criteria involving asset size, supervisory rating, and management.

**Approved: July 7, 1998**

**Published: August 28, 1998**

### **Year 2000 Safety and Soundness Standards**

The FDIC, along with the other bank and thrift agencies, issued an interim amendment to Part 364 of its regulations to incorporate appropriate references to the interagency Year 2000 safety and soundness guidelines. The guidelines establish standards for bank management and boards of directors in developing and managing their institutions' Year 2000 project plans for achieving Y2K readiness, validating remediation efforts, and planning for contingencies.

**For more information about the FDIC's Year 2000 initiatives, please see Pages 13–15, 25.**

**Approved: October 8, 1998**

**Published: October 15, 1998**

## Proposed Rules

### **Simplification of Insurance Rules for Joint Accounts and Payable-on-Death Accounts**

The FDIC issued proposed amendments to Part 330 of its regulations that would simplify the agency's deposit insurance rules governing the coverage of joint accounts and "payable-on-death" accounts. The FDIC is considering the changes because the current rules are frequently misunderstood by both consumers and bankers. That confusion can create losses for depositors if their insured institution fails and they mistakenly believed their funds were within the \$100,000 insurance limits. The proposed rule would eliminate the first step in the current two-step process for determining the insurance coverage of joint accounts. The proposed rule also would change the insurance coverage of payable-on-death accounts by adding parents and siblings to the current list of qualifying beneficiaries.

**Approved: July 7, 1998**

**Published: July 17, 1998**

### **Management Official Interlocks**

The FDIC, along with the other bank and thrift agencies, proposed amendments to Part 348 of its regulations that generally prohibit bank managers from serving simultaneously with two unaffiliated depository institutions or their holding companies. The proposed amendments would provide an exemption from the general prohibition against any management interlock between insured depository institutions located in the same community if their combined share of the total deposits in the community is 20 percent or less. Another provision reflects a statutory change that prohibits management officials of depository institutions with total assets of \$2.5 billion from serving as management officials of unaffiliated depository institutions with assets exceeding \$1.5 billion. These thresholds were raised from \$1 billion and \$500 million, respectively. The proposed rule would also create a general exemption that would allow an otherwise prohibited management interlock if dual service would not create a monopoly, substantially lessen competition, or threaten safety and soundness.

**Approved: May 18, 1998**

**Published: August 11, 1998**

## Proposed Rules

### **"Know Your Customer"**

The FDIC, along with the other federal bank and thrift regulatory agencies, proposed an amendment to Part 326 of its regulations that is designed to deter and detect financial crimes, such as money laundering and fraud at banks and savings institutions. The proposed rule would require banks to adopt compliance measures such as having adequate internal controls, using independent testing, and training personnel to be sensitive to possibly fraudulent or illicit transactions. Insured nonmember banks would be asked to obtain only the information necessary to comply with the regulation, and would safeguard the information gathered to minimize the risk of invasion of the customer's privacy. (The FDIC and the other regulatory agencies withdrew the proposal effective March 29, 1999.)

**Approved: October 27, 1998**

**Published: December 7, 1998**

### **Activities of Insured State Banks and Insured Savings Associations**

The FDIC issued proposed amendments to Parts 303, 337 and 362. The amendments to Part 362 would add safety and soundness standards to govern insured state nonmember banks. These standards would govern those banks that engage in the public sale, distribution or underwriting of stocks, bonds, debentures, notes or other securities through a subsidiary, if those activities are permissible for a national bank subsidiary but are not permissible for the national bank itself. Insured state nonmember banks also would be required to notify the FDIC prior to conducting any other activities that are not permissible for a national bank itself. To avoid duplication, the FDIC also proposed removing and reserving the provisions concerning insured state banks' securities activities found in section 337.4 of the FDIC's regulations. Part 303 currently contains all of the filing content and processing information and would be amended to cover these new filings. These amendments would complete the consolidation of the FDIC's securities activities regulations.

**Approved: November 5, 1998**

**Published: December 1, 1998**

## Withdrawal of Proposed Rules

### **Determination of Economically Depressed Regions**

The FDIC withdrew a proposed amendment to Part 357 of its regulations regarding determination of economically depressed regions. The proposed rule, published in 1992, would have updated the list of states designated as "economically depressed regions." No comments were received, and the rule was never finalized. On the same date that this proposed rule was withdrawn, the FDIC issued a final rule that provides criteria to determine which regions are "economically depressed" rather than identifying particular states. **For a description of that final rule, see Page 50.**

**Approved: February 10, 1998**

**Published: March 3, 1998**



# Financial Statements





## Federal Deposit Insurance Corporation

**Bank Insurance Fund Statements of Financial Position**

Dollars in Thousands

|   | December 31, 1998    | December 31, 1997    |
|---|----------------------|----------------------|
| <b>Assets</b>   |                      |                      |
| Cash and cash equivalents   | \$ 2,117,644         | \$ 219,207           |
| Investment in U.S. Treasury obligations, net (Note 3)   | 26,125,695           | 26,598,825           |
| <i>(Market value of investments at December 31, 1998 and December 31, 1997 was \$27.5 billion and \$27.1 billion, respectively)</i> |                      |                      |
| Interest receivable on investments and other assets, net  | 690,586              | 472,818              |
| Receivables from bank resolutions, net (Note 4)   | 747,948              | 1,109,035            |
| Assets acquired from assisted banks and terminated receiverships, net (Note 5)  | 27,373               | 60,724               |
| Property and equipment, net (Note 6)  | 209,615              | 145,061              |
| <b>Total Assets</b>   | <b>\$ 29,918,861</b> | <b>\$ 28,605,670</b> |
| <b>Liabilities</b>  |                      |                      |
| Accounts payable and other liabilities  | \$ 229,984           | \$ 228,955           |
| <i>Estimated liabilities for: (Note 7)</i>  |                      |                      |
| Anticipated failure of insured institutions   | 32,000               | 11,000               |
| Assistance agreements   | 15,125               | 31,952               |
| Litigation losses   | 22,301               | 13,500               |
| Asset securitization guarantees   | 7,141                | 27,715               |
| <b>Total Liabilities</b>  | <b>306,551</b>       | <b>313,122</b>       |
| <i>Commitments and off-balance-sheet exposure (Note 12)</i>   |                      |                      |
| <b>Fund Balance</b>   |                      |                      |
| Accumulated net income  | 29,601,395           | 28,292,672           |
| Unrealized gain/(loss) on available-for-sale securities, net (Note 3)   | 10,915               | (124)                |
| <b>Total Fund Balance</b>   | <b>29,612,310</b>    | <b>28,292,548</b>    |
| <b>Total Liabilities and Fund Balance</b>   | <b>\$ 29,918,861</b> | <b>\$ 28,605,670</b> |

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

## Federal Deposit Insurance Corporation

**Bank Insurance Fund Statements of Income and Fund Balance**

Dollars in Thousands

|   | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|---|---|---|
| <b>Revenue</b>  |   |   |
| Interest on U.S. Treasury obligations   | \$ 1,674,344                            | \$ 1,519,276                            |
| Interest on advances and subrogated claims                                    | 67,350                                  | 22,073                                  |
| Gain on conversion of benefit plan (Note 11)                                  | 200,532                                 | 0                                       |
| Revenue from assets acquired from assisted banks and terminated receiverships | 20,926                                  | 38,000                                  |
| Assessments (Note 8)  | 21,688                                  | 24,711                                  |
| Other revenue   | 15,422                                  | 11,558                                  |
| <b>Total Revenue</b>  | <b>2,000,262</b>                        | <b>1,615,618</b>                        |
| <b>Expenses and Losses</b>  |   |   |
| Operating expenses  | 697,604                                 | 605,214                                 |
| Provision for insurance losses (Note 9)                                       | (37,699)                                | (495,296)                               |
| Expenses for assets acquired from assisted banks and terminated receiverships | 29,803                                  | 65,901                                  |
| Interest and other insurance expenses   | 1,831                                   | 1,506                                   |
| <b>Total Expenses and Losses</b>  | <b>691,539</b>                          | <b>177,325</b>                          |
| <b>Net Income</b>   | <b>1,308,723</b>                        | <b>1,438,293</b>                        |
| Unrealized gain/(loss) on available-for-sale securities, net (Note 3)         | 11,039                                  | (124)                                   |
| <b>Comprehensive Income</b>   | <b>1,319,762</b>                        | <b>1,438,169</b>                        |
| <b>Fund Balance - Beginning</b>   | <b>28,292,548</b>                       | <b>26,854,379</b>                       |
| <b>Fund Balance - Ending</b>  | <b>\$ 29,612,310</b>                    | <b>\$ 28,292,548</b>                    |

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



## Federal Deposit Insurance Corporation

**Bank Insurance Fund Statements of Cash Flows**

Dollars in Thousands

|   | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|---|---|---|
| <b>Cash Flows From Operating Activities</b>   |   |   |
| <b>Cash provided from:</b>  |   |   |
| Interest on U.S. Treasury obligations   | \$ 1,788,937                            | \$ 1,480,060                            |
| Recoveries from bank resolutions  | 881,802                                 | 3,826,273                               |
| Recoveries from assets acquired from assisted banks<br>and terminated receiverships   | 54,207                                  | 141,765                                 |
| Assessments   | 22,931                                  | 22,201                                  |
| Miscellaneous receipts  | 27,990                                  | 24,951                                  |
| <b>Cash used for:</b>   |   |   |
| Operating expenses  | (711,020)                               | (580,515)                               |
| Disbursements for bank resolutions  | (420,691)                               | (298,943)                               |
| Disbursements for assets acquired from assisted banks<br>and terminated receiverships | (37,391)                                | (67,231)                                |
| Miscellaneous disbursements   | (7,959)                                 | (11,771)                                |
| <b>Net Cash Provided by Operating Activities (Note 14)</b>                            | <b>1,598,806</b>                        | <b>4,536,790</b>                        |
| <b>Cash Flows From Investing Activities</b>   |   |   |
| <b>Cash provided from:</b>  |   |   |
| Maturity and sale of U.S. Treasury obligations, held-to-maturity                      | 5,850,000                               | 6,300,000                               |
| Maturity and sale of U.S. Treasury obligations, available-for-sale                    | 185,456                                 | 0                                       |
| <b>Cash used for:</b>   |   |   |
| Purchase of property and equipment  | (51,058)                                | 0                                       |
| Purchase of U.S. Treasury obligations, held-to-maturity                               | (4,478,337)                             | (10,373,695)                            |
| Purchase of U.S. Treasury obligations, available-for-sale                             | (1,206,430)                             | (502,020)                               |
| <b>Net Cash Provided From (Used by) Investing Activities</b>                          | <b>299,631</b>                          | <b>(4,575,715)</b>                      |
| <b>Net Increase (Decrease) in Cash and Cash Equivalents</b>                           | <b>1,898,437</b>                        | <b>(38,925)</b>                         |
| <b>Cash and Cash Equivalents - Beginning</b>  | <b>219,207</b>                          | <b>258,132</b>                          |
| <b>Cash and Cash Equivalents - Ending</b>   | <b>\$ 2,117,644</b>                     | <b>\$ 219,207</b>                       |

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



# Notes to the Financial Statements

## Bank Insurance Fund

December 31, 1998 and 1997

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### 1. Legislative History and Operations of the Bank Insurance Fund

#### Legislative History

The U.S. Congress created the Federal Deposit Insurance Corporation (FDIC) through enactment of the Banking Act of 1933. The FDIC was created to restore and maintain public confidence in the nation's banking system.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted to reform, recapitalize, and consolidate the federal deposit insurance system. The FIRREA created the Bank Insurance Fund (BIF), the Savings Association Insurance Fund (SAIF), and the FSLIC Resolution Fund (FRF). It also designated the FDIC as the administrator of these funds. All three funds are maintained separately to carry out their respective mandates.

The BIF and the SAIF are insurance funds responsible for protecting insured depositors in operating banks and thrift institutions from loss due to institution failures. The FRF is a resolution fund responsible for winding up the affairs of the former Federal Savings and Loan Insurance Corporation (FSLIC) and liquidating the assets and liabilities transferred from the former Resolution Trust Corporation (RTC).

Pursuant to FIRREA, an active institution's insurance fund membership and primary federal supervisor are generally determined by the institution's charter type. Deposits of BIF-member institutions are generally insured by the BIF; BIF members are predominantly commercial and savings banks supervised by the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve. Deposits of SAIF-member institutions are generally insured by the SAIF; SAIF members are predominantly thrifts supervised by the Office of Thrift Supervision.

In addition to traditional banks and thrifts, several other categories of institutions exist. The Federal Deposit Insurance Act (FDI Act), Section 5(d)(3), provides that a member of one insurance fund may, with the approval of its primary federal supervisor, merge, consolidate with, or acquire the deposit liabilities of an institution that is a member of the other insurance fund without changing insurance fund status for the acquired deposits. These institutions with deposits insured by both insurance funds are referred to as "Oakars" or Oakar banks. The FDI Act, Section 5(d)(2)(G), allows SAIF-member thrifts to convert to a bank charter and retain their SAIF membership. These institutions are referred to as "Sassers." The Home Owners' Loan Act (HOLA), Section 5(o), allows BIF-member banks to convert to a thrift charter and retain their BIF membership. These institutions are referred to as "HOLAs" or HOLA thrifts.

#### Other Significant Legislation

The Competitive Equality Banking Act of 1987 established the Financing Corporation (FICO) as a mixed-ownership government corporation whose sole purpose was to function as a financing vehicle for the FSLIC.

The Omnibus Budget Reconciliation Act of 1990 (1990 OBR Act) and the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) made changes to the FDIC's assessment authority (see Note 8) and borrowing authority. The FDICIA also requires the FDIC to: 1) resolve troubled institutions in a manner that will result in the least possible cost to the deposit insurance funds and 2) maintain the insurance funds at 1.25 percent of insured deposits or a higher percentage as circumstances warrant.

The Deposit Insurance Funds Act of 1996 (DIFA) was enacted to provide for: 1) the capitalization of the SAIF to its designated reserve ratio (DRR) of 1.25 percent by means of a one-time special assessment on SAIF-insured deposits; 2) the expansion of the assessment base for payments of the interest on obligations issued by the FICO to include all FDIC-insured banks and thrifts; 3) beginning January 1, 1997, the imposition of a FICO assessment rate on BIF-assessable deposits that is one-fifth of the rate for SAIF-assessable deposits through the earlier of December 31, 1999, or the date on which the last savings association ceases to exist; 4) the payment of the annual FICO interest obligation of approximately \$790 million on a pro rata basis between banks and thrifts on the earlier of January 1, 2000, or the date on which the last savings association ceases to exist; 5) authorization of BIF assessments only if needed to maintain the fund at the DRR; 6) the refund of amounts in the BIF in excess of the DRR with such refund not to exceed the previous semiannual assessment; and 7) the merger of the BIF and the SAIF on January 1, 1999, if no insured depository institution is a savings association on that date. Subsequently, Congress did not enact legislation during 1998 to either merge the BIF and the SAIF or to eliminate the thrift charter.

#### Recent Legislative Initiatives

Congress continues to focus on legislative proposals to achieve modernization of the financial services industry. Some of these proposals, if enacted into law, may have a significant impact on the BIF and/or the SAIF. However, these proposals continue to vary and FDIC management cannot predict which provisions, if any, will ultimately be enacted.



## Operations of the BIF

The primary purpose of the BIF is to: 1) insure the deposits and protect the depositors of BIF-insured banks and 2) resolve failed banks, including managing and liquidating their assets. In addition, the FDIC, acting on behalf of the BIF, examines state-chartered banks that are not members of the Federal Reserve System. The FDIC also provides assistance to troubled banks and monitors compliance with the assistance agreements.

The BIF is primarily funded from the following sources: 1) interest earned on investments in U.S. Treasury obligations and 2) BIF assessment premiums.

Additional funding sources are U.S. Treasury and Federal Financing Bank (FFB) borrowings, if necessary. The 1990 OBR Act established

the FDIC's authority to borrow working capital from the FFB on behalf of the BIF and the SAIF. The FDICIA increased the FDIC's authority to borrow for insurance losses from the U.S. Treasury, on behalf of the BIF and the SAIF, from \$5 billion to \$30 billion. The FDICIA also established a limitation on obligations that can be incurred by the BIF, known as the maximum obligation limitation (MOL). At December 31, 1998, the MOL for the BIF was \$51.7 billion.

The VA, HUD and Independent Agencies Appropriations Acts of 1999 and 1998 appropriated \$34.7 million for fiscal year 1999 (October 1, 1998, through September 30, 1999) and \$34 million for fiscal year 1998 (October 1, 1997, through September 30, 1998), respectively, for operating expenses incurred by the Office of Inspector General (OIG). These Acts mandate that the funds are to be derived from the BIF, the SAIF, and the FRF.

## 2. Summary of Significant Accounting Policies

### General

These financial statements pertain to the financial position, results of operations, and cash flows of the BIF and are presented in accordance with generally accepted accounting principles (GAAP). These statements do not include reporting for assets and liabilities of closed banks for which the FDIC acts as receiver or liquidating agent. Periodic and final accountability reports of the FDIC's activities as receiver or liquidating agent are furnished to courts, supervisory authorities, and others as required.

### Use of Estimates

FDIC management makes estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Where it is reasonably possible that changes in estimates will cause a material change in the financial statements in the near term, the nature and extent of such changes in estimates have been disclosed.

### Cash Equivalents

Cash equivalents are short-term, highly liquid investments with original maturities of three months or less. Cash equivalents primarily consist of Special U.S. Treasury Certificates.

### Investments in U.S. Treasury Obligations

Investments in U.S. Treasury obligations are recorded pursuant to the provisions of the Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." SFAS No. 115 requires that securities be classified in one of three categories: held-to-maturity, available-for-sale, or trading. Securities designated as held-to-maturity are intended to be held to maturity and are shown at amortized cost. Amortized cost is the face value of securities plus the unamortized premium or less the unamortized discount. Amortizations are computed on a daily basis from the date of acquisition to the date of maturity. Beginning in 1997, the BIF designated a portion of its securities as available-for-sale. These securities are shown at fair value with unrealized gains and losses included in the fund balance. Realized gains and losses are included in other revenue when applicable. Interest on both types of securities is calculated on a daily basis and recorded monthly using the effective interest method. The BIF does not have any securities classified as trading.



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### **Allowance for Losses on Receivables From Bank Resolutions and Assets Acquired From Assisted Banks and Terminated Receiverships**

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The BIF records a receivable for the amounts advanced and/or obligations incurred for resolving troubled and failed banks. The BIF also records as an asset the amounts paid for assets acquired from assisted banks and terminated receiverships. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. The latter is based on estimates of discounted cash recoveries from the assets of assisted or failed banks, net of all estimated liquidation costs.

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### **Receivership Operations**

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The FDIC is responsible for managing and disposing of the assets of failed institutions in an orderly and efficient manner. The assets, and the claims against them, are accounted for separately to ensure that liquidation proceeds are distributed in accordance with applicable laws and regulations. Also, the income and expenses attributable to receiverships are accounted for as transactions of those receiverships. Liquidation expenses incurred by the BIF on behalf of the receiverships are recovered from those receiverships.

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### **Cost Allocations Among Funds**

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Operating expenses not directly charged to the funds are allocated to all funds administered by the FDIC. Workload-based-allocation percentages are developed during the annual corporate planning process and through supplemental functional analyses.

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### **Postretirement Benefits Other Than Pensions**

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The FDIC established an entity to provide the accounting and administration of postretirement benefits on behalf of the BIF, the SAIF, and the FRF. Each fund pays its liabilities for these benefits directly to the entity. The BIF's unfunded net postretirement benefits liability for the plan is presented in the BIF's Statements of Financial Position.

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### **Disclosure About Recent Accounting Standard Pronouncements**

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In February 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 132, "Employers' Disclosures about Pension and Other Postretirement Benefits." The Statement standardizes the disclosure requirements for pensions and other postretirement benefits to the extent practicable. Although changes in the BIF's disclosures for postretirement benefits have been made, the impact is not material.

In June 1998, the FASB also issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The Statement requires that all derivatives be recognized either as assets or liabilities in the statements of financial position and to measure those instruments at fair value. Based upon analysis, derivative instruments of the BIF are immaterial to the financial statements.

In March 1998, the American Institute of Certified Public Accountants issued Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This Statement requires the development or purchase cost of internal-use software to be treated as a capital asset. The FDIC adopted this Statement effective January 1, 1998. This asset is presented in the "Property and equipment, net" line item in the BIF's Statements of Financial Position (see Note 6).

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." The FDIC adopted SFAS No. 130 effective on January 1, 1997. Comprehensive income includes net income as well as certain types of unrealized gain or loss. The only component of SFAS No. 130 that impacts the BIF is unrealized gain or loss on securities classified as available-for-sale, which is presented in the BIF's Statements of Financial Position and the Statements of Income and Fund Balance.

Other recent pronouncements are not applicable to the financial statements.

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### **Depreciation**

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The FDIC has designated the BIF as administrator of property and equipment used in its operations. Consequently, the BIF includes the cost of these assets in its financial statements and provides the necessary funding for them. The BIF charges the other funds rental and service fees representing an allocated share of its annual depreciation expense.

Prior to January 1, 1998, only buildings owned by the Corporation were depreciated. On January 1, 1998, FDIC began capitalizing the development and purchase cost of internal-use software in accordance with the requirements of SOP 98-1. The FDIC also began to capitalize the cost of furniture, fixtures, and general equipment. These costs were expensed in prior years on the basis that the costs were immaterial. The expanded capitalization policy had no material impact on the financial position or operation of the BIF.



The Washington, D.C. office buildings and the L. William Seidman Center in Arlington, Virginia, are depreciated on a straight-line basis over a 50-year estimated life. The San Francisco condominium offices are depreciated on a straight-line basis over a 35-year estimated life. Leasehold improvements will be capitalized and depreciated over the lesser of the remaining life of the lease or the estimated useful life of the improvements, if determined to be material. Capital assets depreciated on a straight-line basis over a five-year estimated life include mainframe equipment; furniture, fixtures and general equipment; and internal-use software. Personal computer equipment is depreciated on a straight-line basis over a three-year estimated life.

### Related Parties

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

### Reclassifications

Reclassifications have been made in the 1997 financial statements to conform to the presentation used in 1998.

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

Cash received by the BIF is invested in U.S. Treasury obligations with maturities exceeding three months unless cash is needed to meet the liquidity needs of the fund. The BIF's current portfolio includes securities classified as held-to-maturity and available-for-sale. The BIF also invests in Special U.S. Treasury Certificates that are included in the "Cash and cash equivalents" line item.

For 1998, the gross realized gain on securities classified as available-for-sale was \$224 thousand. The gain is included in the "Other revenue" line item. Proceeds from the sale were \$186 million. The cost of the securities sold was determined on a specific identification basis. There were no sales in 1997.

### U.S. Treasury Obligations at December 31, 1998

Dollars in Thousands

| Maturity  | Yield at Purchase | Face Value           | Amortized Cost       | Unrealized Holding Gains | Unrealized Holding Losses | Market Value         |
|---|-------------------|----------------------|----------------------|--------------------------|---------------------------|----------------------|
| <b>Held-to-Maturity</b>                                   |                   |                      |                      |                          |                           |                      |
| Less than one year  | 5.57%             | \$ 2,120,000         | \$ 2,133,448         | \$ 10,597                | \$ 0                      | \$ 2,144,045         |
| 1-3 years   | 6.04%             | 5,525,000            | 5,564,524            | 148,112                  | 0                         | 5,712,636            |
| 3-5 years   | 6.19%             | 5,965,000            | 6,345,044            | 322,126                  | 0                         | 6,667,170            |
| 5-10 years  | 6.01%             | 10,295,000           | 10,566,047           | 864,116                  | 0                         | 11,430,163           |
| Total   |                   | \$ 23,905,000        | \$ 24,609,063        | \$ 1,344,951             | \$ 0                      | \$ 25,954,014        |
| <b>Available-for-Sale</b>                                 |                   |                      |                      |                          |                           |                      |
| Less than one year  | 5.09%             | \$ 940,000           | \$ 946,726           | \$ 4,947                 | \$ 0                      | \$ 951,673           |
| 1-3 years   | 5.63%             | 550,000              | 558,991              | 5,968                    | 0                         | 564,959              |
| Total   |                   | \$ 1,490,000         | \$ 1,505,717         | \$ 10,915                | \$ 0                      | \$ 1,516,632         |
| <b>Total Investment in U.S. Treasury Obligations, Net</b> |                   |                      |                      |                          |                           |                      |
| <b>Total</b>  |                   | <b>\$ 25,395,000</b> | <b>\$ 26,114,780</b> | <b>\$ 1,355,866</b>      | <b>\$ 0</b>               | <b>\$ 27,470,646</b> |



**U.S. Treasury Obligations at December 31, 1997**

Dollars in Thousands

| <b>Maturity</b>   | <b>Yield at Purchase</b> | <b>Face Value</b>    | <b>Amortized Cost</b> | <b>Unrealized Holding Gains</b> | <b>Unrealized Holding Losses</b> | <b>Market Value</b>  |
|---|--------------------------|----------------------|-----------------------|---------------------------------|----------------------------------|----------------------|
| <b>Held-to-Maturity</b>                                   |                          |                      |                       |                                 |                                  |                      |
| Less than one year  | 5.58%                    | \$ 5,250,000         | \$ 5,240,657          | \$ 5,369                        | \$ (5,650)                       | \$ 5,240,375         |
| 1-3 years   | 5.83%                    | 5,280,000            | 5,330,281             | 26,113                          | (7,413)                          | 5,348,983            |
| 3-5 years   | 6.15%                    | 5,490,000            | 5,685,279             | 89,744                          | (6,895)                          | 5,768,128            |
| 5-10 years  | 6.57%                    | 9,500,000            | 9,840,712             | 439,733                         | 0                                | 10,280,445           |
| <b>Total</b>  |                          | <b>\$ 25,520,000</b> | <b>\$ 26,096,929</b>  | <b>\$ 560,959</b>               | <b>\$ (19,958)</b>               | <b>\$ 26,637,931</b> |
| <b>Available-for-Sale</b>                                 |                          |                      |                       |                                 |                                  |                      |
| 1-3 years   | 5.67%                    | \$ 490,000           | \$ 502,020            | \$ 19                           | \$ (143)                         | \$ 501,896           |
| <b>Total Investment in U.S. Treasury Obligations, Net</b> |                          |                      |                       |                                 |                                  |                      |
| <b>Total</b>  |                          | <b>\$ 26,010,000</b> | <b>\$ 26,598,949</b>  | <b>\$ 560,978</b>               | <b>\$ (20,101)</b>               | <b>\$ 27,139,827</b> |

In 1998, the unamortized premium, net of unamortized discount, was \$720 million. In 1997, the unamortized premium, net of the unamortized discount, was \$589 million.

**4. Receivables From Bank Resolutions, Net**

The bank resolution process takes different forms depending on the unique facts and circumstances surrounding each failing or failed institution. Payments for institutions that fail are made to cover obligations to insured depositors and represent claims by the BIF against the receiverships' assets. There were three bank failures in 1998 and one in 1997, with assets of \$370 and \$26 million, respectively.

As of December 31, 1998 and 1997, the FDIC, in its receivership capacity for BIF-insured institutions, held assets with a book value of \$1.6 billion and \$2.5 billion, respectively (including cash and miscellaneous receivables of \$480 million and \$1 billion at

December 31, 1998 and 1997, respectively). These assets represent a significant source of repayment of the BIF's receivables from bank resolutions. The estimated cash recoveries from the management and disposition of these assets that are used to derive the allowance for losses are based in part on a statistical sampling of receivership assets. The sample was constructed to produce a statistically valid result. These estimated recoveries are regularly evaluated, but remain subject to uncertainties because of potential changes in economic conditions. These factors could cause the BIF's and other claimants' actual recoveries to vary from the level currently estimated.

### Receivables From Bank Resolutions, Net

Dollars in Thousands

|   | December 31, 1998 | December 31, 1997   |
|---|-------------------|---------------------|
| Assets from open bank assistance            | \$ 112,045        | \$ 140,035          |
| Allowance for losses                        | (10,727)          | (38,497)            |
| <b>Net Assets From Open Bank Assistance</b> | <b>101,318</b>    | <b>101,538</b>      |
| Receivables from closed banks               | 18,656,746        | 23,268,950          |
| Allowance for losses                        | (18,010,116)      | (22,261,453)        |
| <b>Net Receivables From Closed Banks</b>    | <b>646,630</b>    | <b>1,007,497</b>    |
| <b>Total</b>                                | <b>\$ 747,948</b> | <b>\$ 1,109,035</b> |

### 5. Assets Acquired From Assisted Banks and Terminated Receiverships, Net

The BIF has acquired assets from certain troubled and failed banks by either purchasing an institution's assets outright or purchasing the assets under the terms specified in each resolution agreement. In addition, the BIF can purchase assets remaining in a receivership to facilitate termination. The methodology to estimate cash recoveries from these assets, which are used to derive the related allowance for losses, is the same as that for receivables from bank resolutions (see Note 4).

The BIF recognizes revenue and expenses on these acquired assets. Revenue consists primarily of interest earned on performing mortgages and commercial loans. Expenses are recognized for the management and liquidation of these assets.

### Assets Acquired From Assisted Banks and Terminated Receiverships, Net

Dollars in Thousands

|  | December 31, 1998 | December 31, 1997 |
|--|-------------------|-------------------|
| Assets acquired from assisted banks and terminated receiverships | \$ 169,712        | \$ 256,237        |
| Allowance for losses   | (142,339)         | (195,513)         |
| <b>Total</b>   | <b>\$ 27,373</b>  | <b>\$ 60,724</b>  |



## 6. Property and Equipment, Net

### Property and Equipment, Net

Dollars in Thousands

|  | December 31, 1998 | December 31, 1997 |
|--|-------------------|-------------------|
| Land                                       | \$ 29,631         | \$ 29,631         |
| Buildings                                  | 152,078           | 151,443           |
| PC/LAN/WAN equipment                       | 15,612            | 0                 |
| Application software                       | 1,892             | 0                 |
| Mainframe equipment                        | 354               | 0                 |
| Furniture, fixtures, and general equipment | 764               | 0                 |
| Telephone equipment                        | 460               | 0                 |
| Work in Progress - Application Software    | 49,630            | 0                 |
| Accumulated depreciation                   | (40,806)          | (36,013)          |
| <b>Total</b>                               | <b>\$ 209,615</b> | <b>\$ 145,061</b> |

## 7. Estimated Liabilities for:

### Anticipated Failure of Insured Institutions

The BIF records an estimated liability and a loss provision for banks (including Oakar and Sasser financial institutions) that are likely to fail, absent some favorable event such as obtaining additional capital or merging, when the liability becomes probable and reasonably estimable.

The estimated liabilities for anticipated failure of insured institutions as of December 31, 1998 and 1997, were \$32 million and \$11 million, respectively. The estimated liability is derived in part from estimates of recoveries from the management and disposition of the assets of these probable bank failures. Therefore, they are subject to the same uncertainties as those affecting the BIF's receivables from bank resolutions (see Note 4). This could affect the ultimate costs to the BIF from probable failures.

There are other banks where the risk of failure is less certain, but still considered reasonably possible. Should these banks fail, the BIF could incur additional estimated losses of about \$204 million.

The accuracy of these estimates will largely depend on future economic conditions. The FDIC's Board of Directors (Board) has the statutory authority to consider the estimated liability from anticipated failures of insured institutions when setting assessment rates.

### Year 2000 Anticipated Failures

The BIF is also subject to a potential loss from banks that may fail if they are unable to become Year 2000 compliant in a timely manner. In May 1997, the federal financial institution regulatory agencies developed a program to conduct uniform reviews of all FDIC-insured institutions' Year 2000 readiness. The program assesses the five key phases of an institution's Year 2000 conversion efforts: 1) awareness, 2) assessment, 3) renovation, 4) validation, and 5) implementation. The reviews classify each institution as Satisfactory, Needs Improvement, or Unsatisfactory.

*Satisfactory.* Year 2000 efforts of financial institutions and independent data centers are considered "Satisfactory" if they exhibit acceptable performance in all key phases of the Year 2000 project management process as set forth in the May 5, 1997, Federal Financial Institutions Examination Council (FFIEC) Interagency Statement on the Year 2000 and subsequent guidance documents. Performance is satisfactory when project weaknesses are minor in nature and can be readily corrected within the existing project management framework. The institution's remediation progress to date meets or nearly meets expectations laid out in its Year 2000 project plan. Senior management and the board recognize and understand Year 2000 risk, are active in overseeing institutional corrective efforts, and have ensured that the necessary resources are available to address this risk area.



*Needs Improvement:* Year 2000 efforts of financial institutions and independent data centers are evaluated as "Needs Improvement" if they exhibit less than acceptable performance in all key phases of the Year 2000 project management process. Project weaknesses are evident, even if deficiencies are correctable within the existing project management framework. The institution's remediation progress to date is behind the schedule laid out in its Year 2000 project plan. Senior management or the board is not fully aware of the status of Year 2000 correction efforts, may not have committed sufficient financial or human resources to address this risk, or may not fully understand Year 2000 implications.

*Unsatisfactory:* Year 2000 efforts of financial institutions and independent data centers are considered "Unsatisfactory" if they exhibit poor performance in any of the key phases of the Year 2000 project management process. Project weaknesses are serious in nature and are not easily corrected within the existing project management framework. The institution's remediation progress is seriously behind the schedule laid out in its Year 2000 project plan. Senior management and the board do not understand or recognize the impact that the Year 2000 will have on the institution. Management or the board commitment is limited or their oversight activities are not evident.

Based on data updated through April 30, 1999, 10,159 institutions with \$6.4 trillion in assets have received a Satisfactory rating, 216 institutions with \$80 billion in assets a Needs Improvement rating, and 21 institutions with \$1 billion in assets an Unsatisfactory rating (data includes BIF- and SAIF-insured institutions). Although the initial results of the uniform reviews are encouraging, the Year 2000 issue is unprecedented. Therefore, it is difficult to determine which institutions, if any, will ultimately fail. Further, estimates of the cost of resolving Year 2000 failures are complicated by the uncertain nature of technological disruptions and the associated impact on the BIF, if any. Failures caused solely by liquidity problems would pose substantially less exposure to the BIF. Year 2000 failures could conceivably be such liquidity failures. The possibility that any such failure would occur is quite speculative in view of actions taken by the Federal Reserve Board to ensure sufficient liquidity and currency to meet the cash needs of insured banks.

Failures could occur because of the familiar capital insolvency (liabilities exceeding assets) if a substantial number of bank borrowers were unable to repay loans due to their own lack of preparedness for the Year 2000. Insured banks are required to be aware of the measures taken by key customers to protect themselves against adverse impact from the advent of Year 2000, and compliance with such requirements is monitored via the regulatory examination program. The extent to which insured institutions, if any, ultimately experience this type of failure is not measurable.

Financial institutions are required to design a Year 2000 contingency plan to mitigate the risks associated with the failure of systems at critical dates (Business Resumption Contingency Planning). A business resumption contingency plan is designed to provide assurance that core business functions will continue if one or more systems fail.

In order to assess the exposure to the BIF from Year 2000 potential failures, the FDIC evaluated all information relevant to such an assessment, to include Year 2000 on-site examination results, institution capital levels and supervisory examination composite ratings, and other institution past and current financial characteristics. As a result of this assessment, we conclude that, as of December 31, 1998, there are no probable losses to the BIF from Year 2000 failures. Further, any reasonably possible losses from Year 2000 failures were not estimable. During the remainder of 1999, the regulatory agencies will continue their Year 2000 reviews and the FDIC will continue to assess this potential liability.

### Assistance Agreements

The estimated liabilities for assistance agreements resulted from several large transactions where problem assets were purchased by an acquiring institution under an agreement that calls for the FDIC to absorb credit losses and pay related costs for funding and asset administration, plus an incentive fee.

### Litigation Losses

The BIF records an estimated loss for unresolved legal cases to the extent those losses are considered probable and reasonably estimable. In addition to the amount recorded as probable, the FDIC has determined that losses from unresolved legal cases totaling \$178 million are reasonably possible.

### Asset Securitization Guarantees

As part of the FDIC's efforts to maximize the return from the sale or disposition of assets from bank resolutions, the FDIC has securitized some receivership assets. To facilitate the securitizations, the BIF provided limited guarantees to cover certain losses on the securitized assets up to a specified maximum. In exchange for backing the limited guarantees, the BIF received assets from the receiverships in an amount equal to the expected exposure under the guarantees. At December 31, 1998 and 1997, the BIF had an estimated liability under the guarantees of \$7 million and \$28 million, respectively. The maximum off-balance-sheet exposure under the limited guarantees is presented in Note 12.



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## 8. Assessments

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The 1990 OBR Act removed caps on assessment rate increases and authorized the FDIC to set assessment rates for BIF members semiannually, to be applied against a member's average assessment base. The FDICIA: 1) required the FDIC to implement a risk-based assessment system; 2) authorized the FDIC to increase assessment rates for BIF-member institutions as needed to ensure that funds are available to satisfy the BIF's obligations; 3) required the FDIC to build and maintain the reserves in the insurance funds to 1.25 percent of insured deposits; and 4) authorized the FDIC to increase assessment rates more frequently than semiannually and impose emergency special assessments as necessary to ensure that funds are available to repay U.S. Treasury borrowings. In May 1995, the BIF reached the FDICIA mandated capitalization level of 1.25 percent of insured deposits.

The DIFA (see Note 1) provided, among other things, for the elimination of the mandatory minimum assessment formerly provided for in the FDI Act. It also provided for the expansion of the assessment base for payments of the interest on obligations issued by the FICO to include all FDIC-insured institutions (including banks, thrifts, and Oakar and Sasser financial institutions). On January 1, 1997, BIF-insured banks began paying a FICO assessment. The FICO assessment rate on BIF-assessable deposits is one-fifth the rate for SAIF-assessable deposits. The annual FICO interest obligation of approximately \$790 million will be paid on a pro rata basis between

banks and thrifts on the earlier of January 1, 2000, or the date on which the last savings association ceases to exist.

The FICO assessment has no financial impact on the BIF. The FICO assessment is separate from the regular assessments and is imposed on banks and thrifts, not on the insurance funds. The FDIC, as administrator of the BIF and the SAIF, is acting solely as a collection agent for the FICO. During 1998 and 1997, \$341 million and \$338 million respectively, were collected from banks and remitted to the FICO.

The FDIC uses a risk-based assessment system that charges higher rates to those institutions that pose greater risks to the BIF. To arrive at a risk-based assessment for a particular institution, the FDIC places each institution in one of nine risk categories, using a two-step process based first on capital ratios and then on other relevant information. The Board reviews premium rates semiannually. The assessment rate averaged approximately 0.08 cents per \$100 of assessable deposits for 1998 and 1997. On October 27, 1998, the Board voted to retain the BIF assessment schedule of 0 to 27 cents per \$100 of assessable deposits (annual rates) for the first semiannual period of 1999.

## 9. Provision for Insurance Losses

Provision for insurance losses was a negative \$38 million and a negative \$495 million for 1998 and 1997, respectively. In 1998 and 1997, the negative provision resulted primarily from decreased

losses expected for assets in liquidation. The following chart lists the major components of the negative provision for insurance losses.

### Provision for Insurance Losses

Dollars in Thousands

|  | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|--|---|---|
| <b>Valuation adjustments:</b>                                    |   |   |
| Open bank assistance   | \$ (2,431)                              | \$ (12,180)                             |
| Closed banks   | (53,926)                                | (356,347)                               |
| Assets acquired from assisted banks and terminated receiverships | 2,222                                   | (47,245)                                |
| <b>Total</b>   | <b>(54,135)</b>                         | <b>(415,772)</b>                        |
| <b>Contingencies:</b>  |   |   |
| Anticipated failure of insured institutions                      | 29,000                                  | (59,000)                                |
| Assistance agreements  | (8,322)                                 | (12,716)                                |
| Asset securitization guarantees                                  | (13,043)                                | (6,558)                                 |
| Litigation   | 8,801                                   | (1,250)                                 |
| <b>Total</b>   | <b>16,436</b>                           | <b>(79,524)</b>                         |
| <b>Reduction in Provision for Insurance Losses</b>               | <b>\$ (37,699)</b>                      | <b>\$ (495,296)</b>                     |

## 10. Pension Benefits, Savings Plans, and Accrued Annual Leave

Eligible FDIC employees (all permanent and temporary employees with appointments exceeding one year) are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The CSRS is a defined benefit plan, which is offset with the Social Security System in certain cases. Plan benefits are determined on the basis of years of creditable service and compensation levels. The CSRS-covered employees also can contribute to the tax-deferred Federal Thrift Savings Plan (TSP).

The FERS is a three-part plan consisting of a basic defined benefit plan that provides benefits based on years of creditable service and compensation levels, Social Security benefits, and the TSP. Automatic and matching employer contributions to the TSP are provided up to specified amounts under the FERS.

During 1998, there was an open season that allowed employees to switch from CSRS to FERS. This did not have a material impact on BIF's operating expenses.

Although the BIF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The BIF also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported on and accounted for by the U.S. Office of Personnel Management (OPM).

Eligible FDIC employees also may participate in a FDIC-sponsored tax-deferred savings plan with matching contributions. The BIF pays its share of the employer's portion of all related costs.

The BIF's pro rata share of the Corporation's liability to employees for accrued annual leave is approximately \$38.4 million and \$35.7 million at December 31, 1998 and 1997, respectively.



## Pension Benefits and Savings Plans Expenses

Dollars in Thousands

|  | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|--|---|---|
| CSRS/FERS Disability Fund                          | \$ 1,166                                | \$ 488                                  |
| Civil Service Retirement System                    | 10,477                                  | 8,708                                   |
| Federal Employee Retirement System (Basic Benefit) | 27,857                                  | 28,661                                  |
| FDIC Savings Plan                                  | 17,534                                  | 16,974                                  |
| Federal Thrift Savings Plan                        | 10,991                                  | 10,568                                  |
| <b>Total</b>                                       | <b>\$ 68,025</b>                        | <b>\$ 65,399</b>                        |

## 11. Postretirement Benefits Other than Pensions

On January 2, 1998, BIF's obligation under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," for postretirement health benefits was reduced when over 6,500 employees enrolled in the Federal Employees Health Benefits (FEHB) Program for their future health insurance coverage. The OPM assumed the BIF's obligation for postretirement health benefits for these employees at no initial enrollment cost.

In addition, legislation was passed that allowed the remaining 2,600 retirees and near-retirees (employees within five years of retirement) in the FDIC health plan to also enroll in the FEHB

Program for their future health insurance coverage, beginning January 1, 1999. The OPM assumed the BIF's obligation for postretirement health benefits for retirees and near-retirees for a fee of \$150 million. The OPM is now responsible for postretirement health benefits for all employees and covered retirees. The FDIC will continue to be obligated for dental and life insurance coverage for as long as the programs are offered and coverage is extended to retirees.

OPM's assumption of the health care obligation constitutes both a settlement and a curtailment as defined by SFAS No. 106. This conversion resulted in a gain of \$201 million to the BIF.

## Postretirement Benefits Other Than Pensions

Dollars in Thousands

|  | 1998        | 1997             |
|--|-------------|------------------|
| <b>Funded Status at December 31</b>  |             |                  |
| Fair value of plan assets <sup>(a)</sup>                                     | \$ 67,539   | \$ 356,447       |
| Less: Benefit obligation   | 67,539      | 378,227          |
| <b>Under/(Over) Funded Status of the plans</b>                               | <b>\$ 0</b> | <b>\$ 21,780</b> |
| Accrued benefit liability recognized in the Statements of Financial Position | \$ 0        | \$ 39,231        |
| <b>Expenses and Cash Flows for the Period Ended December 31</b>              |             |                  |
| Net periodic benefit cost  | \$ (1,942)  | \$ 3,305         |
| Employer contributions   | 6,229       | 4,604            |
| Benefits paid  | 6,229       | 4,604            |

## Weighted-Average Assumptions at December 31

|                                |       |       |
|--------------------------------|-------|-------|
| Discount rate                  | 4.50% | 5.75% |
| Expected return on plan assets | 4.50% | 5.75% |
| Rate of compensation increase  | 4.00% | 5.75% |

(a) Invested in U.S. Treasury obligations.



For measurement purposes, the per capita cost of covered health care benefits was assumed to increase by an annual rate of 8.75 percent for 1998. Further, the rate was assumed to decrease

gradually each year to a rate of 7.75 percent for the year 2000 and remain at that level thereafter.

## 12. Commitments and Off-Balance-Sheet Exposure

### Commitments

#### Leases

The BIF's allocated share of the FDIC's lease commitments totals \$177.2 million for future years. The lease agreements contain escalation clauses resulting in adjustments, usually on an annual basis. The allocation to the BIF of the FDIC's future lease

commitments is based upon current relationships of the workloads among the BIF, the FRF, and the SAIF. Changes in the relative workloads could cause the amounts allocated to the BIF in the future to vary from the amounts shown below. The BIF recognized leased space expense of \$47.7 million and \$43.6 million for the years ended December 31, 1998 and 1997, respectively.

### Lease Commitments

Dollars in Thousands

| 1999     | 2000     | 2001     | 2002     | 2003     | 2004 and<br>Thereafter |
|----------|----------|----------|----------|----------|------------------------|
| \$39,287 | \$34,699 | \$27,905 | \$24,423 | \$15,096 | \$35,765               |

### Asset Securitization Guarantees

As discussed in Note 7, the BIF provided certain limited guarantees to facilitate securitization transactions. The table below gives the

maximum off-balance-sheet exposure the BIF has under these guarantees.

### Asset Securitization Guarantees

Dollars in Thousands

|  | December 31, 1998 | December 31, 1997 |
|--|-------------------|-------------------|
| Maximum exposure under the limited guarantees                              | \$ 481,313        | \$ 481,313        |
| Less: Guarantee claims paid (inception-to-date)                            | (27,253)          | (19,231)          |
| Less: Amount of exposure recognized as an estimated liability (see Note 7) | (7,141)           | (27,715)          |
| <b>Maximum Off-Balance-Sheet Exposure Under the Limited Guarantees</b>     | <b>\$ 446,919</b> | <b>\$ 434,367</b> |

### Concentration of Credit Risk

As of December 31, 1998, the BIF had \$18.8 billion in gross receivables from bank resolutions and \$170 million in assets acquired from assisted banks and terminated receiverships. An allowance for loss of \$18 billion and \$142 million, respectively, has been

recorded against these assets. The liquidating entities' ability to make repayments to the BIF is largely influenced by the economy of the area in which they are located. The BIF's maximum exposure to possible accounting loss for these assets is shown in the table below.



### Concentration of Credit Risk at December 31, 1998

Dollars in Millions

|   | Southeast   | Southwest    | Northeast     | Midwest      | Central     | West          | Total         |
|---|-------------|--------------|---------------|--------------|-------------|---------------|---------------|
| Receivables from bank resolutions, net                                | \$ 9        | \$ 35        | \$ 575        | \$ 11        | \$ 2        | \$ 116        | \$ 748        |
| Assets acquired from assisted banks and terminated receiverships, net | 0           | 21           | 5             | 0            | 0           | 1             | 27            |
| <b>Total</b>  | <b>\$ 9</b> | <b>\$ 56</b> | <b>\$ 580</b> | <b>\$ 11</b> | <b>\$ 2</b> | <b>\$ 117</b> | <b>\$ 775</b> |

### Other Off-Balance-Sheet Risk

#### Deposit Insurance

As of December 31, 1998, deposits insured by the BIF totaled approximately \$2.1 trillion. This would be the accounting loss if all depository institutions were to fail and the acquired assets provided no recoveries.

### 13. Disclosures About the Fair Value of Financial Instruments

Cash equivalents are short-term, highly liquid investments and are shown at current value. The fair market value of the investment in U.S. Treasury obligations is disclosed in Note 3 and is based on current market prices. The carrying amount of interest receivable on investments, short-term receivables, and accounts payable and other liabilities approximates their fair market value. This is due to their short maturities or comparisons with current interest rates.

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

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

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

The majority of the net assets acquired from assisted banks and terminated receiverships (except real estate) is comprised of various types of financial instruments, including investments, loans and accounts receivables. Like receivership assets, assets acquired from assisted banks and terminated receiverships are valued using discount rates that include consideration of market risk. However, assets acquired from assisted banks and terminated receiverships do not involve the unique aspects of the corporate subrogated claim, and therefore the discounting can be viewed as producing a reasonable estimate of fair market value.

## 14. Supplementary Information Relating to the Statements of Cash Flows

### Reconciliation of Net Income to Net Cash Provided by Operating Activities

Dollars in Thousands

|   | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|---|---|---|
| <b>Net Income</b>   | <b>\$ 1,308,723</b>                     | <b>\$ 1,438,293</b>                     |
| <b>Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities</b> |   |   |
| <b>Income Statement Items:</b>  |   |   |
| Provision for insurance losses  | (37,699)                                | (495,296)                               |
| Amortization of U.S. Treasury obligations   | 133,705                                 | 60,261                                  |
| Gain on sale of investments   | (224)                                   | 0                                       |
| Gain on conversion of benefit plan  | (200,532)                               | 0                                       |
| Depreciation on property and equipment  | 3,745                                   | 3,339                                   |
| <b>Change in Assets and Liabilities:</b>  |   |   |
| (Increase) in interest receivable on investments and other assets                       | (39,983)                                | (87,996)                                |
| Decrease in receivables from bank resolutions   | 417,444                                 | 3,600,647                               |
| Decrease in assets acquired from assisted banks and terminated receiverships            | 31,129                                  | 60,693                                  |
| Increase (Decrease) in accounts payable and other liabilities                           | 6,534                                   | (21,997)                                |
| (Decrease) in estimated liabilities for anticipated failure of insured institutions     | (8,000)                                 | (5,000)                                 |
| (Decrease) in estimated liabilities for assistance agreements                           | (8,505)                                 | (6,147)                                 |
| (Decrease) in estimated liabilities for asset securitization guarantees                 | (7,531)                                 | (10,007)                                |
| <b>Net Cash Provided by Operating Activities</b>  | <b>\$ 1,598,806</b>                     | <b>\$ 4,536,790</b>                     |

## 15. Year 2000 Issues

### State of Readiness

The FDIC, as administrator for the BIF, is conducting a corporate-wide effort to ensure that all FDIC information systems are Year 2000 compliant. This means the systems must accurately process date and time data in calculations, comparisons, and sequences after December 31, 1999, and be able to correctly deal with leap-year calculations in 2000. The Year 2000 Oversight Committee is comprised of FDIC division management that oversees the Year 2000 effort.

The FDIC's Division of Information Resources Management (DIRM) leads the internal Year 2000 effort, under the direction of the Oversight Committee. DIRM used a five-phase approach for ensuring that all FDIC systems and software are Year 2000 compliant. The five phases are:

#### Awareness

The first phase of compliance focuses on defining the Year 2000 problem and gaining executive-level support and sponsorship for the effort.



**Assessment**

The second phase of compliance focuses on assessing the Year 2000 impact on the Corporation as a whole.

**Renovation**

The third phase of compliance focuses on converting, replacing or eliminating selected platforms, applications, databases, and utilities, while modifying interfaces as appropriate.

Platform is a broad term that encompasses computer hardware (including mainframe computers, servers, and personal computers) and software (including computer languages and operating systems). Utility programs, or "utilities," provide file management capabilities, such as sorting, copying, comparing, listing and searching, as well as diagnostic and measurement routines that check the health and performance of the system.

**Validation**

The fourth phase of compliance focuses on testing, verifying and validating converted or replaced platforms, applications, databases, and utilities.

**Implementation**

The fifth phase of compliance focuses on implementing converted or replaced platforms, applications, databases, utilities, and interfaces.

The Awareness, Assessment, and Renovation phases are complete. The Validation phase is scheduled to be completed during January 1999 when all production applications will be validated for Year 2000 readiness. Implementation of the majority of production applications in Year 2000 ready status will be completed by March 31, 1999. Validation and implementation of new systems and modifications to existing systems will continue throughout 1999.

**Year 2000 Estimated Costs**

Year 2000 compliance expenses for the BIF are estimated at \$34.7 million and \$1.6 million at December 31, 1998 and 1997, respectively. These expenses are reflected in the "Operating expenses" line item of the BIF's Statements of Income and Fund Balance. Future expenses are estimated to be \$49 million. Year 2000 estimated future costs are included in the FDIC's budget.

**Risks of Year 2000 Issues**

The FDIC's Division of Supervision has an ongoing aggressive initiative to assess the BIF's supervised financial institutions for Year 2000 compliance. Other BIF-insured institutions are being assessed by their respective regulatory agencies. The BIF is subject to a potential loss from financial institutions that may fail as a result of Year 2000 related issues. Refer to "Estimated Liabilities for: Anticipated Failure of Insured Institutions - Year 2000 Anticipated Failures" (Note 7) for additional information.

No potential loss with internal system failure has been estimated due to the extensive planning and validation that has occurred.

**Contingency Plans**

DIRM is currently developing a disaster recovery plan and contingency plans specific to each mission-critical application.

Other divisions within the FDIC are working together to develop contingency plans to be prepared if any FDIC-insured financial institution fails as a result of lack of Year 2000 preparedness.



# Savings Association Insurance Fund

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Federal Deposit Insurance Corporation

## Savings Association Insurance Fund Statements of Financial Position

Dollars in Thousands

|  | December 31, 1998    | December 31, 1997   |
|--|----------------------|---------------------|
| <b>Assets</b>  |                      |                     |
| Cash and cash equivalents  | \$ 666,736           | \$ 141,392          |
| Cash and other assets: Restricted for SAIF-member exit fees (Note 3)<br><i>(Includes cash and cash equivalents of \$55.248 thousand and \$48.752 thousand at December 31, 1998 and December 31, 1997 respectively)</i> | 253,790              | 239,548             |
| Investment in U.S. Treasury obligations, net (Note 4)<br><i>(Market value of investments at December 31, 1998 and December 31, 1997 was \$9.4 billion and \$9.2 billion, respectively)</i>                             | 9,061,786            | 9,106,386           |
| Interest receivable on investments and other assets  | 140,699              | 122,678             |
| Receivables from thrift resolutions, net (Note 5)  | 8,857                | 5,176               |
| <b>Total Assets</b>  | <b>\$ 10,131,868</b> | <b>\$ 9,615,180</b> |
| <b>Liabilities</b>   |                      |                     |
| Accounts payable and other liabilities   | \$ 7,247             | \$ 7,317            |
| Estimated liability for anticipated failure of insured institutions (Note 6)   | 31,000               | 0                   |
| SAIF-member exit fees and investment proceeds held in escrow (Note 3)  | 253,790              | 239,548             |
| <b>Total Liabilities</b>   | <b>292,037</b>       | <b>246,865</b>      |
| <i>Commitments and off-balance-sheet exposure (Note 10)</i>  |                      |                     |
| <b>Fund Balance</b>  |                      |                     |
| Accumulated net income   | 9,835,577            | 9,368,347           |
| Unrealized gain/(loss) on available-for-sale securities, net (Note 4)  | 4,254                | (32)                |
| <b>Total Fund Balance</b>  | <b>9,839,831</b>     | <b>9,368,315</b>    |
| <b>Total Liabilities and Fund Balance</b>  | <b>\$ 10,131,868</b> | <b>\$ 9,615,180</b> |

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

## Federal Deposit Insurance Corporation

**Savings Association Insurance Fund Statements of Income and Fund Balance**

Dollars in Thousands

|   | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|---|---|---|
| <b>Revenue</b>  |   |   |
| Interest on U.S. Treasury obligations                                 | \$ 562,750                              | \$ 535,463                              |
| Assessments (Note 7)  | 15,352                                  | 13,914                                  |
| Gain on conversion of benefit plan (Note 9)                           | 5,464                                   | 0                                       |
| Other revenue   | 293                                     | 535                                     |
| <b>Total Revenue</b>  | <b>583,859</b>                          | <b>549,912</b>                          |
| <b>Expenses and Losses</b>  |   |   |
| Operating expenses  | 84,628                                  | 71,865                                  |
| Provision for insurance losses  | 31,992                                  | (1,879)                                 |
| Other insurance expenses  | 9                                       | 0                                       |
| <b>Total Expenses and Losses</b>                                      | <b>116,629</b>                          | <b>69,986</b>                           |
| <b>Net Income</b>   | <b>467,230</b>                          | <b>479,926</b>                          |
| Unrealized gain/(loss) on available-for-sale securities, net (Note 4) | 4,286                                   | (32)                                    |
| <b>Comprehensive Income</b>   | <b>471,516</b>                          | <b>479,894</b>                          |
| <b>Fund Balance - Beginning</b>                                       | <b>9,368,315</b>                        | <b>8,888,421</b>                        |
| <b>Fund Balance - Ending</b>  | <b>\$ 9,839,831</b>                     | <b>\$ 9,368,315</b>                     |

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

## Federal Deposit Insurance Corporation

**Savings Association Insurance Fund Statements of Cash Flows**

Dollars in Thousands

|  | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|--|---|---|
| <b>Cash Flows From Operating Activities</b>                      |   |   |
| <b>Cash provided from:</b>                                       |   |   |
| Interest on U.S. Treasury obligations                            | \$ 597,596                              | \$ 544,094                              |
| Assessments  | 13,991                                  | (146,766)                               |
| Entrance and exit fees, including interest on exit fees (Note 3) | 10,306                                  | 13,596                                  |
| Recoveries from thrift resolutions                               | 1,119                                   | 14,728                                  |
| Miscellaneous receipts   | 67                                      | (219)                                   |
| <b>Cash used for:</b>  |   |   |
| Operating expenses   | (85,248)                                | (75,298)                                |
| Disbursements for thrift resolutions                             | (5,732)                                 | (2,693)                                 |
| Disbursements for Oakar banks                                    | 318                                     | 0                                       |
| Miscellaneous disbursements                                      | 0                                       | (7)                                     |
| <b>Net Cash Provided by Operating Activities (Note 12)</b>       | <b>532,417</b>                          | <b>347,435</b>                          |
| <b>Cash Flows From Investing Activities</b>                      |   |   |
| <b>Cash provided from:</b>                                       |   |   |
| Maturity of U.S. Treasury obligations, held-to-maturity          | 1,840,000                               | 1,740,000                               |
| <b>Cash used for:</b>  |   |   |
| Purchase of U.S. Treasury obligations, held-to-maturity          | (1,402,352)                             | (2,133,119)                             |
| Purchase of U.S. Treasury obligations, available-for-sale        | (438,225)                               | (152,125)                               |
| <b>Net Cash Used by Investing Activities</b>                     | <b>(577)</b>                            | <b>(545,244)</b>                        |
| <b>Net Increase (Decrease) in Cash and Cash Equivalents</b>      | <b>531,840</b>                          | <b>(197,809)</b>                        |
| <b>Cash and Cash Equivalents - Beginning</b>                     | <b>190,144</b>                          | <b>387,953</b>                          |
| <b>Cash and Cash Equivalents - Ending</b>                        | <b>\$ 721,984</b>                       | <b>\$ 190,144</b>                       |

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



# Notes to the Financial Statements

## Savings Association Insurance Fund

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December 31, 1998 and 1997

### 1. Legislative History and Operations of the Savings Association Insurance Fund

#### Legislative History

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted to reform, recapitalize, and consolidate the federal deposit insurance system. The FIRREA created the Savings Association Insurance Fund (SAIF), the Bank Insurance Fund (BIF), and the FSLIC Resolution Fund (FRF). It also designated the Federal Deposit Insurance Corporation (FDIC) as the administrator of these funds. All three funds are maintained separately to carry out their respective mandates.

The SAIF and the BIF are insurance funds responsible for protecting insured depositors in operating thrift institutions and banks from loss due to institution failures. The FRF is a resolution fund responsible for winding up the affairs of the former Federal Savings and Loan Insurance Corporation (FSLIC) and liquidating the assets and liabilities transferred from the former Resolution Trust Corporation (RTC).

Pursuant to the Resolution Trust Corporation Completion Act of 1993 (RTC Completion Act), resolution responsibility transferred from the RTC to the SAIF on July 1, 1995. Prior to that date, thrift resolutions were the responsibility of the RTC (January 1, 1989 through June 30, 1995) or the FSLIC (prior to 1989).

Pursuant to FIRREA, an active institution's insurance fund membership and primary federal supervisor are generally determined by the institution's charter type. Deposits of SAIF-member institutions are generally insured by the SAIF; SAIF members are predominantly thrifts supervised by the Office of Thrift Supervision (OTS). Deposits of BIF-member institutions are generally insured by the BIF; BIF members are predominantly commercial and savings banks supervised by the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve.

In addition to traditional thrifts and banks, several other categories of institutions exist. The Federal Deposit Insurance Act (FDI Act), Section 5(d)(3), provides that a member of one insurance fund may, with the approval of its primary federal supervisor, merge, consolidate with, or acquire the deposit liabilities of an institution that is a member of the other insurance fund without changing insurance fund status for the acquired deposits. These institutions with deposits insured by both insurance funds are referred to as "Oakars" or Oakar banks. The transactions specified in Section 5(d)(3) can take place without paying entrance and exit fees, under two principal conditions. One condition is that although the acquiring institution continues to belong to its own insurance fund (primary fund), the institution becomes obliged to pay assessments to the fund that insured the deposits of the acquired institution (secondary fund). The secondary fund assessments are keyed to the amount of the secondary fund deposits so acquired. The other condition is that if the acquiring institution should fail, the losses resulting from the failure are allocated between the two insurance funds according to

a formula that is likewise keyed to the amount of the acquired secondary fund deposits. The FDI Act, Section 5(d)(2)(G), allows SAIF-member thrifts to convert to a bank charter and retain their SAIF membership. These institutions are referred to as "Sassers." The Home Owners' Loan Act (HOLA), Section 5(o), allows BIF-member banks to convert to a thrift charter and retain their BIF membership. These institutions are referred to as "HOLAs" or HOLA thrifts.

#### Other Significant Legislation

The Competitive Equality Banking Act of 1987 established the Financing Corporation (FICO) as a mixed-ownership government corporation whose sole purpose was to function as a financing vehicle for the FSLIC.

The Omnibus Budget Reconciliation Act of 1990 (1990 OBR Act) and the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) made changes to the FDIC's assessment authority (see Note 7) and borrowing authority. The FDICIA also requires the FDIC to: 1) resolve troubled institutions in a manner that will result in the least possible cost to the deposit insurance funds and 2) maintain the insurance funds at 1.25 percent of insured deposits or a higher percentage as circumstances warrant.

The Deposit Insurance Funds Act of 1996 (DIFA) was enacted to provide for: 1) the capitalization of the SAIF to its designated reserve ratio (DRR) of 1.25 percent by means of a one-time special assessment on SAIF-insured deposits; 2) the expansion of the assessment base for payments of the interest on obligations issued by the FICO to include all FDIC-insured banks and thrifts; 3) beginning January 1, 1997, the imposition of a FICO assessment rate for SAIF-assessable deposits that is five times the rate for BIF-assessable deposits through the earlier of December 31, 1999, or the date on which the last savings association ceases to exist; 4) the payment of the annual FICO interest obligation of approximately \$790 million on a pro rata basis between banks and thrifts on the earlier of January 1, 2000, or the date on which the last savings association ceases to exist; 5) authorization of SAIF assessments only if needed to maintain the fund at the DRR; 6) the refund of amounts in the SAIF in excess of the DRR with such refund not to exceed the previous semiannual assessment; 7) assessment rates for SAIF members not lower than the assessment rates for BIF members with comparable risk; and 8) the merger of the SAIF and the BIF on January 1, 1999, if no insured depository institution is a savings association on that date. Subsequently, Congress did not enact legislation during 1998 to either merge the SAIF and the BIF or to eliminate the thrift charter.

#### Recent Legislative Initiatives

Congress continues to focus on legislative proposals to achieve modernization of the financial services industry. Some of these

proposals, if enacted into law, may have a significant impact on the SAIF and/or the BIF. However, these proposals continue to vary and FDIC management cannot predict which provisions, if any, will ultimately be enacted.

### Operations of the SAIF

The primary purpose of the SAIF is to: 1) insure the deposits and protect the depositors of SAIF-insured institutions and 2) resolve failed SAIF-insured institutions including managing and liquidating their assets. In this capacity, the SAIF has financial responsibility for all SAIF-insured deposits held by SAIF-member institutions and by BIF-member banks designated as Oakar banks.

The SAIF is primarily funded from the following sources: 1) interest earned on investments in U.S. Treasury obligations and 2) SAIF assessment premiums. Additional funding sources are borrowings

from the U.S. Treasury, the Federal Financing Bank (FFB), and the Federal Home Loan Banks, if necessary. The 1990 OBR Act established the FDIC's authority to borrow working capital from the FFB on behalf of the SAIF and the BIF. The FDICIA increased the FDIC's authority to borrow for insurance losses from the U.S. Treasury, on behalf of the SAIF and the BIF, from \$5 billion to \$30 billion. The FDICIA also established a limitation on obligations that can be incurred by the SAIF, known as the maximum obligation limitation (MOL). At December 31, 1998, the MOL for the SAIF was \$17.3 billion.

The VA, HUD and Independent Agencies Appropriations Acts of 1999 and 1998 appropriated \$34.7 million for fiscal year 1999 (October 1, 1998, through September 30, 1999) and \$34 million for fiscal year 1998 (October 1, 1997, through September 30, 1998), respectively, for operating expenses incurred by the Office of Inspector General (OIG). These Acts mandate that the funds are to be derived from the SAIF, the BIF, and the FRF.

## 2. Summary of Significant Accounting Policies

### General

These financial statements pertain to the financial position, results of operations, and cash flows of the SAIF and are presented in accordance with generally accepted accounting principles (GAAP). These statements do not include reporting for assets and liabilities of closed thrift institutions for which the FDIC acts as receiver or liquidating agent. Periodic and final accountability reports of the FDIC's activities as receiver or liquidating agent are furnished to courts, supervisory authorities, and others as required.

### Use of Estimates

FDIC management makes estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Where it is reasonably possible that changes in estimates will cause a material change in the financial statements in the near term, the nature and extent of such changes in estimates have been disclosed.

### Cash Equivalents

Cash equivalents are short-term, highly liquid investments with original maturities of three months or less. Cash equivalents primarily consist of Special U.S. Treasury Certificates.

### Investments in U.S. Treasury Obligations

Investments in U.S. Treasury obligations are recorded pursuant to the provisions of the Statement of Financial Accounting Standards

(SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." SFAS No. 115 requires that securities be classified in one of three categories: held-to-maturity, available-for-sale, or trading. Securities designated as held-to-maturity are intended to be held to maturity and are shown at amortized cost. Amortized cost is the face value of securities plus the unamortized premium or less the unamortized discount. Amortizations are computed on a daily basis from the date of acquisition to the date of maturity. Beginning in 1997, the SAIF designated a portion of its securities as available-for-sale. These securities are shown at fair value with unrealized gains and losses included in the fund balance. Realized gains and losses are included in other revenue when applicable. Interest on both types of securities is calculated on a daily basis and recorded monthly using the effective interest method. The SAIF does not have any securities classified as trading.

### Allowance for Losses on Receivables From Thrift Resolutions

The SAIF records a receivable for the amounts advanced and/or obligations incurred for resolving troubled and failed thrifts. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. The latter is based on estimates of discounted cash recoveries from the assets of assisted or failed thrifts, net of all estimated liquidation costs.

### Receivership Operations

The FDIC is responsible for managing and disposing of the assets of failed institutions in an orderly and efficient manner. The assets,

and the claims against them, are accounted for separately to ensure that liquidation proceeds are distributed in accordance with applicable laws and regulations. Also, the income and expenses attributable to receiverships are accounted for as transactions of those receiverships. Liquidation expenses incurred by the SAIF on behalf of the receiverships are recovered from those receiverships.

### Cost Allocations Among Funds

Operating expenses not directly charged to the funds are allocated to all funds administered by the FDIC. Workload-based-allocation percentages are developed during the annual corporate planning process and through supplemental functional analyses.

### Postretirement Benefits Other Than Pensions

The FDIC established an entity to provide the accounting and administration of postretirement benefits on behalf of the SAIF, the BIF, and the FRF. Each fund pays its liabilities for these benefits directly to the entity. The SAIF's unfunded net postretirement benefits liability for the plan is presented in the SAIF's Statements of Financial Position.

### Disclosure About Recent Accounting Standards Pronouncements

In February 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 132, "Employers' Disclosures about Pension and Other Postretirement Benefits." The Statement standardizes the

disclosure requirements for pensions and other postretirement benefits to the extent practicable. Although changes in the SAIF's disclosures for postretirement benefits have been made, the impact is not material.

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." The FDIC adopted SFAS No. 130 effective on January 1, 1997. Comprehensive income includes net income as well as certain types of unrealized gain or loss. The only component of SFAS No. 130 that impacts the SAIF is unrealized gain or loss on securities classified as available-for-sale, which is presented in the SAIF's Statements of Financial Position and the Statements of Income and Fund Balance.

Other recent pronouncements are not applicable to the financial statements.

### Related Parties

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

### Reclassifications

Reclassifications have been made in the 1997 financial statements to conform to the presentation used in 1998.

## 3. Cash and Other Assets: Restricted for SAIF-Member Exit Fees

The SAIF receives entrance and exit fees for conversion transactions when an insured depository institution converts from the BIF to the SAIF (resulting in an entrance fee) or from the SAIF to the BIF (resulting in an exit fee). Regulations approved by the FDIC's Board of Directors (Board) and published in the *Federal Register* on March 21, 1990, directed that exit fees paid to the SAIF be held in escrow.

The FDIC and the Secretary of the Treasury will determine when it is no longer necessary to escrow such funds for the payment of interest on obligations previously issued by the FICO. These escrowed exit fees are invested in U.S. Treasury securities pending determination of ownership. The interest earned is also held in escrow. There were no conversion transactions during 1998 and 1997 that resulted in an exit fee to the SAIF.

### Cash and Other Assets: Restricted for SAIF-Member Exit Fees

Dollars in Thousands

|  | December 31, 1998 | December 31, 1997 |
|--|-------------------|-------------------|
| Cash and cash equivalents                        | \$ 55,248         | \$ 48,752         |
| Investments in U.S. Treasury obligations, net    | 193,350           | 185,390           |
| Interest receivable on U.S. Treasury obligations | 4,190             | 3,981             |
| Exit fees receivable                             | 1,002             | 1,425             |
| <b>Total</b>                                     | <b>\$ 253,790</b> | <b>\$ 239,548</b> |



**U.S. Treasury Obligations at December 31, 1998 (Restricted)**

Dollars in Thousands

| <b>Maturity</b>         | <b>Yield at Purchase</b> | <b>Face Value</b> | <b>Amortized Cost</b> | <b>Unrealized Holding Gains</b> | <b>Unrealized Holding Losses</b> | <b>Market Value</b> |
|-------------------------|--------------------------|-------------------|-----------------------|---------------------------------|----------------------------------|---------------------|
| <b>Held-to Maturity</b> |                          |                   |                       |                                 |                                  |                     |
| 1-3 years               | 5.52%                    | \$ 15,000         | \$ 15,359             | \$ 335                          | \$ 0                             | \$ 15,694           |
| 3-5 years               | 6.12%                    | 135,000           | 134,722               | 6,550                           | 0                                | 141,272             |
| 5-10 years              | 5.69%                    | 40,000            | 43,269                | 2,156                           | 0                                | 45,425              |
| <b>Total</b>            |                          | <b>\$ 190,000</b> | <b>\$ 193,350</b>     | <b>\$ 9,041</b>                 | <b>\$ 0</b>                      | <b>\$ 202,391</b>   |

**U.S. Treasury Obligations at December 31, 1997 (Restricted)**

Dollars in Thousands

| <b>Maturity</b>         | <b>Yield at Purchase</b> | <b>Face Value</b> | <b>Amortized Cost</b> | <b>Unrealized Holding Gains</b> | <b>Unrealized Holding Losses</b> | <b>Market Value</b> |
|-------------------------|--------------------------|-------------------|-----------------------|---------------------------------|----------------------------------|---------------------|
| <b>Held-to Maturity</b> |                          |                   |                       |                                 |                                  |                     |
| Less than one year      | 5.68%                    | \$ 40,000         | \$ 40,058             | \$ 11                           | \$ 0                             | \$ 40,069           |
| 3-5 years               | 5.95%                    | 100,000           | 100,182               | 833                             | 0                                | 101,015             |
| 5-10 years              | 6.46%                    | 45,000            | 45,150                | 1,439                           | 0                                | 46,589              |
| <b>Total</b>            |                          | <b>\$ 185,000</b> | <b>\$ 185,390</b>     | <b>\$ 2,283</b>                 | <b>\$ 0</b>                      | <b>\$ 187,673</b>   |

In 1998, the unamortized premium, net of unamortized discount, was \$3.4 million. In 1997, the unamortized premium, net of the unamortized discount, was \$390 thousand.

**4. Investment in U.S. Treasury Obligations, Net**

Cash received by the SAIF is invested in U.S. Treasury obligations with maturities exceeding three months unless cash is needed to meet the liquidity needs of the fund. The SAIF's current portfolio

includes securities classified as held-to-maturity and available-for-sale. The SAIF also invests in Special U.S. Treasury Certificates that are included in the "Cash and cash equivalents" line item.

**U.S. Treasury Obligations at December 31, 1998 (Unrestricted)**

Dollars in Thousands

| <b>Maturity</b>   | <b>Yield at Purchase</b> | <b>Face Value</b>   | <b>Amortized Cost</b> | <b>Unrealized Holding Gains</b> | <b>Unrealized Holding Losses</b> | <b>Market Value</b> |
|---|--------------------------|---------------------|-----------------------|---------------------------------|----------------------------------|---------------------|
| <b>Held-to Maturity</b>                                   |                          |                     |                       |                                 |                                  |                     |
| Less than one year  | 5.82%                    | \$ 1,490,000        | \$ 1,496,779          | \$ 8,790                        | \$ 0                             | \$ 1,505,569        |
| 1-3 years   | 5.96%                    | 3,585,000           | 3,609,527             | 88,035                          | 0                                | 3,697,562           |
| 3-5 years   | 6.04%                    | 1,640,000           | 1,703,669             | 76,027                          | 0                                | 1,779,696           |
| 5-10 years  | 6.00%                    | 1,615,000           | 1,664,974             | 117,633                         | 0                                | 1,782,607           |
| <b>Total</b>  |                          | <b>\$ 8,330,000</b> | <b>\$ 8,474,949</b>   | <b>\$ 290,485</b>               | <b>\$ 0</b>                      | <b>\$ 8,765,434</b> |
| <b>Available-for-Sale</b>                                 |                          |                     |                       |                                 |                                  |                     |
| Less than one year  | 5.55%                    | \$ 370,000          | \$ 373,840            | \$ 2,172                        | \$ 0                             | \$ 376,012          |
| 1-3 years   | 5.61%                    | 205,000             | 208,743               | 2,082                           | 0                                | 210,825             |
| <b>Total</b>  |                          | <b>\$ 575,000</b>   | <b>\$ 582,583</b>     | <b>\$ 4,254</b>                 | <b>\$ 0</b>                      | <b>\$ 586,837</b>   |
| <b>Total Investment in U.S. Treasury Obligations, Net</b> |                          |                     |                       |                                 |                                  |                     |
| <b>Total</b>  |                          | <b>\$ 8,905,000</b> | <b>\$ 9,057,532</b>   | <b>\$ 294,739</b>               | <b>\$ 0</b>                      | <b>\$ 9,352,271</b> |

**U.S. Treasury Obligations at December 31, 1997 (Unrestricted)**

Dollars in Thousands

| <b>Maturity</b>   | <b>Yield at Purchase</b> | <b>Face Value</b>   | <b>Amortized Cost</b> | <b>Unrealized Holding Gains</b> | <b>Unrealized Holding Losses</b> | <b>Market Value</b> |
|---|--------------------------|---------------------|-----------------------|---------------------------------|----------------------------------|---------------------|
| <b>Held-to Maturity</b>                                   |                          |                     |                       |                                 |                                  |                     |
| Less than one year  | 5.91%                    | \$ 1,650,000        | \$ 1,647,211          | \$ 2,751                        | \$ (319)                         | \$ 1,649,643        |
| 1-3 years   | 5.87%                    | 3,415,000           | 3,451,362             | 16,852                          | (3,309)                          | 3,464,905           |
| 3-5 years   | 6.03%                    | 2,510,000           | 2,541,949             | 26,808                          | (969)                            | 2,567,788           |
| 5-10 years  | 6.47%                    | 1,265,000           | 1,313,739             | 49,888                          | 0                                | 1,363,627           |
| <b>Total</b>  |                          | <b>\$ 8,840,000</b> | <b>\$ 8,954,261</b>   | <b>\$ 96,299</b>                | <b>\$ (4,597)</b>                | <b>\$ 9,045,963</b> |
| <b>Available-for-Sale</b>                                 |                          |                     |                       |                                 |                                  |                     |
| 1-3 years   | 5.67%                    | \$ 150,000          | \$ 152,157            | \$ 32                           | \$ (64)                          | \$ 152,125          |
| <b>Total Investment in U.S. Treasury Obligations, Net</b> |                          |                     |                       |                                 |                                  |                     |
| <b>Total</b>  |                          | <b>\$ 8,990,000</b> | <b>\$ 9,106,418</b>   | <b>\$ 96,331</b>                | <b>\$ (4,661)</b>                | <b>\$ 9,198,088</b> |

In 1998, the unamortized premium, net of unamortized discount, was \$152.5 million. In 1997, the unamortized premium, net of the unamortized discount, was \$116.4 million.

## 5. Receivables From Thrift Resolutions, Net

The thrift resolution process takes different forms depending on the unique facts and circumstances surrounding each failing or failed institution. Payments for institutions that fail are made to cover obligations to insured depositors and represent claims by the SAIF against the receiverships' assets. There were no thrift failures in 1998, or in 1997.

As of December 31, 1998 and 1997, the FDIC, in its receivership capacity for SAIF-insured institutions, held assets with a book value of \$46.1 million and \$56.6 million, respectively (including cash and miscellaneous receivables of \$45.7 million and \$40 million at

December 31, 1998 and 1997, respectively). These assets represent a significant source of repayment of the SAIF's receivables from thrift resolutions. The estimated cash recoveries from the management and disposition of these assets that are used to derive the allowance for losses are based in part on a statistical sampling of receivership assets. The sample was constructed to produce a statistically valid result. These estimated recoveries are regularly evaluated, but remain subject to uncertainties because of potential changes in economic conditions. These factors could cause the SAIF's and other claimants' actual recoveries to vary from the level currently estimated.

## 6. Estimated Liabilities for:

### Anticipated Failure of Insured Institutions

The SAIF records an estimated liability and a loss provision for thrifts (including Oakar and Sasser financial institutions) that are likely to fail, absent some favorable event such as obtaining additional capital or merging, when the liability becomes probable and reasonably estimable.

The estimated liabilities for anticipated failure of insured institutions as of December 31, 1998 and 1997, were \$31 million and zero, respectively. The estimated liability is derived in part from estimates of recoveries from the management and disposition of the assets of these probable thrift failures. Therefore, they are subject to the same uncertainties as those affecting the SAIF's receivables from thrift resolutions (see Note 5). This could affect the ultimate costs to the SAIF from probable failures.

There are other thrifts where the risk of failure is less certain, but still considered reasonably possible. Should these thrifts fail, the SAIF could incur additional estimated losses of about \$77 million.

The accuracy of these estimates will largely depend on future economic conditions. The Board has the statutory authority to consider the estimated liability from anticipated failures of insured institutions when setting assessment rates.

### Year 2000 Anticipated Failures

The SAIF is also subject to a potential loss from thrifts that may fail if they are unable to become Year 2000 compliant in a timely manner. In May 1997, the federal financial institution regulatory agencies developed a program to conduct uniform reviews of all FDIC-insured institutions' Year 2000 readiness. The program assesses the five key phases of an institution's Year 2000 conversion efforts: 1) awareness, 2) assessment, 3) renovation,

4) validation, and 5) implementation. The reviews classify each institution as Satisfactory, Needs Improvement, or Unsatisfactory.

*Satisfactory.* Year 2000 efforts of financial institutions and independent data centers are considered "Satisfactory" if they exhibit acceptable performance in all key phases of the Year 2000 project management process as set forth in the May 5, 1997, Federal Financial Institutions Examination Council (FFIEC) Interagency Statement on the Year 2000 and subsequent guidance documents. Performance is satisfactory when project weaknesses are minor in nature and can be readily corrected within the existing project management framework. The institution's remediation progress to date meets or nearly meets expectations laid out in its Year 2000 project plan. Senior management and the board recognize and understand Year 2000 risk, are active in overseeing institutional corrective efforts, and have ensured that the necessary resources are available to address this risk area.

*Needs Improvement.* Year 2000 efforts of financial institutions and independent data centers are evaluated as "Needs Improvement" if they exhibit less than acceptable performance in all key phases of the Year 2000 project management process. Project weaknesses are evident, even if deficiencies are correctable within the existing project management framework. The institution's remediation progress to date is behind the schedule laid out in its Year 2000 project plan. Senior management or the board is not fully aware of the status of Year 2000 correction efforts, may not have committed sufficient financial or human resources to address this risk, or may not fully understand Year 2000 implications.

*Unsatisfactory.* Year 2000 efforts of financial institutions and independent data centers are considered "Unsatisfactory" if they exhibit poor performance in any of the key phases of the Year 2000 project management process. Project weaknesses are serious in nature and are not easily corrected within the existing project management framework. The institution's remediation progress is seriously behind the schedule laid out in its Year 2000 project plan.



Senior management and the board do not understand or recognize the impact that the Year 2000 will have on the institution. Management or the board commitment is limited or their oversight activities are not evident.

Based on data updated through April 30, 1999, 10,159 institutions with \$6.4 trillion in assets have received a Satisfactory rating, 216 institutions with \$80 billion in assets a Needs Improvement rating, and 21 institutions with \$1 billion in assets an Unsatisfactory rating (data includes SAIF-and BIF-insured institutions). Although the initial results of the uniform reviews are encouraging, the Year 2000 issue is unprecedented. Therefore, it is difficult to determine which institutions, if any, will ultimately fail. Further, estimates of the cost of resolving Year 2000 failures are complicated by the uncertain nature of technological disruptions and the associated impact on the SAIF, if any. Failures caused solely by liquidity problems would pose substantially less exposure to the SAIF. Year 2000 failures could conceivably be such liquidity failures. The possibility that any such failure would occur is quite speculative in view of actions taken by the Federal Reserve Board to ensure sufficient liquidity and currency to meet the cash needs of insured thrifts.

Failures could occur because of the familiar capital insolvency (liabilities exceeding assets) if a substantial number of thrift borrowers were unable to repay loans due to their own lack of preparedness for the Year 2000. Insured thrifts are required to be aware of the measures taken by key customers to protect themselves against adverse impact from the advent of Year 2000, and compliance with such requirements is monitored via the regulatory examination program. The extent to which insured institutions, if any, ultimately experience this type of failure is not measurable.

Financial institutions are required to design a Year 2000 contingency plan to mitigate the risks associated with the failure of systems at critical dates (Business Resumption Contingency Planning). A business resumption contingency plan is designed to provide assurance that core business functions will continue if one or more systems fail.

In order to assess exposure to the SAIF from Year 2000 potential failures, the FDIC evaluated all information relevant to such an assessment, to include Year 2000 on-site examination results, institution capital levels and supervisory examination composite ratings, and other institution past and current financial characteristics. As a result of this assessment, we conclude that, as of December 31, 1998, there are no probable losses to the SAIF from Year 2000 failures. Further, any reasonably possible losses from Year 2000 failures were not estimable. During the remainder of 1999, the regulatory agencies will continue their Year 2000 reviews and the FDIC will continue to assess this potential liability.

### Litigation Losses

The SAIF records an estimated loss for unresolved legal cases to the extent those losses are considered probable and reasonably estimable. For 1998 and 1997, no legal cases were deemed probable in occurrence. In 1998, no unresolved legal cases were identified as reasonably possible.

## 7. Assessments

The 1990 OBR Act removed caps on assessment rate increases and authorized the FDIC to set assessment rates for SAIF members semiannually, to be applied against a member's average assessment base. The FDICIA: 1) required the FDIC to implement a risk-based assessment system; 2) authorized the FDIC to increase assessment rates for SAIF-member institutions as needed to ensure that funds are available to satisfy the SAIF's obligations; 3) required the FDIC to build and maintain the reserves in the insurance funds to 1.25 percent of insured deposits; and 4) authorized the FDIC to increase assessment rates more frequently than semiannually and impose emergency special assessments as necessary to ensure that funds are available to repay U.S. Treasury borrowings.

The DIFA (see Note 1) provided, among other things, for the capitalization of the SAIF to its DRR of 1.25 percent by means of a one-time special assessment on SAIF-insured deposits. The SAIF achieved its required capitalization by means of a \$4.5 billion special assessment effective October 1, 1996.

Prior to January 1, 1997, the FICO had priority over the SAIF for receiving and utilizing SAIF assessments to ensure availability of funds for interest on the FICO's debt obligations. Accordingly, the SAIF recognized as assessment revenue only that portion of SAIF assessments not required by the FICO. Assessments on the SAIF-insured deposits held by BIF-member Oakar or SAIF-member Sasser institutions prior to January 1, 1997, were not subject to draws by the FICO and, thus, were retained in SAIF in their entirety.

The DIFA expanded the assessment base for payments of the interest on obligations issued by the FICO to include all FDIC-insured institutions (including banks, thrifts, and Oakar and Sasser financial institutions) and made the FICO assessment separate from regular assessments, effective on January 1, 1997.

The FICO assessment has no financial impact on the SAIF. The FICO assessment is separate from the regular assessments and is imposed on thrifts and banks, not on the insurance funds. The FDIC, as administrator of the SAIF and the BIF, is acting solely as a collection agent for the FICO. During 1998 and 1997, \$446 million and \$454 million respectively, were collected from savings associations and remitted to the FICO.

The FDIC uses a risk-based assessment system that charges higher rates to those institutions that pose greater risks to the SAIF.

To arrive at a risk-based assessment for a particular institution, the FDIC places each institution in one of nine risk categories, using a two-step process based first on capital ratios and then on other relevant information. The Board reviews premium rates semiannually. The assessment rate averaged approximately 0.21 cents and 0.39 cents per \$100 of assessable deposits for 1998 and 1997, respectively. On October 27, 1998, the Board voted to retain the SAIF assessment schedule of 0 to 27 cents per \$100 of assessable deposits (annual rates) for the first semiannual period of 1999.

## 8. Pension Benefits, Savings Plans, and Accrued Annual Leave

Eligible FDIC employees (all permanent and temporary employees with appointments exceeding one year) are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The CSRS is a defined benefit plan, which is offset with the Social Security System in certain cases. Plan benefits are determined on the basis of years of creditable service and compensation levels. The CSRS-covered employees also can contribute to the tax-deferred Federal Thrift Savings Plan (TSP).

The FERS is a three-part plan consisting of a basic defined benefit plan that provides benefits based on years of creditable service and compensation levels, Social Security benefits, and the TSP. Automatic and matching employer contributions to the TSP are provided up to specified amounts under the FERS.

During 1998, there was an open season that allowed employees to switch from CSRS to FERS. This did not have a material impact on SAIF's operating expenses.

Although the SAIF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The SAIF also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported on and accounted for by the U.S. Office of Personnel Management (OPM).

Eligible FDIC employees also may participate in a FDIC-sponsored tax-deferred savings plan with matching contributions. The SAIF pays its share of the employer's portion of all related costs.

The SAIF's pro rata share of the Corporation's liability to employees for accrued annual leave is approximately \$4.4 million and \$3 million at December 31, 1998 and 1997, respectively.

## Pension Benefits and Savings Plans Expenses

Dollars in Thousands

|  | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|--|---|---|
| CSRS/FERS Disability Fund                          | \$ 140                                  | \$ 44                                   |
| Civil Service Retirement System                    | 1,242                                   | 855                                     |
| Federal Employee Retirement System (Basic Benefit) | 3,002                                   | 2,242                                   |
| FDIC Savings Plan                                  | 1,947                                   | 1,446                                   |
| Federal Thrift Savings Plan                        | 1,176                                   | 840                                     |
| <b>Total</b>                                       | <b>\$ 7,507</b>                         | <b>\$ 5,427</b>                         |

## 9. Postretirement Benefits Other Than Pensions

On January 2, 1998, SAIF's obligation under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," for postretirement health benefits was reduced when over 6,500 employees enrolled in the Federal Employees Health Benefits (FEHB) Program for their future health insurance coverage. The OPM assumed the SAIF's obligation for postretirement health benefits for these employees at no initial enrollment cost.

In addition, legislation was passed that allowed the remaining 2,600 retirees and near-retirees (employees within five years of retirement) in the FDIC health plan to also enroll in the FEHB Program for their future health insurance coverage, beginning

January 1, 1999. The OPM assumed the SAIF's obligation for postretirement health benefits for retirees and near-retirees for a fee of \$3.7 million. The OPM is now responsible for postretirement health benefits for all employees and covered retirees. The FDIC will continue to be obligated for dental and life insurance coverage for as long as the programs are offered and coverage is extended to retirees.

OPM's assumption of the health care obligation constitutes both a settlement and a curtailment as defined by SFAS No. 106. This conversion resulted in a gain of \$5.5 million to the SAIF.

### Postretirement Benefits Other Than Pensions

Dollars in Thousands

|  | 1998        | 1997            |
|--|-------------|-----------------|
| <b>Funded Status at December 31</b>  |             |                 |
| Fair value of plan assets <sup>(a)</sup>                                     | \$ 5,048    | \$ 10,011       |
| Less: Benefit obligation   | 5,048       | 9,411           |
| <b>Under/(Over) Funded Status of the plans</b>                               | <b>\$ 0</b> | <b>\$ (600)</b> |
| Accrued benefit liability recognized in the Statements of Financial Position | \$ 0        | \$ 867          |
| <b>Expenses and Cash Flows for the Period Ended December 31</b>              |             |                 |
| Net periodic benefit cost  | \$ 1,516    | \$ 451          |
| Employer contributions   | 718         | 342             |
| Benefits paid  | 718         | 342             |
| <b>Weighted-Average Assumptions at December 31</b>                           |             |                 |
| Discount rate  | 4.50 %      | 5.75 %          |
| Expected return on plan assets   | 4.50 %      | 5.75 %          |
| Rate of compensation increase  | 4.00 %      | 4.00 %          |

*(a) Invested in U.S. Treasury obligations.*

For measurement purposes, the per capita cost of covered health care benefits was assumed to increase by an annual rate of 8.75 percent for 1998. Further, the rate was assumed to decrease

gradually each year to a rate of 7.75 percent for the year 2000 and remain at that level thereafter.



## 10. Commitments and Off-Balance-Sheet Exposure

### Commitments

#### Leases

The SAIF's allocated share of the FDIC's lease commitments totals \$20.2 million for future years. The lease agreements contain escalation clauses resulting in adjustments, usually on an annual basis. The allocation to the SAIF of the FDIC's future lease commitments

is based upon current relationships of the workloads among the SAIF, the BIF and the FRF. Changes in the relative workloads could cause the amounts allocated to the SAIF in the future to vary from the amounts shown below. The SAIF recognized leased space expense of \$4.8 million and \$3.3 million for the years ended December 31, 1998 and 1997, respectively.

### Lease Commitments

Dollars in Thousands

| 1999    | 2000    | 2001    | 2002    | 2003    | 2004 and<br>Thereafter |
|---------|---------|---------|---------|---------|------------------------|
| \$4,488 | \$3,963 | \$3,187 | \$2,788 | \$1,723 | \$4,079                |

### Other Off-Balance Sheet Risk

#### Deposit Insurance

As of December 31, 1998, deposits insured by the SAIF totaled approximately \$709 billion. This would be the accounting loss if all

depository institutions were to fail and the acquired assets provided no recoveries.

## 11. Disclosures About the Fair Value of Financial Instruments

Cash equivalents are short-term, highly liquid investments and are shown at current value. The fair market value of the investment in U.S. Treasury obligations is disclosed in Notes 3 and 4 and is based on current market prices. The carrying amount of interest receivable on investments, short-term receivables, and accounts payable and other liabilities approximates their fair market value. This is due to their short maturities or comparisons with current interest rates. As explained in Note 3, entrance and exit fees receivable are net of discounts calculated using an interest rate comparable to U.S. Treasury Bill or Government bond/note rates at the time the receivables are accrued.

The net receivables from thrift resolutions primarily include the SAIF's subrogated claim arising from payments to insured depositors. The receivership assets that will ultimately be used to pay the corporate subrogated claim are valued using discount rates that include consideration of market risk. These discounts ultimately affect the SAIF's allowance for loss against the net receivables from thrift resolutions. Therefore, the corporate subrogated claim indirectly includes the effect of discounting

and should not be viewed as being stated in terms of nominal cash flows.

Although the value of the corporate subrogated claim is influenced by valuation of receivership assets (see Note 5), such receivership valuation is not equivalent to the valuation of the corporate claim. Since the corporate claim is unique, not intended for sale to the private sector, and has no established market, it is not practicable to estimate its fair market value.

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

## 12. Supplementary Information Relating to the Statements of Cash Flows

### Reconciliation of Net Income to Net Cash Provided by Operating Activities

Dollars in Thousands

|  | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|--|---|---|
| <b>Net Income</b>  | <b>\$ 467,230</b>                       | <b>\$ 479,926</b>                       |
| <b>Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities</b>                        |   |   |
| <b>Income Statement Items:</b>   |   |   |
| Provision for insurance losses   | 31,992                                  | (1,879)                                 |
| Amortization of U.S. Treasury obligations (unrestricted)   | 41,198                                  | 17,675                                  |
| Gain on conversion of benefit plan   | 5,464                                   | 0                                       |
| <b>Change in Assets and Liabilities:</b>   |   |   |
| Decrease (Increase) in amortization of U.S. Treasury obligations (restricted)                                  | 304                                     | (147)                                   |
| (Increase) in entrance and exit fees receivable, including interest receivable on investments and other assets | (20,187)                                | (33)                                    |
| (Increase) Decrease in receivables from thrift resolutions   | (4,700)                                 | 11,652                                  |
| (Decrease) in accounts payable and other liabilities   | (3,126)                                 | (171,732)                               |
| Increase in exit fees and investment proceeds held in escrow   | 14,242                                  | 11,973                                  |
| <b>Net Cash Provided by Operating Activities</b>   | <b>\$ 532,417</b>                       | <b>\$ 347,435</b>                       |

## 13. Year 2000 Issues

### State of Readiness

The FDIC, as administrator for the SAIF, is conducting a corporate-wide effort to ensure that all FDIC information systems are Year 2000 compliant. This means the systems must accurately process date and time data in calculations, comparisons, and sequences after December 31, 1999, and be able to correctly deal with leap-year calculations in 2000. The Year 2000 Oversight Committee is comprised of FDIC division management that oversees the Year 2000 effort.

The FDIC's Division of Information Resources Management (DIRM) leads the internal Year 2000 effort, under the direction of the Oversight Committee. DIRM used a five-phase approach for ensuring that all FDIC systems and software are Year 2000 compliant. The five phases are:

#### Awareness

The first phase of compliance focuses on defining the Year 2000 problem and gaining executive-level support and sponsorship for the effort.

### Assessment

The second phase of compliance focuses on assessing the Year 2000 impact on the Corporation as a whole.

### Renovation

The third phase of compliance focuses on converting, replacing or eliminating selected platforms, applications, databases, and utilities, while modifying interfaces as appropriate.

Platform is a broad term that encompasses computer hardware (including mainframe computers, servers, and personal computers) and software (including computer languages and operating systems). Utility programs, or "utilities," provide file management capabilities, such as sorting, copying, comparing, listing and searching, as well as diagnostic and measurement routines that check the health and performance of the system.

### Validation

The fourth phase of compliance focuses on testing, verifying and validating converted or replaced platforms, applications, databases, and utilities.

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**Implementation**

The fifth phase of compliance focuses on implementing converted or replaced platforms, applications, databases, utilities, and interfaces.

The Awareness, Assessment, and Renovation phases are complete. The Validation phase is scheduled to be completed during January 1999 when all production applications will be validated for Year 2000 readiness. Implementation of the majority of production applications in Year 2000 ready status will be completed by March 31, 1999. Validation and implementation of new systems and modifications to existing systems will continue throughout 1999.

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**Year 2000 Estimated Costs**

Year 2000 compliance expenses for the SAIF are estimated at \$4.4 million and \$191 thousand at December 31, 1998 and 1997, respectively. These expenses are reflected in the "Operating expenses" line item of the SAIF's Statements of Income and Fund Balance. Future expenses are estimated to be \$6.2 million. Year 2000 estimated future costs are included in the FDIC's budget.

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**Risks of Year 2000 Issues**

The OTS has an ongoing aggressive initiative to assess the SAIF's insured financial institutions for Year 2000 compliance. The SAIF is subject to a potential loss from financial institutions that may fail as a result of Year 2000 related issues. Refer to "Estimated Liabilities for: Anticipated Failure of Insured Institutions - Year 2000 Anticipated Failures" (Note 6) for additional information.

No potential loss with internal system failure has been estimated due to the extensive planning and validation that has occurred.

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**Contingency Plans**

DIRM is currently developing a disaster recovery plan and contingency plans specific to each mission-critical application.

Other divisions within the FDIC are working together to develop contingency plans to be prepared if any FDIC-insured financial institution fails as a result of lack of Year 2000 preparedness.

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**14. Subsequent Events**

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**SAIF Special Reserve**

DIFA requires the establishment of a Special Reserve of the SAIF if, on January 1, 1999, the reserve ratio exceeds the DRR of 1.25 percent. The reserve ratio exceeded the DRR by approximately 0.14 percent on January 1, 1999. As a result, \$978 million was placed in a Special Reserve of the SAIF and is being administered by the FDIC.

The Corporation may, in its sole discretion, transfer amounts from the Special Reserve to the SAIF for an "emergency use." An emergency use is authorized only if the reserve ratio of the SAIF is less than 50 percent of the DRR and is expected to remain at less than 50 percent for each of the next four calendar quarters. The Special Reserve must be excluded when calculating the reserve ratio of the SAIF.





## Federal Deposit Insurance Corporation

**FSLIC Resolution Fund Statements of Financial Position**

Dollars in Thousands

|  | December 31, 1998    | December 31, 1997   |
|--|----------------------|---------------------|
| <b>Assets</b>  |                      |                     |
| Cash and cash equivalents  | \$ 4,631,379         | \$ 2,107,171        |
| Receivables from thrift resolutions, net (Note 3)                                | 1,388,579            | 2,570,486           |
| Securitization funds held by trustee, net (Note 4)                               | 2,796,646            | 4,890,568           |
| Investment in securitization residual certificates (Note 5)                      | 1,538,339            |                     |
| Assets acquired from assisted thrifts and terminated receiverships, net (Note 6) | 64,101               | 73,051              |
| Other assets, net (Note 7)   | 40,721               | 7,391               |
| <b>Total Assets</b>  | <b>\$ 10,459,765</b> | <b>\$ 9,648,667</b> |
| <b>Liabilities</b>   |                      |                     |
| Accounts payable and other liabilities   | \$ 40,396            | \$ 164,401          |
| Notes payable - Federal Financing Bank borrowings (Note 8)                       | 0                    | 849,294             |
| Liabilities from thrift resolutions (Note 9)                                     | 74,336               | 105,168             |
| <i>Estimated Liabilities for: (Note 10)</i>                                      |                      |                     |
| Assistance agreements  | 4,852                | 6,328               |
| Litigation losses  | 18,340               | 2,634               |
| <b>Total Liabilities</b>   | <b>137,924</b>       | <b>1,127,825</b>    |
| <i>Commitments and concentration of credit risks (Note 15)</i>                   |                      |                     |
| <b>Resolution Equity (Note 12)</b>   |                      |                     |
| Contributed capital  | 135,490,741          | 135,493,762         |
| Accumulated deficit  | (125,243,229)        | (126,972,920)       |
| Unrealized gain on available-for-sale securities, net (Note 5)                   | 74,329               |                     |
| Accumulated deficit, net   | (125,168,900)        | (126,972,920)       |
| <b>Total Resolution Equity</b>   | <b>10,321,841</b>    | <b>8,520,842</b>    |
| <b>Total Liabilities and Resolution Equity</b>                                   | <b>\$ 10,459,765</b> | <b>\$ 9,648,667</b> |

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

## Federal Deposit Insurance Corporation

**FSLIC Resolution Fund Statements of Income and Accumulated Deficit**

Dollars in Thousands

|   | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|---|---|---|
| <b>Revenue</b>  |   |   |
| Interest on securitization funds held by trustee                                | \$ 262,962                              | \$ 299,854                              |
| Interest on U.S. Treasury obligations   | 109,045                                 | 86,959                                  |
| Interest on advances and subrogated claims                                      | 212,645                                 | (28,348)                                |
| Gain on conversion of benefit plan (Note 14)                                    | 39,297                                  | 0                                       |
| Revenue from assets acquired from assisted thrifts and terminated receiverships | 40,124                                  | 74,286                                  |
| Limited partnership equity interests and other revenue                          | 31,593                                  | 22,600                                  |
| <b>Total Revenue</b>  | <b>695,666</b>                          | <b>455,351</b>                          |
| <b>Expenses and Losses</b>  |   |   |
| Operating expenses  | 56,336                                  | 16,732                                  |
| Provision for losses (Note 11)  | (1,290,752)                             | (1,741,639)                             |
| Expenses for goodwill settlements and litigation                                | 154,492                                 | 33,833                                  |
| Interest expense on FFB debt and other notes payable                            | 22,413                                  | 130,435                                 |
| Expenses for assets acquired from assisted thrifts and terminated receiverships | 19,652                                  | 65,175                                  |
| Other expenses  | 3,834                                   | 4,412                                   |
| <b>Total Expenses and Losses</b>  | <b>(1,034,025)</b>                      | <b>(1,491,052)</b>                      |
| <b>Net Income</b>   | <b>1,729,691</b>                        | <b>1,946,403</b>                        |
| Unrealized gain on available-for-sale securities, net (Note 5)                  | 74,329                                  | 0                                       |
| <b>Comprehensive Income</b>   | <b>1,804,020</b>                        | <b>1,946,403</b>                        |
| <b>Accumulated Deficit - Beginning</b>  | <b>(126,972,920)</b>                    | <b>(128,919,323)</b>                    |
| <b>Accumulated Deficit - Ending</b>   | <b>\$ (125,168,900)</b>                 | <b>\$ (126,972,920)</b>                 |

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



## Federal Deposit Insurance Corporation

**FSLIC Resolution Fund Statements of Cash Flows**

Dollars in Thousands

|   | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|---|---|---|
| <b>Cash Flows From Operating Activities</b>   |   |   |
| <b>Cash provided from:</b>  |   |   |
| Interest on U.S. Treasury obligations   | \$ 109,045                              | \$ 86,966                               |
| Recoveries from thrift resolutions  | 890,566                                 | 3,791,256                               |
| Recoveries from securitization funds held by trustee                                    | 2,390,945                               | 1,078,815                               |
| Recoveries from limited partnership equity interests                                    | 188,801                                 | 121,369                                 |
| Recoveries from assets acquired from assisted thrifts<br>and terminated receiverships   | 48,580                                  | 483,524                                 |
| Miscellaneous receipts  | 1,383                                   | 13,962                                  |
| <b>Cash used for:</b>   |   |   |
| Operating expenses  | (78,526)                                | (41,268)                                |
| Interest paid on notes payable  | (29,997)                                | (173,981)                               |
| Disbursements for thrift resolutions  | (177,365)                               | (390,632)                               |
| Disbursements for goodwill settlements and litigation expenses                          | (154,492)                               | (26,610)                                |
| Disbursements for assets acquired from assisted thrifts<br>and terminated receiverships | (26,952)                                | (176,933)                               |
| Miscellaneous disbursements   | (220)                                   | (4,913)                                 |
| <b>Net Cash Provided by Operating Activities (Note 17)</b>                              | <b>3,161,768</b>                        | <b>4,761,555</b>                        |
| <b>Cash Flows From Investing Activities</b>   |   |   |
| <b>Cash provided from:</b>  |   |   |
| Redemption of Securitization Residual Certificates, available-for-sale                  | 260,856                                 |   |
| <b>Cash used for:</b>   |   |   |
| Purchase of Residual Certificates, available-for-sale                                   | (25,425)                                |   |
| <b>Net Cash Provided from Investing Activities</b>                                      | <b>235,431</b>                          |   |
| <b>Cash Flows From Financing Activities</b>   |   |   |
| <b>Cash used for:</b>   |   |   |
| Return of U.S. Treasury payments  | (3,020)                                 | (8,053)                                 |
| Repayments of Federal Financing Bank borrowings   | (838,412)                               | (3,718,692)                             |
| Repayments of indebtedness from thrift resolutions                                      | (31,559)                                | (31,560)                                |
| <b>Net Cash Used by Financing Activities</b>  | <b>(872,991)</b>                        | <b>(3,758,305)</b>                      |
| <b>Net Increase in Cash and Cash Equivalents</b>  | <b>2,524,208</b>                        | <b>1,003,250</b>                        |
| <b>Cash and Cash Equivalents - Beginning</b>  | <b>2,107,171</b>                        | <b>1,103,921</b>                        |
| <b>Cash and Cash Equivalents - Ending</b>   | <b>\$ 4,631,379</b>                     | <b>\$ 2,107,171</b>                     |

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

# Notes to the Financial Statements

## FSLIC Resolution Fund

December 31, 1998 and 1997

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### 1. Legislative History and Operations of the FSLIC Resolution Fund

#### Legislative History

The U.S. Congress created the Federal Savings and Loan Insurance Corporation (FSLIC) through the enactment of the National Housing Act of 1934. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) abolished the insolvent FSLIC, created the FSLIC Resolution Fund (FRF), and transferred the assets and liabilities of the FSLIC to the FRF (except those assets and liabilities transferred to the Resolution Trust Corporation (RTC)), effective on August 9, 1989. The FRF is responsible for winding up the affairs of the former FSLIC.

The FIRREA was enacted to reform, recapitalize, and consolidate the federal deposit insurance system. In addition to the FRF, FIRREA created the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). It also designated the Federal Deposit Insurance Corporation (FDIC) as the administrator of these funds. All three funds are maintained separately to carry out their respective mandates.

The FIRREA also created the RTC to manage and resolve all thrifts previously insured by the FSLIC for which a conservator or receiver was appointed during the period January 1, 1989, through August 8, 1992. The FIRREA established the Resolution Funding Corporation (REFCORP) to provide part of the initial funds used by the RTC for thrift resolutions. Additionally, funds were appropriated for RTC resolutions pursuant to FIRREA, the RTC Funding Act of 1991, the RTC Refinancing, Restructuring and Improvement Act of 1991, and the RTC Completion Act.

The RTC's resolution responsibility was extended through subsequent legislation from the original termination date of August 8, 1992. Resolution responsibility transferred from the RTC to the SAIF on July 1, 1995.

The RTC Completion Act of 1993 (RTC Completion Act) terminated the RTC as of December 31, 1995. All remaining assets and liabilities of the RTC were transferred to the FRF on January 1, 1996. Today, the FRF consists of two distinct pools of assets and liabilities: one composed of the assets and liabilities of the FSLIC transferred to the FRF upon the dissolution of the FSLIC on August 9, 1989 (FRF-FSLIC), and the other composed of the RTC assets and liabilities transferred to the FRF on January 1, 1996 (FRF-RTC). The assets of one pool are not available to satisfy obligations of the other.

The RTC Completion Act requires the FDIC to return to the U.S. Treasury any funds that were transferred to the RTC pursuant to the RTC Completion Act but not needed by the RTC. The RTC Completion Act made available approximately \$18 billion worth of additional funding. The RTC actually drew down \$4.556 billion.

The FDIC must transfer to the REFCORP the net proceeds from the FRF's sale of RTC assets, after providing for all outstanding RTC

liabilities. Any such funds transferred to the REFCORP pay the interest on the REFCORP bonds issued to fund the early RTC resolutions. Any such payments benefit the U.S. Treasury, which would otherwise be obligated to pay the interest on the bonds (see Note 12).

#### Operations of the FRF

The FRF will continue operations until all of its assets are sold or otherwise liquidated and all of its liabilities are satisfied. Any funds remaining in the FRF-FSLIC will be paid to the U.S. Treasury. Any remaining funds of the FRF-RTC will be distributed to the U.S. Treasury to repay RTC Completion Act appropriations and to the REFCORP to pay the interest on the REFCORP bonds.

The FRF has been primarily funded from the following sources: 1) U.S. Treasury appropriations; 2) amounts borrowed by the RTC from the Federal Financing Bank (FFB); 3) amounts recorded from the issuance of capital certificates to REFCORP; 4) funds received from the management and disposition of assets of the FRF; 5) the FRF's portion of liquidating dividends paid by FRF receiverships; and 6) interest earned on Special U.S. Treasury Certificates purchased with proceeds of 4) and 5). If these sources are insufficient to satisfy the liabilities of the FRF, payments will be made from the U.S. Treasury in amounts necessary, as are appropriated by Congress, to carry out the objectives of the FRF.

Public Law 103-327 provides \$827 million in funding to be available until expended to facilitate efforts to wind up the resolution activity of the FRF. The FRF received \$165 million under this appropriation on November 2, 1995. In addition, Public Law 104-208 and Public Law 105-61 authorized the use by the Department of Justice (DOJ) of \$26.1 million and \$33.7 million, respectively, from the original \$827 million in funding, thus reducing the amount available to be expended to \$602.2 million. The funding made available to DOJ covers the reimbursement of reasonable expenses of litigation incurred in the defense of claims against the U.S. arising from the goodwill litigation cases.

Additional goodwill litigation expenses incurred by DOJ will be paid directly from the FRF-FSLIC based on a Memorandum of Understanding (MOU) dated October 2, 1998, between FDIC and DOJ. Under the terms of the MOU, the FRF-FSLIC paid \$51.2 million to DOJ during 1998. Separate funding for goodwill judgements and settlements is available through Public Law 105-277 (see Note 10).

The VA, HUD and Independent Agencies Appropriations Acts of 1999 and 1998 appropriated \$34.7 million for fiscal year 1999 (October 1, 1998, through September 30, 1999) and \$34 million for fiscal year 1998 (October 1, 1997, through September 30, 1998), respectively, for operating expenses incurred by the Office of Inspector General (OIG). These Acts mandate that the funds are to be derived from the FRF, the BIF, and the SAIF.



## 2. Summary of Significant Accounting Policies

### General

These financial statements pertain to the financial position, results of operations, and cash flows of the FRF and are presented in accordance with generally accepted accounting principles (GAAP). These statements do not include reporting for assets and liabilities of closed thrift institutions for which the FDIC acts as receiver or liquidating agent. Periodic and final accountability reports of the FDIC's activities as receiver or liquidating agent are furnished to courts, supervisory authorities, and others as required.

### Use of Estimates

FDIC management makes estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Where it is reasonably possible that changes in estimates will cause a material change in the financial statements in the near term, the nature and extent of such changes in estimates have been disclosed.

### Cash Equivalents

Cash equivalents are short-term, highly liquid investments with original maturities of three months or less. Cash equivalents primarily consist of Special U.S. Treasury Certificates.

### Investment in Securitization Residual Certificates

The Investment in Securitization Residual Certificates is recorded pursuant to the provisions of the Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." SFAS No. 115 requires that securities be classified in one of three categories: held-to-maturity, available-for-sale, or trading. The Investment in Securitization Residual Certificates is classified as available-for-sale and is shown at fair value with unrealized gains and losses included in Resolution Equity. Realized gains are included in the "Limited partnership equity interests and other revenue" line item with realized losses included in the "Provision for losses" line item when applicable. The FRF does not have any securities classified as held-to-maturity or trading.

### Allowance for Losses on Receivables From Thrift Resolutions and Assets Acquired From Assisted Thrifts and Terminated Receiverships

The FRF records a receivable for the amounts advanced and/or obligations incurred for resolving troubled and failed thrifts. The

FRF also records as an asset the amounts paid for assets acquired from assisted thrifts and terminated receiverships. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. The latter is based on estimates of discounted cash recoveries from the assets of assisted or failed thrift institutions, net of all estimated liquidation costs. Estimated cash recoveries also include dividends and gains on sales from equity instruments acquired in resolution transactions.

### Receivership Operations

The FDIC is responsible for managing and disposing of the assets of failed institutions in an orderly and efficient manner. The assets, and the claims against them, are accounted for separately to ensure that liquidation proceeds are distributed in accordance with applicable laws and regulations. Also, the income and expenses attributable to receiverships are accounted for as transactions of those receiverships. Liquidation expenses incurred by the FRF on behalf of the receiverships are recovered from those receiverships.

### Cost Allocations Among Funds

Operating expenses not directly charged to the funds are allocated to all funds administered by the FDIC. Workload-based-allocation percentages are developed during the annual corporate planning process and through supplemental functional analyses.

### Postretirement Benefits Other Than Pensions

The FDIC established an entity to provide the accounting and administration of postretirement benefits on behalf of the FRF, the BIF, and the SAIF. Each fund pays its liabilities for these benefits directly to the entity. The FRF's unfunded net postretirement benefits liability for the plan is presented in FRF's Statements of Financial Position.

### Disclosure About Recent Financial Accounting Standard Pronouncements

In February 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 132, "Employers' Disclosures about Pension and Other Postretirement Benefits." The Statement standardizes the disclosure requirements for pensions and other postretirement benefits to the extent practicable. Although changes in the FRF's disclosures for postretirement benefits have been made, the impact is not material.



In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." The FDIC adopted SFAS No. 130 effective on January 1, 1997. Comprehensive income includes net income as well as certain types of unrealized gain or loss. The only component of SFAS No. 130 that impacts the FRF is unrealized gain or loss on the securitization residual certificates that are classified as available-for-sale, which is presented in the FRF's Statements of Financial Position and the Statements of Income and Accumulated Deficit.

Other recent pronouncements are not applicable to the financial statements.

### Wholly Owned Subsidiary

The Federal Asset Disposition Association (FADA) is a wholly owned subsidiary of the FRF. The FADA was placed in receivership on February 5, 1990. Final judgement on the remaining litigation was made on December 16, 1998. However, a final liquidating dividend to the FRF was still pending at year-end. This liquidating dividend will be disbursed during 1999. The investment in the FADA is accounted for using the equity method and is included in the "Other assets, net" line item (see Note 7).

### Related Parties

*National Judgments, Deficiencies, and Charge-offs Joint Venture Program.* The former RTC purchased assets from receiverships, conservatorships, and their subsidiaries to facilitate the sale and/or transfer of selected assets to several joint ventures in which the former RTC retained a financial interest. These assets are presented in "Assets acquired from assisted thrifts and terminated receiverships, net" line item in the FRF's Statements of Financial Position.

*Limited Partnership Equity Interests.* Former RTC receiverships were holders of limited partnership equity interests as a result of various RTC sales programs that included the National Land Fund, Multiple Investor Fund, N-Series, and S-Series programs. Over the past two years, the majority of the limited partnership equity interests were transferred from the receiverships to the FRF. These assets are included in the "Receivables from thrift resolutions, net" line item in the FRF's Statements of Financial Position.

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

### Reclassifications

Reclassifications have been made in the 1997 financial statements to conform to the presentation used in 1998.

## 3. Receivables From Thrift Resolutions, Net

The thrift resolution process took different forms depending on the unique facts and circumstances surrounding each failing or failed institution. Payments to prevent a failure were made to operating institutions when cost and other criteria were met. These payments resulted in acquiring "Assets from open thrift assistance," which are various types of financial instruments from the assisted institutions.

As of December 31, 1998 and 1997, the FDIC, in its receivership capacity for the former FSLIC and SAIF insured institutions, held assets with a book value of \$2.6 billion and \$3.6 billion, respectively (including cash and miscellaneous receivables of \$1.7 billion and

\$1.4 billion at December 31, 1998 and 1997, respectively). These assets represent a significant source of repayment of the FRF's receivables from thrift resolutions. The estimated cash recoveries from the management and disposition of these assets that are used to derive the allowance for losses are based in part on a statistical sampling of receivership assets. The sample was constructed to produce a statistically valid result. These estimated recoveries are regularly evaluated, but remain subject to uncertainties because of potential changes in economic conditions. These factors could cause the FRF's and other claimants' actual recoveries to vary from the level currently estimated.



### Receivables From Thrift Resolutions, Net

Dollars in Thousands

|   | December 31, 1998   | December 31, 1997   |
|---|---------------------|---------------------|
| Assets from open thrift assistance            | \$ 529,123          | \$ 804,217          |
| Allowance for losses                          | (386,935)           | (446,064)           |
| <b>Net Assets From Open Thrift Assistance</b> | <b>142,188</b>      | <b>358,153</b>      |
| Receivables from closed thrifts               | 72,727,268          | 76,680,026          |
| Allowance for losses                          | (71,480,877)        | (74,467,693)        |
| <b>Net Receivables From Closed Thrifts</b>    | <b>1,246,391</b>    | <b>2,212,333</b>    |
| <b>Total</b>                                  | <b>\$ 1,388,579</b> | <b>\$ 2,570,486</b> |

### Representations and Warranties

The FRF estimated corporate losses related to the receiverships' representations and warranties as part of the FRF's allowance for loss valuation. The allowance for these losses was \$81 million and \$90 million as of December 31, 1998 and 1997, respectively. There are additional amounts of representation and warranty claims that are considered reasonably possible. As of December 31, 1998, the amount is estimated at \$330 million. The RTC provided guarantees, representations, and warranties on approximately \$115 billion in unpaid principal balance of loans sold and approximately \$141 billion in unpaid principal balance of loans under servicing right contracts that had been sold. In general, the guarantees, representations and warranties on loans sold related to the completeness and accuracy of loan documentation, the

quality of the underwriting standards used, the accuracy of the delinquency status when sold, and the conformity of the loans with characteristics of the pool in which they were sold. The representations and warranties made in connection with the sale of servicing rights were limited to the responsibilities of acting as a servicer of the loans. Future losses on representations and warranties could significantly increase or decrease over the remaining life of the loans that were sold, which could be as long as 20 years.

The estimated liability for representations and warranties associated with loan sales that involved assets acquired from assisted thrifts and terminated receiverships are included in "Accounts payable and other liabilities" (\$5 million and \$18 million for 1998 and 1997, respectively).

### 4. Securitization Funds Held by Trustee, Net

In order to maximize the return from the sale or disposition of assets, the RTC engaged in numerous securitization transactions. The RTC sold \$42.4 billion of receivership, conservatorship, and corporate loans to various trusts that issued regular pass-through certificates through its mortgage-backed securities program. A portion of the proceeds from the sale of the certificates was placed in credit enhancement escrow accounts (escrow accounts) to cover future credit losses with respect to the loans underlying the certificates. In addition, the escrow accounts were established to increase the likelihood of full and timely distributions of interest and principal to the certificate holders and thus increase the marketability of the certificates. FRF's exposure from credit losses on loans sold through the program is limited to the balance of the escrow accounts. The escrow account balance is reduced for

claims paid and when the trustee releases the funds at the termination of a securitization deal. Funds are also released if the trustee deems the escrow account balance to be excessive.

Through December 1998, the amount of claims paid was approximately 19 percent of the initial escrow accounts. At December 31, 1998 and 1997, escrow accounts totaled \$2.9 billion and \$5.2 billion, respectively. At December 31, 1998 and 1997, the allowance for estimated future losses which would be paid from the escrow accounts totaled \$0.1 billion and \$0.3 billion, respectively.

The FRF earned interest income from the securitization funds held by trustee of \$263 million during 1998 and \$300 million during 1997.



## 5. Investment in Securitization Residual Certificates

As part of the securitization transactions described in Note 4, receivership and conservatorship loans were sold to various trusts. In return, the receiverships received a participation in the residual pass-through certificates (residual certificates) issued through its mortgage-backed securities program. The residual certificates entitle the holder to any cash flow from the sale of collateral remaining in the trust after the regular pass-through certificates and actual termination expenses are paid.

In October 1998, the residual certificates were transferred from the receiverships to the FRF. The \$1.8 billion transferred to the FRF was offset by amounts owed by the receiverships to the FRF. The residual certificates were adjusted to fair market value for this transaction and as a result, FRF's provision for losses decreased by \$0.5 billion and FRF's resolution equity increased by \$0.5 billion.

Realized gains and losses are recorded based on the difference between the proceeds at termination and the cost of the original investment. In 1998, the FDIC received \$241.3 million in proceeds from deals terminated by December 31, 1998. Additionally, at termination, \$48.8 million was deposited into the securitization funds held by trustee. The realized gains are included in "Limited partnership equity interests and other revenue" line item and the realized losses are included in the "Provision for losses" line item. At December 31, 1998, realized gains were \$2.7 million and realized losses were \$47.1 million.

### Investment in Securitization Residual Certificates at December 31, 1998

Dollars in Millions

| Cost     | Unrealized<br>Holding<br>Gains | Unrealized<br>Holding<br>Losses | Market<br>Value |
|----------|--------------------------------|---------------------------------|-----------------|
| \$ 1,464 | \$ 81                          | \$ 7                            | \$ 1,538        |

## 6. Assets Acquired From Assisted Thrifts and Terminated Receiverships, Net

The FRF's assets acquired from assisted thrifts and terminated receiverships includes: 1) assets the former FSLIC and the former RTC purchased from troubled or failed thrifts and 2) assets the FRF acquired from receiverships and purchased under assistance agreements. The methodology to estimate cash recoveries from these assets, which are used to derive the related allowance for losses, is the same as that for receivables from thrift resolutions (see Note 3).

The FRF recognizes revenue and expenses on these acquired assets. Revenue consists primarily of interest earned on mortgage loans and proceeds from professional liability claims. Expenses are recognized for the management and liquidation of these assets.

### Assets Acquired From Assisted Thrifts and Terminated Receiverships, Net

Dollars in Thousands

|  | December 31, 1998 | December 31, 1997 |
|--|-------------------|-------------------|
| Assets acquired from assisted thrifts and terminated receiverships | \$ 216,006        | \$ 277,607        |
| Allowance for losses   | (151,905)         | (204,556)         |
| <b>Total</b>   | <b>\$ 64,101</b>  | <b>\$ 73,051</b>  |



## 7. Other Assets, Net

### Other Assets, Net

Dollars in Thousands

|                                    | December 31, 1998 | December 31, 1997 |
|------------------------------------|-------------------|-------------------|
| Investment in FADA (Note 2)        | \$ 15,000         | \$ 15,000         |
| Allowance for loss                 | (11,074)          | (11,074)          |
| <b>Investment in FADA, Net</b>     | <b>3,926</b>      | <b>3,926</b>      |
| Accounts receivable                | 33,200            | 607               |
| Due from other government entities | 3,595             | 2,858             |
| <b>Other Receivables</b>           | <b>36,795</b>     | <b>3,465</b>      |
| <b>Total</b>                       | <b>\$ 40,721</b>  | <b>\$ 7,391</b>   |

## 8. Notes Payable—Federal Financing Bank Borrowings

Working capital was made available to the RTC under an agreement with the FFB to fund the resolution of thrifts and for use in the RTC's high-cost funds replacement and emergency liquidity programs. The outstanding note was due to mature on January 1, 2010; however, the entire principal and interest amounts were paid on August 10, 1998. The FFB borrowing authority ceased upon the termination of the RTC.

The note payable carried a floating rate of interest that was adjusted quarterly. The FFB established the interest rate and during 1998 these rates ranged between 5.487 percent and 5.228 percent.

## 9. Liabilities From Thrift Resolutions

The FSLIC issued promissory notes and entered into assistance agreements to prevent the default and subsequent liquidation of certain insured thrift institutions. These notes and agreements required the FSLIC to provide financial assistance over time. Pursuant to FIRREA, the FRF assumed these obligations.

Notes payable and obligations for assistance agreements are presented in the "Liabilities from thrift resolutions" line item. Estimated future assistance payments are included in the "Estimated liabilities for: Assistance agreements" line item (see Note 10).

### Liabilities From Thrift Resolutions

Dollars in Thousands

|  | December 31, 1998 | December 31, 1997 |
|--|-------------------|-------------------|
| Capital instruments                      | \$ 0              | \$ 725            |
| Assistance agreement notes payable       | 62,360            | 94,680            |
| Interest payable                         | 994               | 1,419             |
| Other liabilities to thrift institutions | 10,982            | 8,344             |
| <b>Total</b>                             | <b>\$ 74,336</b>  | <b>\$ 105,168</b> |

## 10. Estimated Liabilities for:

### Assistance Agreements

The estimated liabilities for assistance agreements are \$5 million and \$6 million at December 31, 1998 and 1997, respectively. The liability represents an estimate of future assistance payments to acquirers of troubled thrift institutions. The balances for both years were not discounted because the remaining assistance agreements will terminate within the next two years, and the discount adjustment was deemed to be immaterial.

There were 33 assistance agreements outstanding as of December 31, 1998 and 1997. The last agreement is scheduled to expire in July 2000.

### Litigation Losses

The FRF records an estimated loss for unresolved legal cases to the extent those losses are considered probable and reasonably estimable. In addition to the amount recorded as probable, the FDIC's Legal Division has determined that losses from unresolved legal cases totaling \$144 million are reasonably possible.

### Additional Contingency

In *United States v. Winstar Corp.*, 518 U.S. 839 (1996), the Supreme Court held that when it became impossible following the enactment of FIRREA in 1989 for the Federal Home Loan Bank Board to perform certain agreements to count goodwill toward regulatory capital, the plaintiffs were entitled to recover damages from the United States. To date, approximately 120 lawsuits have been filed against the United States based on alleged breaches of these agreements (Goodwill Litigation).

On July 23, 1998, the U.S. Treasury determined, based on an opinion of the DOJ's Office of Legal Counsel (OLC) dated July 22, 1998, that the FRF is legally available to satisfy all judgments and settlements in the Goodwill Litigation involving supervisory action or assistance agreements. The U.S. Treasury further determined that the FRF is the appropriate source of funds for payment of any such judgments and settlements.

The OLC opinion concluded that the nonperformance of these agreements was a contingent liability that was transferred to the FRF on August 9, 1989, upon the dissolution of the FSLIC. Under the analysis set forth in the OLC opinion, as liabilities transferred on August 9, 1989, these contingent liabilities for future nonperformance of prior agreements with respect to supervisory goodwill

were transferred to the FRF-FSLIC, which is that portion of the FRF encompassing the obligations of the former FSLIC. On July 31, 1998, the FDIC Board of Directors authorized the payment of four settlements in the Goodwill Litigation aggregating \$103.3 million. This payment was made from the FRF-FSLIC. The FRF-RTC, which encompasses the obligations of the former RTC and was created upon the termination of the RTC on December 31, 1995, is not available to pay any settlements and judgments arising out of the Goodwill Litigation.

The lawsuits comprising the Goodwill Litigation are against the United States and as such are defended by the DOJ. On March 19, 1999, DOJ informed the FDIC that, "as a practical matter, there are likely to be substantial recoveries against the government as these matters proceed to resolution." DOJ also advised that "variations among the ... cases [are] so great, including [the government's] possible recovery of fraud related damages and penalties against various plaintiffs, ... [that] it is simply impossible to predict what the overall outcome is likely to be."

The FDIC believes that it is probable that additional amounts, possibly substantial, may be paid from the FRF-FSLIC as a result of future judgments and settlements in the Goodwill Litigation. However, based on the response from the DOJ, the FDIC is unable to estimate a range of loss to the FRF-FSLIC from the Goodwill Litigation or determine whether any such loss would have a material effect on the financial condition of the FRF-FSLIC.

Section 130 of the Department of Justice Appropriations Act, 1999 (Section 130), as amended, provides to the FRF-FSLIC such sums as may be necessary for the payment of judgments and settlements in the Goodwill Litigation, to remain available until expended. In the Budget for Fiscal Year 2000, the President has requested a permanent appropriation to the FRF-FSLIC of such sums as may be necessary for the payment of judgments and settlements in the Goodwill Litigation, to remain available until expended. It is anticipated that such an appropriation for the Goodwill Litigation judgments and settlements will be adopted. As a consequence, the FDIC believes that even if the Goodwill Litigation judgments and settlements were to exceed other available resources of the FRF-FSLIC, an appropriation is currently available and, it is anticipated, will be available in the future to pay such judgments and settlements. In these circumstances any liabilities for the Goodwill Litigation should have no material impact on the financial condition of the FRF-FSLIC. If an appropriation to the FRF-FSLIC were not available to pay the Goodwill Litigation judgments and settlements, the liabilities of the FRF-FSLIC in respect of the Goodwill Litigation would be material and adversely affect the financial condition of the FRF-FSLIC.



## 11. Provision for Losses

The provision for losses was a negative \$1.3 billion and a negative \$1.7 billion for 1998 and 1997, respectively. In both years, the negative provision resulted primarily from decreased losses expected

for assets in liquidation. The following chart lists the major components of the negative provision for losses.

### Provision for Losses

Dollars in Thousands

|   | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1998 |
|---|---|---|
| <b>Valuation adjustments:</b>   |   |   |
| Open thrift assistance  | \$ 12,514                               | \$ (77,900)                             |
| Recovery of tax benefits  | (115,401)                               | (39,126)                                |
| Closed thrifts  | (1,125,523)                             | (1,481,702)                             |
| Assets acquired from assisted thrifts<br>and terminated receiverships | (66,709)                                | (242,253)                               |
| Securitization funds held by trustee                                  | (58,207)                                | 134,424                                 |
| Investment in securitization residual certificates                    | 47,076                                  |   |
| Miscellaneous receivables   | (42)                                    | (88)                                    |
| <b>Total</b>  | <b>\$ (1,306,292)</b>                   | <b>\$ (1,706,645)</b>                   |
| <b>Contingencies:</b>   |   |   |
| Assistance agreements   | 0                                       | 1,961                                   |
| Litigation  | 15,540                                  | (36,955)                                |
| <b>Total</b>  | <b>15,540</b>                           | <b>(34,994)</b>                         |
| <b>Reduction in Provision for Losses</b>                              | <b>\$ (1,290,752)</b>                   | <b>\$ (1,741,639)</b>                   |

## 12. Resolution Equity

As stated in Note 1, the FRF is comprised of two distinct pools: The FRF-FSLIC and the FRF-RTC. The FRF-FSLIC consists of the assets and liabilities of the former FSLIC. The FRF-RTC consists of the assets and liabilities of the former RTC. Pursuant to legal restrictions, the two pools are maintained separately and the

assets of one pool are not available to satisfy obligations of the other.

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

### Resolution Equity at December 31, 1998

Dollars in Thousands

|   | FRF-FSLIC           | FRF-RTC             | FRF<br>Consolidated  |
|---|---------------------|---------------------|----------------------|
| Contributed capital                     | \$ 44,156,000       | \$ 91,334,741       | \$ 135,490,741       |
| Accumulated deficit                     | (42,057,685)        | (83,185,544)        | (125,243,229)        |
| Less: Unrealized gain on AFS securities | 0                   | 74,329              | 74,329               |
| Accumulated deficit, net                | (42,057,685)        | (83,111,215)        | (125,168,900)        |
| <b>Total Resolution Equity</b>          | <b>\$ 2,098,315</b> | <b>\$ 8,223,526</b> | <b>\$ 10,321,841</b> |



### Resolution Equity at December 31, 1997

Dollars in Thousands

|                                | FRF-FSLIC           | FRF-RTC             | FRF Consolidated    |
|--------------------------------|---------------------|---------------------|---------------------|
| Contributed capital            | \$ 44,156,000       | \$ 91,337,762       | \$ 135,493,762      |
| Accumulated deficit            | (42,194,200)        | (84,778,720)        | (126,972,920)       |
| <b>Total Resolution Equity</b> | <b>\$ 1,961,800</b> | <b>\$ 6,559,042</b> | <b>\$ 8,520,842</b> |

#### Contributed Capital

To date, the former RTC and the FRF-FSLIC received \$60.1 billion and \$43.5 billion from the U.S. Treasury, respectively. These payments were used to fund losses from thrift resolutions prior to July 1, 1995. Additionally, the RTC issued \$31.3 billion in capital certificates to the REFCORP and the FRF-FSLIC issued \$670 million of these instruments to the FICO. FIRREA prohibited the payment of dividends on any of these capital certificates.

#### Accumulated Deficit

The accumulated deficit represents the cumulative excess of expenses over revenue for liquidation activity related to the former FSLIC and the former RTC (\$29.7 billion and \$87.9 billion were brought forward from the FSLIC and RTC, respectively).

#### Resolution Equity Restrictions

**FRF-FSLIC:** The FRF-FSLIC has unrecorded, pending judgments and settlements that are inestimable at this time and that could substantially reduce or eliminate the FRF-FSLIC Resolution Equity (see Note 10).

**FRF-RTC:** The former RTC drew down \$4.556 billion of the approximately \$18 billion made available by the RTC Completion Act. The Completion Act requires the FDIC to deposit in the general fund of the U.S. Treasury any funds transferred to the RTC but not needed by the RTC. The FDIC will return these funds to the U.S. Treasury pursuant to the RTC Completion Act. In addition, the FDIC must transfer net proceeds from the sale of RTC assets to pay interest on the REFCORP bonds, after providing for all outstanding RTC liabilities. Any such payments benefit the U.S. Treasury, which would otherwise be obligated to pay the interest on the bonds (see Note 1).

### 13. Pension Benefits, Savings Plans, and Accrued Annual Leave

Eligible FDIC employees (all permanent and temporary employees with appointments exceeding one year) are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The CSRS is a defined benefit plan, which is offset with the Social Security System in certain cases. Plan benefits are determined on the basis of years of creditable service and compensation levels. The CSRS-covered employees also can contribute to the tax-deferred Federal Thrift Savings Plan (TSP).

The FERS is a three-part plan consisting of a basic defined benefit plan that provides benefits based on years of creditable service and compensation levels, Social Security benefits, and the TSP. Automatic and matching employer contributions to the TSP are provided up to specified amounts under the FERS.

During 1998, there was an open season that allowed employees to switch from CSRS to FERS. This did not have a material impact on FRF's operating expenses.

Although the FRF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The FRF also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported on and accounted for by the U.S. Office of Personnel Management (OPM).

Eligible FDIC employees also may participate in a FDIC-sponsored tax-deferred savings plan with matching contributions. The FRF pays its share of the employer's portion of all related costs.

The FRF's pro rata share of the Corporation's liability to employees for accrued annual leave is approximately \$5.4 million and \$11.2 million at December 31, 1998 and 1997, respectively.

### Pension Benefits and Savings Plans Expenses

Dollars in Thousands

|  | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|--|---|---|
| CSRS/FERS Disability Fund                          | \$ 308                                  | \$ 168                                  |
| Civil Service Retirement System                    | 1,382                                   | 2,047                                   |
| Federal Employee Retirement System (Basic Benefit) | 4,438                                   | 9,473                                   |
| FDIC Savings Plan                                  | 2,619                                   | 4,893                                   |
| Federal Thrift Savings Plan                        | 1,675                                   | 3,264                                   |
| <b>Total</b>                                       | <b>\$ 10,422</b>                        | <b>\$ 19,845</b>                        |

### 14. Postretirement Benefits Other Than Pensions

On January 2, 1998, FRF's obligation under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," for postretirement health benefits was reduced when over 6,500 employees enrolled in the Federal Employees Health Benefits (FEHB) Program for their future health insurance coverage. The OPM assumed the FRF's obligation for postretirement health benefits for these employees at no initial enrollment cost.

In addition, legislation was passed that allowed the remaining 2,600 retirees and near-retirees (employees within five years of retirement) in the FDIC health plan to also enroll in the FEHB Program for their future health insurance coverage, beginning

January 1, 1999. The OPM assumed the FRF's obligation for postretirement health benefits for retirees and near-retirees for a fee of \$32 million. The OPM is now responsible for postretirement health benefits for all employees and covered retirees. The FDIC will continue to be obligated for dental and life insurance coverage for as long as the programs are offered and coverage is extended to retirees.

OPM's assumption of the health care obligation constitutes both a settlement and a curtailment as defined by SFAS No. 106. This conversion resulted in a gain of \$39 million to the FRF.



## Postretirement Benefits Other Than Pensions

Dollars in Thousands

|  | 1998        | 1997             |
|--|-------------|------------------|
| <b>Funded Status at December 31</b>  |             |                  |
| Fair value of plan assets <sup>(a)</sup>                                     | \$ 14,337   | \$ 68,010        |
| Less: Benefit obligation   | 14,337      | 81,614           |
| <b>Under/(Over) Funded Status of the plans</b>                               | <b>\$ 0</b> | <b>\$ 13,604</b> |
| Accrued benefit liability recognized in the Statements of Financial Position | \$ 0        | \$ 19,099        |
| <b>Expenses and Cash Flows for the Period Ended December 31</b>              |             |                  |
| Net periodic benefit cost  | \$ (919)    | \$ 1,150         |
| Employer contributions   | 886         | 1,280            |
| Benefits paid  | 886         | 1,280            |
| <b>Weighted-Average Assumptions at December 31</b>                           |             |                  |
| Discount rate  | 4.50%       | 5.75%            |
| Expected return on plan assets   | 4.50%       | 5.75%            |
| Rate of compensation increase  | 4.00%       | 4.00%            |

(a) Invested in U.S. Treasury obligations.

For measurement purposes, the per capita cost of covered health care benefits was assumed to increase by an annual rate of 8.75 percent for 1998. Further, the rate was assumed to decrease

gradually each year to a rate of 7.75 percent for the year 2000 and remain at that level thereafter.

## 15. Commitments and Concentration of Credit Risk

### Commitments

#### Letters of Credit

The RTC had adopted special policies that included honoring outstanding conservatorship and receivership collateralized letters of credit. This enabled the RTC to minimize the impact of its actions on capital markets. In most cases, these letters of credit were issued by thrifts that later failed and were used to guarantee tax exempt bonds issued by state and local housing authorities or other public agencies to finance housing projects for low and moderate income individuals or families. As of December 31, 1998 and 1997, securities pledged as collateral to honor these letters of credit totaled \$21.4 million and \$51.4 million, respectively. The FRF estimated corporate losses related to the receiverships' letters of

credit as part of the allowance for loss valuation. The allowance for these losses was \$7.6 million and \$41.1 million as of December 31, 1998 and 1997, respectively.

#### Leases

The FRF's allocated share of the FDIC's lease commitments totals \$22.8 million for future years. The lease agreements contain escalation clauses resulting in adjustments, usually on an annual basis. The allocation to the FRF of the FDIC's future lease commitments is based upon current relationships of the workloads among the FRF, the BIF, and the SAIF. Changes in the relative workloads could cause the amounts allocated to the FRF in the future to vary from the amount shown below. The FRF recognized leased space expense of \$6.3 million and \$18.2 million for the years ended December 31, 1998 and 1997, respectively.



**Lease Commitments**

Dollars in Thousands

| 1999    | 2000    | 2001    | 2002    | 2003    | 2004 and<br>Thereafter |
|---------|---------|---------|---------|---------|------------------------|
| \$4,776 | \$4,313 | \$3,520 | \$3,149 | \$2,035 | \$5,013                |

**Concentration of Credit Risk**

As of December 31, 1998, the FRF had gross receivables from thrift resolutions totaling \$73.3 billion, gross assets acquired from assisted thrifts and terminated receiverships totaling \$216 million, gross securitization funds held by trustee totaling \$2.9 billion, and an investment in securitization residual certificates totaling \$1.5 billion. The allowance for loss against receivables from thrift resolutions totaled \$71.9 billion, the allowance against the assets acquired from assisted thrifts and terminated receiverships totaled

\$152 million, and the allowance against the securitization funds held by trustee totaled \$0.1 billion.

Cash recoveries may be influenced by economic conditions. Similarly, the value of the investment in securitization residual certificates can be influenced by the economy of the area relating to the underlying loans and other assets. Accordingly, the FRF's maximum exposure to possible accounting loss is the recorded (net of allowance) value and is also shown in the table below.

**Concentration of Credit Risk at December 31, 1998**

Dollars in Millions

|   | Southeast       | Southwest     | Northeast     | Midwest       | Central       | West            | Total           |
|---|-----------------|---------------|---------------|---------------|---------------|-----------------|-----------------|
| Receivables from thrift resolutions, net                                | \$ 313          | \$ 165        | \$ 200        | \$ 127        | \$ 72         | \$ 512          | \$ 1,389        |
| Assets acquired from assisted thrifts and terminated receiverships, net | 0               | 42            | 1             | 0             | 0             | 21              | 64              |
| Securitization funds held by trustee                                    | 436             | 320           | 376           | 87            | 80            | 1,498           | 2,797           |
| Investment in securitization residual certificates                      | 319             | 192           | 200           | 68            | 55            | 704             | 1,538           |
| <b>Total</b>  | <b>\$ 1,068</b> | <b>\$ 719</b> | <b>\$ 777</b> | <b>\$ 282</b> | <b>\$ 207</b> | <b>\$ 2,735</b> | <b>\$ 5,788</b> |

**16. Disclosures About the Fair Value of Financial Instruments**

Cash equivalents are short-term, highly liquid investments and are shown at current value. The carrying amount of short-term receivables and accounts payable and other liabilities approximates their fair market value. This is due to their short maturities or comparisons with current interest rates.

The net receivables from thrift resolutions primarily include the FRF's subrogated claim arising from payments to insured depositors. The receivership assets that will ultimately be used to pay the corporate subrogated claim are valued using discount rates that include consideration of market risk. These discounts ultimately

affect the FRF's allowance for loss against the net receivables from thrift resolutions. Therefore, the corporate subrogated claim indirectly includes the effect of discounting and should not be viewed as being stated in terms of nominal cash flows.

Although the value of the corporate subrogated claim is influenced by valuation of receivership assets (see Note 3), such receivership valuation is not equivalent to the valuation of the corporate claim. Since the corporate claim is unique, not intended for sale to the private sector, and has no established market, it is not practicable to estimate its fair market value.

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

Like the corporate subrogated claim, the securitization credit enhancement reserves involve an asset that is unique and is not intended for sale to the private sector. Therefore, it is not practicable to estimate the fair market value of the securitization credit enhancement reserves. These reserves are carried at net realizable value, which is the book value of the reserves less the related allowance for loss (see Note 4).

The majority of the net assets acquired from assisted thrifts and terminated receiverships (except real estate) is comprised of various types of financial instruments, including investments, loans and accounts receivables. Like receivership assets, assets acquired from assisted thrifts and terminated receiverships are valued using discount rates that include consideration of market risk. However, assets acquired from assisted thrifts and terminated receiverships do not involve the unique aspects of the corporate subrogated claim, and therefore the discounting can be viewed as producing a reasonable estimate of fair market value.

The investment in securitization residual certificates is adjusted to its fair value at each reporting date using a valuation model which estimates the present value of estimated expected future cash flows discounted for the various risks involved, including both market and credit risks, as well as other attributes of the underlying assets.

## 17. Supplementary Information Relating to the Statements of Cash Flows

### Reconciliation of Net Income to Net Cash Provided by Operating Activities

Dollars in Thousands

|   | For the Year Ended<br>December 31, 1998 | For the Year Ended<br>December 31, 1997 |
|---|---|---|
| <b>Net Income</b>   | <b>\$ 1,729,691</b>                     | <b>\$ 1,946,403</b>                     |
| <b>Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities</b> |   |   |
| <b>Income Statement Items:</b>  |   |   |
| Interest on Federal Financing Bank borrowings   | 18,068                                  | 124,322                                 |
| Provision for losses  | (1,290,752)                             | (1,744,690)                             |
| Gain on conversion of benefit plan  | (39,297)                                | 0                                       |
| OIG income recognized   | 0                                       | 792                                     |
| <b>Change in Assets and Liabilities:</b>  |   |   |
| Decrease in receivables from thrift resolutions   | 663,799                                 | 3,360,072                               |
| Decrease in securitization funds held by trustee  | 2,152,129                               | 779,071                                 |
| Decrease in assets acquired from assisted thrifts and terminated receiverships          | 61,928                                  | 335,624                                 |
| Decrease in other assets  | 5,982                                   | 8,480                                   |
| (Decrease) Increase in accounts payable and other liabilities                           | (125,545)                               | 20,772                                  |
| (Decrease) in accrued interest on notes payable   | (28,950)                                | (173,484)                               |
| Increase (Decrease) in liabilities from thrift resolutions                              | 2,294                                   | (6,998)                                 |
| Increase in estimated liabilities for litigation losses                                 | 13,897                                  | 0                                       |
| (Decrease) Increase in estimated liabilities for assistance agreements                  | (1,476)                                 | 111,191                                 |
| <b>Net Cash Provided by Operating Activities</b>  | <b>\$ 3,161,768</b>                     | <b>\$ 4,761,555</b>                     |



### Noncash Investing Activity

In October 1998, the FRF acquired securitization residual certificates through a noncash purchase from its receiverships. This non-cash transaction valued at \$1.8 billion was applied to amounts

owed by FRF receiverships which resulted in a reduction to the "Receivable from thrift resolutions, net" line item and the creation of the "Investment in securitization residual certificates" line item (see Note 5).

## 18. Year 2000 Issues

### State of Readiness

The FDIC, as administrator for the FRF, is conducting a corporate-wide effort to ensure that all FDIC information systems are Year 2000 compliant. This means the systems must accurately process date and time data in calculations, comparisons, and sequences after December 31, 1999, and be able to correctly deal with leap-year calculations in 2000. The Year 2000 Oversight Committee is comprised of FDIC division management that oversees the Year 2000 effort.

The FDIC's Division of Information Resources Management (DIRM) leads the internal Year 2000 effort, under the direction of the Oversight Committee. DIRM used a five-phase approach for ensuring that all FDIC systems and software are Year 2000 compliant. The five phases are:

#### Awareness

The first phase of compliance focuses on defining the Year 2000 problem and gaining executive-level support and sponsorship for the effort.

#### Assessment

The second phase of compliance focuses on assessing the Year 2000 impact on the Corporation as a whole.

#### Renovation

The third phase of compliance focuses on converting, replacing or eliminating selected platforms, applications, databases, and utilities, while modifying interfaces as appropriate.

Platform is a broad term that encompasses computer hardware (including mainframe computers, servers, and personal computers) and software (including computer languages and operating systems). Utility programs, or "utilities," provide file management capabilities, such as sorting, copying, comparing, listing and searching, as well as diagnostic and measurement routines that check the health and performance of the system.

#### Validation

The fourth phase of compliance focuses on testing, verifying and validating converted or replaced platforms, applications, databases, and utilities.

#### Implementation

The fifth phase of compliance focuses on implementing converted or replaced platforms, applications, databases, utilities, and interfaces.

The Awareness, Assessment, and Renovation phases are complete. The Validation phase is scheduled to be completed during January 1999 when all production applications will be validated for Year 2000 readiness. Implementation of the majority of production applications in Year 2000 ready status will be completed by March 31, 1999. Validation and implementation of new systems and modifications to existing systems will continue throughout 1999.

### Year 2000 Estimated Costs

Year 2000 compliance expenses for the FRF are estimated at \$2.1 million and \$201 thousand at December 31, 1998 and 1997, respectively. These expenses are reflected in the "Operating expenses" line item of the FRF's Statements of Income and Accumulated Deficit. Future expenses are estimated to be \$2.6 million. Year 2000 estimated future costs are included in the FDIC's budget.

### Risks of Year 2000 Issues

No potential loss with internal system failure has been estimated due to the extensive planning and validation that has occurred.

### Contingency Plans

DIRM is currently developing a disaster recovery plan and contingency plans specific to each mission-critical application.



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## 19. Subsequent Events

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On April 9, 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 DOJ 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 Federal case, awarded California Federal Bank

\$23 million. The California Federal Bank was seeking more than \$1.0 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 expected appeals and the conflicting analyses in the two cases, the final outcome is uncertain.



To the Board of Directors  
Federal Deposit Insurance Corporation

We have audited the statements of financial position as of December 31, 1998 and 1997, of the three funds administered by the Federal Deposit Insurance Corporation (FDIC), the related statements of income and fund balance (accumulated deficit), and the statements of cash flows for the years then ended. In our audits of the Bank Insurance Fund (BIF), the Savings Association Insurance Fund (SAIF), and the FSLIC Resolution Fund (FRF), we found

- the financial statements of each fund were fairly presented in all material respects;
- FDIC management fairly stated that internal control in place on December 31, 1998, was effective in assuring that there were no material misstatements in the financial statements of the three funds administered by FDIC (including safeguarding assets from material loss), and assuring material compliance with selected laws and regulations; and
- no reportable noncompliance with laws and regulations we tested.

The following sections discuss our conclusions in more detail. They also present information on (1) the scope of our audits, (2) Year 2000 (Y2K) and insured financial institutions, (3) the current status of the goodwill litigation cases, (4) the current status of FRF's liquidation activities and funding, (5) FDIC's progress in addressing a reportable condition<sup>1</sup> identified during our 1997 audits, and (6) our evaluation of the Corporation's comments on a draft of this report.

#### **Opinion on Bank Insurance Fund's Financial Statements**

The financial statements and accompanying notes present fairly, in all material respects, in conformity with generally accepted accounting principles, the Bank Insurance Fund's financial position as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended.

#### **Opinion on Savings Association Insurance Fund's Financial Statements**

The financial statements and accompanying notes present fairly, in all material respects, in conformity with generally accepted accounting principles, the Savings Association Insurance Fund's financial position as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended.

#### **Opinion on FSLIC Resolution Fund's Financial Statements**

The financial statements and accompanying notes present fairly, in all material respects, in conformity with generally accepted accounting principles, the FSLIC Resolution Fund's financial position as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended.

As discussed in note 10 of FRF's financial statements, a significant contingency exists from approximately 120 lawsuits pending in the United States Court of Federal Claims concerning the counting of goodwill assets as part of regulatory capital. Based on information currently available, a reasonable estimate cannot be made regarding future losses and settlements related to these cases. Information on the current status of the goodwill cases is presented later in this report.

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<sup>1</sup>Reportable conditions involve matters coming to the auditor's attention relating to significant deficiencies in the design or operation of internal control that, in the auditor's judgment, could adversely affect an entity's ability to (1) properly record, process, and summarize transactions to permit the preparation of financial statements in accordance with generally accepted accounting principles (including safeguarding of assets) and (2) ensure the execution of transactions in accordance with laws and regulations that could have a direct and material effect on the financial statements.

### **Opinion on FDIC Management's Assertions About the Effectiveness of Internal Control**

For the three funds administered by FDIC, we evaluated FDIC management's assertions about the effectiveness of its internal control designed to provide reasonable assurance that the following objectives are met:

- reliability of financial reporting – transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles (including safeguarding of assets) and
- compliance with applicable laws and regulations – transactions are executed in accordance with laws and regulations that could have a direct and material effect on the financial statements.

FDIC management fairly stated that internal control in place on December 31, 1998, provided reasonable assurance that misstatements, losses, or noncompliance, material in relation to the financial statements would be prevented or detected on a timely basis. FDIC management made this assertion based on criteria established under the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

### **Compliance With Laws and Regulations**

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

### **Objectives, Scope, and Methodology**

FDIC's management is responsible for

- preparing the annual financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of FMFIA are met; and
- complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether

- the financial statements are free of material misstatement and presented fairly, in all material respects, in conformity with generally accepted accounting principles and
- FDIC management's assertion about the effectiveness of internal control is fairly stated, in all material respects, based upon the criteria established under FMFIA.

We are also responsible for testing compliance with selected provisions of laws and regulations and for performing limited procedures with respect to certain other information appearing in FDIC's annual financial report.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of internal control related to financial reporting, including safeguarding assets, compliance with laws and regulations, including the execution of transactions in accordance with management's authority;



- tested relevant internal controls over financial reporting, including safeguarding assets, and compliance, and evaluated management's assertion about the effectiveness of internal control; and
- tested compliance with selected provisions of the Federal Deposit Insurance Act, as amended; the Chief Financial Officers Act of 1990; and the Federal Home Loan Bank Act, as amended.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to those controls necessary to achieve the objectives outlined in our opinion on management's assertion about the effectiveness of internal control. Because of inherent limitations in internal control, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.

We conducted our audits from July 1998 through May 1999. We did our work in accordance with generally accepted government auditing standards.

FDIC provided comments on a draft of this report. FDIC's comments are discussed and evaluated in the "Corporation Comments and Our Evaluation" section.

#### **Information on Y2K and Insured Financial Institutions**

Insured financial institutions face an unprecedented challenge in preparing their computer systems for the Y2K date change. Banks and thrifts are vulnerable to Y2K problems due to their widespread reliance on computer systems to make loans, invest deposits, transfer funds, issue credit cards, calculate interest, and handle routine business functions. In addition, many critical financial institution functions are dependent on public infrastructure such as telecommunications and electric power networks, which could also encounter difficulties or interruptions in service due to the Y2K problem.

Addressing the Y2K problem on time has been and will continue to be a tremendous challenge. FDIC, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision (the regulators), have made considerable progress in assisting banks and thrifts in their Y2K efforts, and identifying those institutions at a high risk of not remediating their systems on time. Since June 1996, when their Y2K oversight efforts began, FDIC and the other regulators have taken many important steps to alert financial institutions of the risks associated with the Y2K problem and to assess institutions' progress in mitigating the risks.<sup>2</sup>

To raise awareness, FDIC and the other regulators issued letters to all insured banks and thrifts describing the Y2K problem and special risks facing financial institutions, and recommended approaches to planning and managing effective Y2K programs. In addition, the regulators provided extensive guidance to assist financial institutions in critical Y2K tasks, including guidance on (1) Y2K project management, (2) addressing Y2K business risks, (3) assessing risk from customers, service providers, and software vendors, (4) testing systems for Y2K readiness, (5) contingency planning, and (6) establishing effective Y2K customer awareness programs. FDIC and the other regulators have also undertaken extensive outreach efforts to raise the Y2K awareness of insured financial institutions and the public.

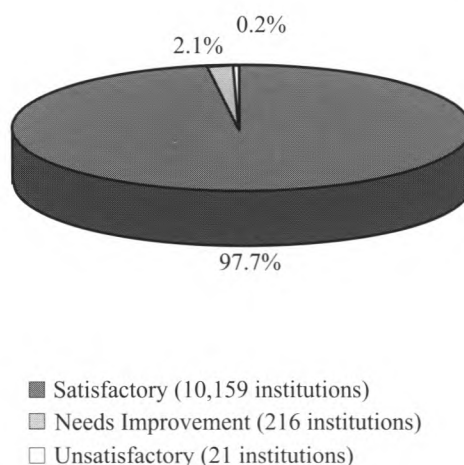
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<sup>2</sup>Year 2000 Computing Crisis: Federal Depository Institution Regulators Are Making Progress, But Challenges Remain (GAO/T-AIMD-98-305, September 17, 1998).

To assess institutions' progress in addressing Y2K issues, the regulators have performed a series of high-level and more detailed assessments for each institution.<sup>3</sup> These supervisory efforts have generally been divided into three phases. Phase I focused on institutions' awareness, assessment, and renovation efforts. Phase II focused on the institutions' testing efforts and credit risk assessments. Phase III is currently in process and will continue throughout 1999, and will focus on implementation, business resumption and contingency planning, customer awareness initiatives, and liquidity planning. In addition, during Phase III the regulators plan to pay particular attention to those institutions identified as having risk for potential Y2K problems.

Based on Y2K assessments through April 30, 1999, the regulators have found that the vast majority of financial institutions have acceptable performance in key phases of the Y2K project management process, including awareness, assessment, renovation, testing, and implementation. As discussed in the notes to BIF's and SAIF's financial statements, 97.7 percent of insured financial institutions were rated by the regulators as having made satisfactory progress in their Y2K project management through Phase II. Those institutions held 98.7 percent of industry assets. Of the remaining 2.3 percent of institutions rated by the regulators as less than satisfactory, 216 institutions are rated as "needs improvement" and 21 institutions are considered as having made "unsatisfactory" progress. See figure 1.

**Figure 1: Y2K Ratings for FDIC-Insured Institutions as of April 30, 1999**

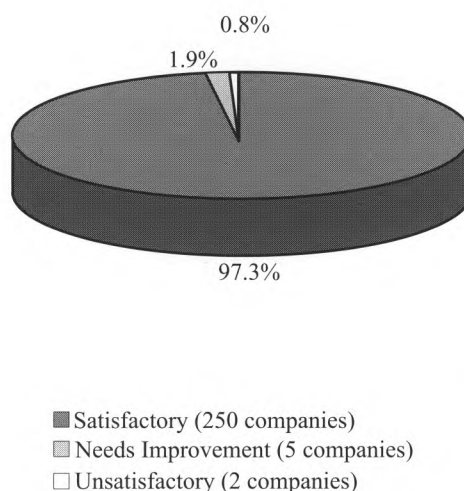


Source: FDIC Division of Supervision.

Virtually all banks and thrifts rely on service providers and software vendors for at least a portion of their data processing services. The regulators have also completed Phase II assessments of service providers and software vendors that provide data processing services or software to the industry. Of the 257 service providers and software vendors examined, as of April 30, 1999, the regulators reported that 97.3 percent showed satisfactory progress. Of the remaining servicers rated by the regulators as less than satisfactory, 5 were rated as "needs improvement" and 2 were rated as having made "unsatisfactory" progress. See figure 2.

<sup>3</sup>As a result of these assessments, the regulators have assigned each institution one of the following ratings: satisfactory, needs improvement, or unsatisfactory. Generally, institutions are considered "satisfactory" if they exhibit acceptable performance in all key phases of the Y2K project management process as set forth in the May 5, 1997, Federal Financial Institutions Examination Council (FFIEC) Interagency Statement. A "needs improvement" rating results from less than acceptable performance under FFIEC guidelines; however, project weaknesses can be readily corrected within the existing project management framework. An "unsatisfactory" rating results from poor performance under FFIEC guidelines where weaknesses are serious and are not easily corrected within the existing project management framework. See note 7 to BIF's financial statements and note 6 to SAIF's financial statements for additional information.

**Figure 2: Y2K Assessment Ratings for Service Providers and Software Vendors, as of April 30, 1999**



Source: FDIC Division of Supervision.

The FDIC and the other regulators have stated that they will focus additional attention throughout the remainder of 1999 on those institutions and service providers not rated satisfactory. Due to the short time frame remaining until the year 2000, the regulators have stated that they will adopt a more aggressive stance to achieve the necessary remedial action at institutions rated less than satisfactory.

Although the regulators reported that the vast majority of institutions, service providers, and software vendors had made satisfactory progress on mitigating their Y2K risks through April 30, 1999, uncertainties still exist regarding the potential for Y2K problems. Y2K assessment ratings do not constitute certification of a financial institution's Y2K readiness. They reflect an institution's ongoing progress in addressing Y2K issues at a certain point in time. It is possible that ratings could change over time. In addition, because of the unprecedented nature of the Y2K problem, unanticipated events could occur for which the institution was not prepared. Institutions are required, however, to design Y2K contingency plans to mitigate the risks associated with unsuccessful implementation of their Y2K efforts, and to provide assurance that core business functions will continue if one or more computer systems fail. Institutions could also encounter difficulties due to the Y2K problems of third parties. Therefore, it is difficult to determine which institutions, if any, could ultimately fail due to potential Y2K problems.

As stated in the notes to FDIC's financial statements, BIF and SAIF are subject to potential loss from financial institutions that may fail due to Y2K problems. In order to assess exposure to BIF and SAIF as a result of potential Y2K failures, FDIC evaluated Y2K assessment results, as well as the financial condition and supervisory ratings for all institutions. As of December 31, 1998, FDIC has not identified any probable losses to BIF and SAIF from Y2K failures. Further, any reasonably possible losses from Y2K failures were not estimable as of December 31, 1998. During 1999, FDIC and the other regulators are continuing to collect data on the impact of banks' and thrifts' potential Y2K problems on the deposit insurance funds, and plan to take supervisory action as necessary to minimize any potential impact to the insurance funds.



### Current Status of the Goodwill Litigation Cases

As discussed in note 10 of FRF's financial statements, a significant contingency exists from approximately 120 lawsuits pending against the United States government in the United States Court of Federal Claims. These lawsuits assert that certain agreements were breached when Congress enacted and the Office of Thrift Supervision implemented the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), which affected the thrift industry. The legislation changed the computation for regulatory capital requirements, thereby eliminating the special accounting treatment previously allowed for goodwill assets acquired when institutions merged with or acquired failing thrifts. The changes in regulatory treatment of goodwill assets caused some institutions to fall out of capital compliance. In such cases, institutions had to take action to meet capital requirements or they were subject to regulatory action.

On July 1, 1996, the United States Supreme Court concluded that the government is liable for damages in three cases, consolidated for appeal to the Supreme Court, in which the changes in regulatory treatment required by FIRREA led the government to not honor its contractual obligations related to the accounting treatment of goodwill assets. The cases were then referred back to the Court of Federal Claims for trials to determine the amount of damages. On July 23, 1998, the Department of the Treasury determined, based on an opinion of the Department of Justice, that FRF is legally available to satisfy all judgments and settlements in the goodwill litigation involving supervisory action or assistance agreements, in which FSLIC was a party to those agreements. Treasury further determined that FRF is the appropriate source of funds for payment of any such judgments and settlements. During 1998, FDIC paid \$103.3 million in settlements for four cases. Two of the settlements were related to cases that had been consolidated for appeal to the Supreme Court.

Subsequent to December 31, 1998, damages awards in two goodwill-related cases have been decided. On April 9, 1999, the Court of Federal Claims ruled that the federal government must pay Glendale Federal Bank \$908.9 million for breaching the contract that allowed the thrift to count goodwill toward regulatory capital.<sup>4</sup> The plaintiffs were seeking up to \$2 billion in damages. Both the plaintiffs and the Department of Justice are expected to appeal the decision. In another case the Court of Federal Claims awarded \$23 million in damages on April 16, 1999, to California Federal Bank, which had been seeking more than \$1 billion in damages. California Federal is expected to appeal the decision.

Because of the expected appeals and the differences in awarding damages in the above cases, the final outcome of both cases is uncertain. With regard to the remaining cases, the outcome of each case and the amount of any possible damages remain uncertain. However, FDIC has concluded that it is probable that FRF will be required to pay additional, possibly substantial amounts as a result of future judgments and settlements. Because of the uncertainties surrounding the cases, such losses are currently not estimable.

### Current Status of FRF's Liquidation Activities and Funding

FDIC, as administrator of FRF, is responsible for liquidating the assets and liabilities of the former Resolution Trust Corporation (RTC),<sup>5</sup> as well as the former FSLIC's assets and liabilities. As of December 31, 1998, FRF held total assets valued at \$10.5 billion. Of that total, \$4.6 billion was held in cash and investments, with \$5.9 billion remaining to be liquidated. As of December 31, 1998, FRF's liabilities had been reduced to \$138 million. The reduction was mainly due to FRF paying off the note to the Federal Financing Bank, which was issued to RTC to provide working capital for RTC's liquidation activities. In addition to the liabilities shown on FRF's Statements of Financial Position, FRF is subject to significant future contingent liabilities resulting from the goodwill litigation cases, as noted in the previous section.

As of December 31, 1998, FRF's total accumulated deficit was \$125.2 billion. FRF's accumulated deficit represents the realized losses to date for all RTC and FSLIC-related liquidation activity, as well as future estimated losses from assets and liabilities not yet liquidated. Uncertainties still exist with regard to the unrealized losses, and the final amount of total losses will not be known with certainty until all remaining assets and liabilities are liquidated.

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<sup>4</sup>Glendale Federal Bank was one of the three cases consolidated for appeal to the Supreme Court.

<sup>5</sup>On January 1, 1996, FRF assumed responsibility for all remaining assets and liabilities of the former RTC.

In total, \$135.5 billion was received to cover liabilities and losses associated with the former FSLIC and RTC resolution activities. Of the \$135.5 billion total, \$91.3 billion<sup>6</sup> was received by RTC and \$44.2 billion was received by FRF to cover losses and expenses associated with failed institutions from RTC's caseload and to cover losses associated with the former FSLIC activities.

As shown in table 1, after reducing the total amount of funding received by the amount of recorded accumulated deficit, an estimated \$10.3 billion in funds will remain available. FRF consists of two distinct pools of assets and liabilities: one composed of the assets and liabilities of FSLIC transferred to FRF on August 9, 1989 (FRF-FSLIC) and the other composed of the RTC assets and liabilities transferred to FRF on January 1, 1996 (FRF-RTC). Of the \$10.3 billion in funds available, \$2.1 billion is available to FRF-FSLIC and \$8.2 billion is available to FRF-RTC.

**Table 1: FRF's Estimated Funds Available as of December 31, 1998**

| (Dollars in billions)            |               |               |                |
|----------------------------------|---------------|---------------|----------------|
|                                  | FRF-FSLIC     | FRF-RTC       | Total FRF      |
| Total funds received             | \$ 44.2       | \$ 91.3       | \$ 135.5       |
| Less: Accumulated deficit        | 42.1          | 83.1          | 125.2          |
| <b>Estimated funds available</b> | <b>\$ 2.1</b> | <b>\$ 8.2</b> | <b>\$ 10.3</b> |

Funds available in FRF-FSLIC will be used to pay future liabilities of the FRF-FSLIC, including the contingency related to the goodwill litigation cases. Because additional and possibly substantial amounts could be paid out of the FRF-FSLIC for the goodwill cases, FRF has been provided with an indefinite appropriation for the payment of judgments and settlements in the goodwill litigation, without fiscal year limitation.<sup>7</sup>

The RTC Completion Act requires FDIC to deposit in the general fund of the Treasury any funds transferred to RTC pursuant to the Completion Act but not needed for RTC-related losses. In total, RTC drew down \$4.6 billion of funding provided by the act. After providing for all outstanding RTC liabilities, FDIC must transfer to the Resolution Funding Corporation (REFCORP) the net proceeds from the sale of RTC-related assets.

Any such funds transferred to REFCORP are to pay the interest on REFCORP bonds issued to provide funding for the early RTC resolutions. Any payments to REFCORP benefit the U.S. Treasury, which is otherwise obligated to pay the interest on the bonds. The final amount of unused funds will not be known with certainty until all of FRF's remaining assets and liabilities are liquidated.

<sup>6</sup>FIRREA provided an initial \$50 billion to RTC. The Resolution Trust Corporation Funding Act of 1991 provided an additional \$30 billion. The Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 provided \$25 billion in December 1991, of which \$6.7 billion was obligated prior to the April 1, 1992, deadline. In December 1993, the RTC Completion Act removed the April 1, 1992, deadline, thus making the remaining \$18.3 billion available to RTC for resolution activities. Prior to RTC's termination on December 31, 1995, RTC drew down \$4.6 billion of the \$18.3 billion that was made available by the RTC Completion Act.

<sup>7</sup>Section 130 of the Department of Justice Appropriation Act, 1999, appropriates for paying judgments against the United States and compromise settlements in the goodwill cases "such sums as may be necessary, to remain available until expended." We believe section 130 establishes an indefinite, permanent appropriation. FDIC has not expressed a view on the permanency of section 130 and the President's budget proposes clarifying language for the fiscal year 2000 appropriation act, which is designed to provide FDIC with a permanent appropriation.

### Progress on Prior Year's Reportable Condition

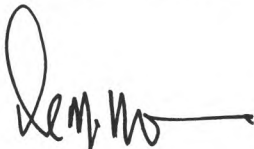
In our 1997 audit report<sup>8</sup> on the three funds administered by FDIC, we identified one reportable condition that affected FDIC's ability to ensure that internal control objectives were achieved. The weakness related to FDIC's internal controls designed to ensure that assets valued outside of FDIC's Standard Asset Valuation Estimation (SAVE) process were accurately and appropriately valued. During our 1997 audits, we found significant errors in the estimated recoveries for a portfolio of partnership interests, and we found unsupported recoveries and other errors in the estimated recoveries for another portfolio of debt and equity securities.

During 1998, FDIC developed standard valuation methodologies for assets previously valued outside of its SAVE process. FDIC's objective was to establish consistent asset valuation methodologies for those assets. FDIC also clearly designated responsibility for valuing those assets and for reviewing completed valuations. While we continued to find some instances where recovery estimates for FRF assets were not fully supported, we concluded that they were isolated problems that were not significant to FRF's financial statements. We will discuss this matter further in a management letter.

We did not identify any reportable conditions during our 1998 audits. However, we noted other less significant matters involving FDIC's internal accounting and electronic data processing general controls that we will be reporting separately to FDIC in two management letters.

### Corporation Comments and Our Evaluation

In commenting on a draft of this report, FDIC acknowledged the importance of an effective internal control program, and stated a commitment to achieving corporate objectives by ensuring that the Corporation operates within an environment conducive to strong internal controls. FDIC also stated that it will continue to monitor the other matters discussed in the audit report, including the Y2K issues related to insured financial institutions, the goodwill litigation cases, and FRF's liquidation activities and funding. We also plan to monitor these issues as a part of our audits of FDIC's 1999 financial statements.



David M. Walker  
Comptroller General  
of the United States

May 14, 1999

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<sup>8</sup>Financial Audit: Federal Deposit Insurance Corporation's 1997 and 1996 Financial Statements (GAO/AIMD-98-204, June 29, 1998).



# Statistical Tables



**Number and Deposits of BIF-Insured Banks Closed  
Because of Financial Difficulties, 1934 through 1998<sup>1</sup>**

(Dollars in Thousands)

| Year  | Number of Insured Banks |                               |                            | Deposits of Insured Banks |                               |                            | Assets        |
|-------|-------------------------|-------------------------------|----------------------------|---------------------------|-------------------------------|----------------------------|---------------|
|       | Total                   | Without disbursements by FDIC | With disbursements by FDIC | Total                     | Without disbursements by FDIC | With disbursements by FDIC |               |
| Total | 2,084                   | 19                            | 2,065                      | \$213,065,807             | \$4,298,814                   | \$208,766,993              | \$252,957,752 |
| 1998  | 3                       | ...                           | 3                          | \$335,076                 | ...                           | \$335,076                  | \$370,400     |
| 1997  | 1                       | ...                           | 1                          | 26,800                    | ...                           | 26,800                     | 25,921        |
| 1996  | 5                       | ...                           | 5                          | 168,228                   | ...                           | 168,228                    | 182,502       |
| 1995  | 6                       | ...                           | 6                          | 632,700                   | ...                           | 632,700                    | 753,024       |
| 1994  | 13                      | 1                             | 12                         | 1,236,488                 | ...                           | 1,236,488                  | 1,392,140     |
| 1993  | 41                      | ...                           | 41                         | 3,132,177                 | ...                           | 3,132,177                  | 3,539,373     |
| 1992  | 120                     | 10                            | 110                        | 41,150,898                | 4,257,667                     | 36,893,231                 | 44,197,009    |
| 1991  | 124                     | ...                           | 124                        | 53,751,763                | ...                           | 53,751,763                 | 63,119,870    |
| 1990  | 168                     | ...                           | 168                        | 14,473,300                | ...                           | 14,473,300                 | 15,660,800    |
| 1989  | 206                     | ...                           | 206                        | 24,090,551                | ...                           | 24,090,551                 | 29,168,596    |
| 1988  | 200                     | ...                           | 200                        | 24,931,302                | ...                           | 24,931,302                 | 35,697,789    |
| 1987  | 184                     | ...                           | 184                        | 6,281,500                 | ...                           | 6,281,500                  | 6,850,700     |
| 1986  | 138                     | ...                           | 138                        | 6,471,100                 | ...                           | 6,471,100                  | 6,991,600     |
| 1985  | 120                     | ...                           | 120                        | 8,059,441                 | ...                           | 8,059,441                  | 8,741,268     |
| 1984  | 79                      | ...                           | 79                         | 2,883,162                 | ...                           | 2,883,162                  | 3,276,411     |
| 1983  | 48                      | ...                           | 48                         | 5,441,608                 | ...                           | 5,441,608                  | 7,026,923     |
| 1982  | 42                      | ...                           | 42                         | 9,908,379                 | ...                           | 9,908,379                  | 11,632,415    |
| 1981  | 10                      | ...                           | 10                         | 3,826,022                 | ...                           | 3,826,022                  | 4,859,060     |
| 1980  | 10                      | ...                           | 10                         | 216,300                   | ...                           | 216,300                    | 236,164       |
| 1979  | 10                      | ...                           | 10                         | 110,696                   | ...                           | 110,696                    | 132,988       |
| 1978  | 7                       | ...                           | 7                          | 854,154                   | ...                           | 854,154                    | 994,035       |
| 1977  | 6                       | ...                           | 6                          | 205,208                   | ...                           | 205,208                    | 232,612       |
| 1976  | 16                      | ...                           | 16                         | 864,859                   | ...                           | 864,859                    | 1,039,293     |
| 1975  | 13                      | ...                           | 13                         | 339,574                   | ...                           | 339,574                    | 419,950       |
| 1974  | 4                       | ...                           | 4                          | 1,575,832                 | ...                           | 1,575,832                  | 3,822,596     |
| 1973  | 6                       | ...                           | 6                          | 971,296                   | ...                           | 971,296                    | 1,309,675     |
| 1972  | 1                       | ...                           | 1                          | 20,480                    | ...                           | 20,480                     | 22,054        |
| 1971  | 6                       | ...                           | 6                          | 132,058                   | ...                           | 132,058                    | 196,520       |
| 1970  | 7                       | ...                           | 7                          | 54,806                    | ...                           | 54,806                     | 62,147        |
| 1969  | 9                       | ...                           | 9                          | 40,134                    | ...                           | 40,134                     | 43,572        |
| 1968  | 3                       | ...                           | 3                          | 22,524                    | ...                           | 22,524                     | 25,154        |
| 1967  | 4                       | ...                           | 4                          | 10,878                    | ...                           | 10,878                     | 11,993        |
| 1966  | 7                       | ...                           | 7                          | 103,523                   | ...                           | 103,523                    | 120,647       |
| 1965  | 5                       | ...                           | 5                          | 43,861                    | ...                           | 43,861                     | 58,750        |
| 1964  | 7                       | ...                           | 7                          | 23,438                    | ...                           | 23,438                     | 25,849        |
| 1963  | 2                       | ...                           | 2                          | 23,444                    | ...                           | 23,444                     | 26,179        |
| 1962  | 1                       | 1                             | 0                          | 3,011                     | 3,011                         | 0                          | N/A           |
| 1961  | 5                       | ...                           | 5                          | 8,936                     | ...                           | 8,936                      | 9,820         |
| 1960  | 1                       | ...                           | 1                          | 6,930                     | ...                           | 6,930                      | 7,506         |
| 1959  | 3                       | ...                           | 3                          | 2,593                     | ...                           | 2,593                      | 2,858         |
| 1958  | 4                       | ...                           | 4                          | 8,240                     | ...                           | 8,240                      | 8,905         |
| 1957  | 2                       | 1                             | 1                          | 11,247                    | 10,084                        | 1,163                      | 1,253         |
| 1956  | 2                       | ...                           | 2                          | 11,330                    | ...                           | 11,330                     | 12,914        |
| 1955  | 5                       | ...                           | 5                          | 11,953                    | ...                           | 11,953                     | 11,985        |
| 1954  | 2                       | ...                           | 2                          | 998                       | ...                           | 998                        | 1,138         |
| 1953  | 4                       | 2                             | 2                          | 44,711                    | 26,449                        | 18,262                     | 18,811        |
| 1952  | 3                       | ...                           | 3                          | 3,170                     | ...                           | 3,170                      | 2,388         |
| 1951  | 2                       | ...                           | 2                          | 3,408                     | ...                           | 3,408                      | 3,050         |
| 1950  | 4                       | ...                           | 4                          | 5,513                     | ...                           | 5,513                      | 4,005         |
| 1949  | 5                       | 1                             | 4                          | 6,665                     | 1,190                         | 5,475                      | 4,886         |
| 1948  | 3                       | ...                           | 3                          | 10,674                    | ...                           | 10,674                     | 10,360        |
| 1947  | 5                       | ...                           | 5                          | 7,040                     | ...                           | 7,040                      | 6,798         |
| 1946  | 1                       | ...                           | 1                          | 347                       | ...                           | 347                        | 351           |
| 1945  | 1                       | ...                           | 1                          | 5,695                     | ...                           | 5,695                      | 6,392         |
| 1944  | 2                       | ...                           | 2                          | 1,915                     | ...                           | 1,915                      | 2,098         |
| 1943  | 5                       | ...                           | 5                          | 12,525                    | ...                           | 12,525                     | 14,058        |
| 1942  | 20                      | ...                           | 20                         | 19,185                    | ...                           | 19,185                     | 22,254        |
| 1941  | 15                      | ...                           | 15                         | 29,717                    | ...                           | 29,717                     | 34,804        |
| 1940  | 43                      | ...                           | 43                         | 142,430                   | ...                           | 142,430                    | 161,898       |
| 1939  | 60                      | ...                           | 60                         | 157,772                   | ...                           | 157,772                    | 181,514       |
| 1938  | 74                      | ...                           | 74                         | 59,684                    | ...                           | 59,684                     | 69,513        |
| 1937  | 77                      | 2                             | 75                         | 33,677                    | 328                           | 33,349                     | 40,370        |
| 1936  | 69                      | ...                           | 69                         | 27,508                    | ...                           | 27,508                     | 31,941        |
| 1935  | 26                      | 1                             | 25                         | 13,405                    | 85                            | 13,320                     | 17,242        |
| 1934  | 9                       | ...                           | 9                          | 1,968                     | ...                           | 1,968                      | 2,661         |

<sup>1</sup> Does not include institutions insured by the Savings Association Insurance Fund (SAIF), which was established by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.



# Recoveries and Losses by the Bank Insurance Fund on Disbursements for the Protection of Depositors, 1934 through 1998

(Dollars in Thousands)

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| ALL CASES <sup>1</sup> |                    |                    |            |                                       |                     |
|------------------------|--------------------|--------------------|------------|---------------------------------------|---------------------|
| Year                   | No.<br>of<br>banks | Disburse-<br>ments | Recoveries | Estimated<br>Additional<br>Recoveries | Estimated<br>Losses |
| Total                  | 2,195              | 106,846,170        | 69,052,424 | 687,626                               | 37,106,120          |
| 1998                   | 3                  | 286,086            | 5,434      | 101,676                               | 178,976             |
| 1997                   | 1                  | 25,546             | 19,131     | 2,316                                 | 4,099               |
| 1996                   | 5                  | 169,397            | 117,980    | 11,884                                | 39,533              |
| 1995                   | 6                  | 717,799            | 621,501    | 9,400                                 | 86,898              |
| 1994                   | 13                 | 1,224,797          | 1,022,285  | 20,389                                | 182,123             |
| 1993                   | 41                 | 1,797,297          | 1,137,570  | 14,800                                | 644,927             |
| 1992                   | 122                | 14,084,663         | 10,262,276 | 156,722                               | 3,665,665           |
| 1991                   | 127                | 21,412,647         | 14,921,028 | 302,556                               | 6,189,063           |
| 1990                   | 169                | 10,816,602         | 8,004,529  | 38,672                                | 2,773,401           |
| 1989                   | 207                | 11,445,829         | 5,217,606  | 27,110                                | 6,201,113           |
| 1988                   | 280                | 12,163,006         | 5,238,503  | 505                                   | 6,923,998           |
| 1987                   | 203                | 5,037,871          | 3,012,571  | 1,136                                 | 2,024,164           |
| 1986                   | 145                | 4,790,969          | 3,014,714  | 25                                    | 1,776,230           |
| 1985                   | 120                | 2,920,687          | 1,913,455  | 0                                     | 1,007,232           |
| 1984                   | 80                 | 7,696,215          | 6,056,061  | 0                                     | 1,640,154           |
| 1983                   | 48                 | 3,807,082          | 2,400,010  | 435                                   | 1,406,637           |
| 1982                   | 42                 | 2,275,150          | 1,106,579  | 0                                     | 1,168,571           |
| 1981                   | 10                 | 888,999            | 107,221    | 0                                     | 781,778             |
| 1980                   | 11                 | 152,355            | 121,675    | 0                                     | 30,680              |
| 1934-79                | 562                | 5,133,173          | 4,752,295  | 0                                     | 380,878             |

| Deposit payoff cases <sup>2</sup> |                    |                    |            |                                       |                     |
|-----------------------------------|--------------------|--------------------|------------|---------------------------------------|---------------------|
| Year                              | No.<br>of<br>banks | Disburse-<br>ments | Recoveries | Estimated<br>Additional<br>Recoveries | Estimated<br>Losses |
| Total                             | 603                | 14,469,299         | 9,874,652  | 56,090                                | 4,538,557           |
| 1998                              | 0                  | 0                  | 0          | 0                                     | 0                   |
| 1997                              | 0                  | 0                  | 0          | 0                                     | 0                   |
| 1996                              | 0                  | 0                  | 0          | 0                                     | 0                   |
| 1995                              | 0                  | 0                  | 0          | 0                                     | 0                   |
| 1994                              | 0                  | 0                  | 0          | 0                                     | 0                   |
| 1993                              | 5                  | 261,203            | 158,669    | 621                                   | 101,913             |
| 1992                              | 25                 | 1,802,655          | 1,302,583  | 7,512                                 | 492,560             |
| 1991                              | 21                 | 1,468,407          | 979,700    | 15,956                                | 472,751             |
| 1990                              | 20                 | 2,182,583          | 1,432,817  | 11,767                                | 737,999             |
| 1989                              | 32                 | 2,116,556          | 1,243,740  | 18,965                                | 853,851             |
| 1988                              | 36                 | 1,252,160          | 822,446    | 401                                   | 429,313             |
| 1987                              | 51                 | 2,103,792          | 1,399,216  | 868                                   | 703,708             |
| 1986                              | 40                 | 1,155,981          | 739,659    | 0                                     | 416,322             |
| 1985                              | 29                 | 523,789            | 411,175    | 0                                     | 112,614             |
| 1984                              | 16                 | 791,838            | 699,483    | 0                                     | 92,355              |
| 1983                              | 9                  | 148,423            | 122,484    | 0                                     | 25,939              |
| 1982                              | 7                  | 277,240            | 206,247    | 0                                     | 70,993              |
| 1981                              | 2                  | 35,736             | 34,598     | 0                                     | 1,138               |
| 1980                              | 3                  | 13,732             | 11,427     | 0                                     | 2,305               |
| 1934-79                           | 307                | 335,204            | 310,408    | 0                                     | 24,796              |

| Deposit assumption cases |                    |                    |              |                                       |                     |
|--------------------------|--------------------|--------------------|--------------|---------------------------------------|---------------------|
| Year                     | No.<br>of<br>banks | Disburse-<br>ments | Recoveries   | Estimated<br>Additional<br>Recoveries | Estimated<br>Losses |
| Total                    | 1,451              | \$80,746,515       | \$52,978,709 | \$631,101                             | \$27,136,705        |
| 1998                     | 3                  | 286,086            | 5,434        | 101,676                               | 178,976             |
| 1997                     | 1                  | 25,546             | 19,131       | 2,316                                 | 4,099               |
| 1996                     | 5                  | \$169,397          | \$117,980    | \$11,884                              | \$39,533            |
| 1995                     | 6                  | 717,799            | 621,501      | 9,400                                 | 86,898              |
| 1994                     | 13                 | 1,224,797          | 1,022,285    | 20,389                                | 182,123             |
| 1993                     | 36                 | 1,536,094          | 978,901      | 14,179                                | 543,014             |
| 1992                     | 95                 | 12,280,522         | 8,958,457    | 149,210                               | 3,172,855           |
| 1991                     | 103                | 19,938,123         | 13,938,235   | 286,600                               | 5,713,288           |
| 1990                     | 148                | 8,629,084          | 6,569,115    | 26,905                                | 2,033,064           |
| 1989                     | 174                | 9,326,725          | 3,973,614    | 8,145                                 | 5,344,966           |
| 1988                     | 164                | 9,180,495          | 4,226,946    | 104                                   | 4,953,445           |
| 1987                     | 133                | 2,773,202          | 1,612,642    | 268                                   | 1,160,292           |
| 1986                     | 98                 | 3,476,140          | 2,209,566    | 25                                    | 1,266,549           |
| 1985                     | 87                 | 1,631,166          | 1,095,604    | 0                                     | 535,562             |
| 1984                     | 62                 | 1,373,198          | 941,674      | 0                                     | 431,524             |
| 1983                     | 35                 | 2,893,969          | 1,850,553    | 0                                     | 1,043,416           |
| 1982                     | 25                 | 268,372            | 213,578      | 0                                     | 54,794              |
| 1981                     | 5                  | 79,208             | 71,358       | 0                                     | 7,850               |
| 1980                     | 7                  | 138,623            | 110,248      | 0                                     | 28,375              |
| 1934-79                  | 251                | 4,797,969          | 4,441,887    | 0                                     | 356,082             |

| Assistance transactions <sup>1</sup> |                    |                    |             |                                       |                     |
|--------------------------------------|--------------------|--------------------|-------------|---------------------------------------|---------------------|
| Year                                 | No.<br>of<br>banks | Disburse-<br>ments | Recoveries  | Estimated<br>Additional<br>Recoveries | Estimated<br>Losses |
| Total                                | 141                | \$11,630,356       | \$6,199,063 | \$435                                 | \$5,430,858         |
| 1998                                 | 0                  | 0                  | 0           | 0                                     | 0                   |
| 1997                                 | 0                  | 0                  | 0           | 0                                     | 0                   |
| 1996                                 | 0                  | 0                  | 0           | 0                                     | 0                   |
| 1995                                 | 0                  | 0                  | 0           | 0                                     | 0                   |
| 1994                                 | 0                  | 0                  | 0           | 0                                     | 0                   |
| 1993                                 | 0                  | 0                  | 0           | 0                                     | 0                   |
| 1992                                 | 2                  | 1,486              | 1,236       | 0                                     | 250                 |
| 1991                                 | 3                  | 6,117              | 3,093       | 0                                     | 3,024               |
| 1990                                 | 1                  | 4,935              | 2,597       | 0                                     | 2,338               |
| 1989                                 | 1                  | 2,548              | 252         | 0                                     | 2,296               |
| 1988                                 | 80                 | 1,730,351          | 189,111     | 0                                     | 1,541,240           |
| 1987                                 | 19                 | 160,877            | 713         | 0                                     | 160,164             |
| 1986                                 | 7                  | 158,848            | 65,489      | 0                                     | 93,359              |
| 1985                                 | 4                  | 765,732            | 406,676     | 0                                     | 359,056             |
| 1984                                 | 2                  | 5,531,179          | 4,414,904   | 0                                     | 1,116,275           |
| 1983                                 | 4                  | 764,690            | 426,973     | 435                                   | 337,282             |
| 1982                                 | 10                 | 1,729,538          | 686,754     | 0                                     | 1,042,784           |
| 1981                                 | 3                  | 774,055            | 1,265       | 0                                     | 772,790             |
| 1980                                 | 1                  | N/A                | N/A         | N/A                                   | N/A                 |
| 1934-79                              | 4                  | 0                  | 0           | 0                                     | 0                   |

<sup>1</sup> Totals do not include dollar amounts for five open bank assistance transactions between 1971 and 1980. Excludes eight transactions prior to 1962 that required no disbursements. Also, disbursements, recoveries, and estimated additional recoveries do not include working capital advances to and repayments by receiverships.

<sup>2</sup> Includes insured deposit transfer cases.

<sup>3</sup> For detail of years 1934 through 1979, refer to Table C of the 1994 Annual Report.

**Income and Expenses, Bank Insurance Fund,  
from Beginning of Operations, September 11, 1933, through December 31, 1998**

(Dollars in Millions)

| Year     | Income     |                      |                       |                                    |  | Expenses and Losses |                            |   |                                      | Net Income/<br>(Loss) |
|----------|------------|----------------------|-----------------------|------------------------------------|--|---------------------|----------------------------|---|--------------------------------------|-----------------------|
|          | Total      | Assessment<br>Income | Assessment<br>Credits | Investment<br>and Other<br>Sources | Effective<br>Assessment<br>Rate <sup>1</sup> | Total               | Provision<br>for<br>Losses | Administrative<br>and Operating<br>Expenses | Interest<br>& Other Ins.<br>Expenses |                       |
| Total    | \$77,989.0 | \$53,134.4           | \$6,709.1             | \$31,563.7                         |  | \$48,387.4          | \$34,430.0                 | \$7,050.3                                   | \$6,907.1                            | \$29,601.6            |
| 1998     | 2,000.3    | 21.7                 | 0.0                   | 1,978.6                            | 0.0008%                                      | 691.5               | (37.7)                     | 697.6                                       | 31.6                                 | 1,308.8               |
| 1997     | 1,615.6    | 24.7                 | 0.0                   | 1,590.9                            | 0.0008%                                      | 177.3               | (503.7)                    | 605.2                                       | 75.8                                 | 1,438.3               |
| 1996     | 1,655.3    | 72.7                 | 0.0                   | 1,582.6                            | 0.0024%                                      | 254.6               | (325.2)                    | 505.3                                       | 74.5                                 | 1,400.7               |
| 1995     | 4,089.1    | 2,906.9              | 0.0                   | 1,182.2                            | 0.1240%                                      | 483.2               | (33.2)                     | 470.6                                       | 45.8                                 | 3,605.9               |
| 1994     | 6,467.0    | 5,590.6              | 0.0                   | 876.4                              | 0.2360%                                      | (2,259.1)           | (2,873.4)                  | 423.2                                       | 191.1                                | 8,726.1               |
| 1993     | 6,430.8    | 5,784.3              | 0.0                   | 646.5                              | 0.2440%                                      | (6,791.4)           | (7,677.4)                  | 388.5                                       | 497.5                                | 13,222.2              |
| 1992     | 6,301.5    | 5,587.8              | 0.0                   | 713.7                              | 0.2300%                                      | (625.8)             | (2,259.7)                  | 570.8                                       | 1,063.1                              | 6,927.3               |
| 1991     | 5,790.0    | 5,160.5              | 0.0                   | 629.5                              | 0.2125%                                      | 16,862.3            | 15,476.2                   | 284.1                                       | 1,102.0                              | (11,072.3)            |
| 1990     | 3,838.3    | 2,855.3              | 0.0                   | 983.0                              | 0.1200%                                      | 13,003.3            | 12,133.1                   | 219.6                                       | 650.6                                | (9,165.0)             |
| 1989     | 3,494.6    | 1,885.0              | 0.0                   | 1,609.6                            | 0.0833%                                      | 4,346.2             | 3,811.3                    | 213.9                                       | 321.0                                | (851.6)               |
| 1988     | 3,347.7    | 1,773.0              | 0.0                   | 1,574.7                            | 0.0833%                                      | 7,588.4             | 6,298.3                    | 223.9                                       | 1,066.2                              | (4,240.7)             |
| 1987     | 3,319.4    | 1,696.0              | 0.0                   | 1,623.4                            | 0.0833%                                      | 3,270.9             | 2,996.9                    | 204.9                                       | 69.1                                 | 48.5                  |
| 1986     | 3,260.1    | 1,516.9              | 0.0                   | 1,743.2                            | 0.0833%                                      | 2,963.7             | 2,827.7                    | 180.3                                       | (44.3)                               | 296.4                 |
| 1985     | 3,385.4    | 1,433.4              | 0.0                   | 1,952.0                            | 0.0833%                                      | 1,957.9             | 1,569.0                    | 179.2                                       | 209.7                                | 1,427.5               |
| 1984     | 3,099.5    | 1,321.5              | 0.0                   | 1,778.0                            | 0.0800%                                      | 1,999.2             | 1,633.4                    | 151.2                                       | 214.6                                | 1,100.3               |
| 1983     | 2,628.1    | 1,214.9              | 164.0                 | 1,577.2                            | 0.0714%                                      | 969.9               | 675.1                      | 135.7                                       | 159.1                                | 1,658.2               |
| 1982     | 2,524.6    | 1,108.9              | 96.2                  | 1,511.9                            | 0.0769%                                      | 999.8               | 126.4                      | 129.9                                       | 743.5                                | 1,524.8               |
| 1981     | 2,074.7    | 1,039.0              | 117.1                 | 1,152.8                            | 0.0714%                                      | 848.1               | 320.4                      | 127.2                                       | 400.5                                | 1,226.6               |
| 1980     | 1,310.4    | 951.9                | 521.1                 | 879.6                              | 0.0370%                                      | 83.6                | (38.1)                     | 118.2                                       | 3.5                                  | 1,226.8               |
| 1979     | 1,090.4    | 881.0                | 524.6                 | 734.0                              | 0.0333%                                      | 93.7                | (17.2)                     | 106.8                                       | 4.1                                  | 996.7                 |
| 1978     | 952.1      | 810.1                | 443.1                 | 585.1                              | 0.0385%                                      | 148.9               | 36.5                       | 103.3                                       | 9.1                                  | 803.2                 |
| 1977     | 837.8      | 731.3                | 411.9                 | 518.4                              | 0.0370%                                      | 113.6               | 20.8                       | 89.3  | 3.5                                  | 724.2                 |
| 1976     | 764.9      | 676.1                | 379.6                 | 468.4                              | 0.0370%                                      | 212.3               | 28.0                       | 180.4                                       | 3.9                                  | 552.6                 |
| 1975     | 689.3      | 641.3                | 362.4                 | 410.4                              | 0.0357%                                      | 97.5                | 27.6                       | 67.7  | 2.2                                  | 591.8                 |
| 1974     | 668.1      | 587.4                | 285.4                 | 366.1                              | 0.0435%                                      | 159.2               | 97.9                       | 59.2  | 2.1                                  | 508.9                 |
| 1973     | 561.0      | 529.4                | 283.4                 | 315.0                              | 0.0385%                                      | 108.2               | 52.5                       | 54.4  | 1.3                                  | 452.8                 |
| 1933-72* | 5,793.0    | 6,332.8              | 3,120.3               | 2,580.5                            |  | 630.4               | 64.5                       | 559.9                                       | 6.0                                  | 5,162.6               |

<sup>1</sup> The effective rates from 1950 through 1984 vary from the statutory rate of 0.0833 percent due to assessment credits provided in those years. The statutory rate increased to 0.12 percent in 1990 and to a minimum of 0.15 percent in 1991. The effective rates in 1991 and 1992 vary because the FDIC exercised new authority to increase assessments above the statutory rate when needed. Beginning in 1993, the effective rate is based on a risk-related premium system under which institutions pay assessments in the range of 0.23 percent to 0.31 percent. In May 1995, the BIF reached the mandatory recapitalization level of 1.25%. As a result, the assessment rate was reduced to 4.4 cents per \$100 of insured deposits and assessment premiums totaling \$1.5 billion were refunded in September 1995.

<sup>2</sup> Includes \$210 million for the cumulative effect of an accounting change for certain postretirement benefits.

<sup>3</sup> Includes \$105.6 million net loss on government securities.

<sup>4</sup> Includes \$80.6 million of interest paid on capital stock between 1933 and 1948.

\*For detail of years 1933 through 1972, please refer to the 1996 annual report.

# Estimated Insured Deposits and the Bank Insurance Fund, December 31, 1934, through 1998

| Year <sup>1</sup> | Insurance Coverage | (Dollars in Millions)          |                               |                                |                        | Insurance Fund as a Percentage of |                       |
|-------------------|--------------------|--------------------------------|-------------------------------|--------------------------------|------------------------|-----------------------------------|-----------------------|
|                   |                    | Est. Deposits in Insured Banks |                               | Percentage of Insured Deposits | Deposit Insurance Fund | Total Domestic Deposits           | Est. Insured Deposits |
|                   |                    | Total Domestic Deposits        | Insured <sup>2</sup> Deposits |                                |                        |                                   |                       |
| 1998              | \$100,000          | \$2,996,396                    | \$2,141,268                   | 71.5                           | \$29,612.3             | 0.99                              | 1.38                  |
| 1997              | 100,000            | 2,785,990                      | 2,055,874                     | 73.8                           | 28,292.5               | 1.02                              | 1.38                  |
| 1996              | 100,000            | 2,642,107                      | 2,007,447                     | 76.0                           | 26,854.4               | 1.02                              | 1.34                  |
| 1995              | 100,000            | 2,575,966                      | 1,952,543                     | 75.8                           | 25,453.7               | 0.99                              | 1.30                  |
| 1994              | 100,000            | 2,463,813                      | 1,896,060                     | 77.0                           | 21,847.8               | 0.89                              | 1.15                  |
| 1993              | 100,000            | 2,493,636                      | 1,906,885                     | 76.5                           | 13,121.6               | 0.53                              | 0.69                  |
| 1992              | 100,000            | 2,512,278                      | 1,945,623                     | 77.4                           | (100.6)                | (0.00)                            | (0.01)                |
| 1991              | 100,000            | 2,520,074                      | 1,957,722                     | 77.7                           | (7,027.9)              | (0.28)                            | (0.36)                |
| 1990              | 100,000            | 2,540,930                      | 1,929,612                     | 75.9                           | 4,044.5                | 0.16                              | 0.21                  |
| 1989              | 100,000            | 2,465,922                      | 1,873,837                     | 76.0                           | 13,209.5               | 0.54                              | 0.70                  |
| 1988              | 100,000            | 2,330,768                      | 1,750,259                     | 75.1                           | 14,061.1               | 0.60                              | 0.80                  |
| 1987              | 100,000            | 2,201,549                      | 1,658,802                     | 75.3                           | 18,301.8               | 0.83                              | 1.10                  |
| 1986              | 100,000            | 2,167,596                      | 1,634,302                     | 75.4                           | 18,253.3               | 0.84                              | 1.12                  |
| 1985              | 100,000            | 1,974,512                      | 1,503,393                     | 76.1                           | 17,956.9               | 0.91                              | 1.19                  |
| 1984              | 100,000            | 1,806,520                      | 1,389,874                     | 76.9                           | 16,529.4               | 0.92                              | 1.19                  |
| 1983              | 100,000            | 1,690,576                      | 1,268,332                     | 75.0                           | 15,429.1               | 0.91                              | 1.22                  |
| 1982              | 100,000            | 1,544,697                      | 1,134,221                     | 73.4                           | 13,770.9               | 0.89                              | 1.21                  |
| 1981              | 100,000            | 1,409,322                      | 988,898                       | 70.2                           | 12,246.1               | 0.87                              | 1.24                  |
| 1980              | 100,000            | 1,324,463                      | 948,717                       | 71.6                           | 11,019.5               | 0.83                              | 1.16                  |
| 1979              | 40,000             | 1,226,943                      | 808,555                       | 65.9                           | 9,792.7                | 0.80                              | 1.21                  |
| 1978              | 40,000             | 1,145,835                      | 760,706                       | 66.4                           | 8,796.0                | 0.77                              | 1.16                  |
| 1977              | 40,000             | 1,050,435                      | 692,533                       | 65.9                           | 7,992.8                | 0.76                              | 1.15                  |
| 1976              | 40,000             | 941,923                        | 628,263                       | 66.7                           | 7,268.8                | 0.77                              | 1.16                  |
| 1975              | 40,000             | 875,985                        | 569,101                       | 65.0                           | 6,716.0                | 0.77                              | 1.18                  |
| 1974              | 40,000             | 833,277                        | 520,309                       | 62.5                           | 6,124.2                | 0.73                              | 1.18                  |
| 1973              | 20,000             | 766,509                        | 465,600                       | 60.7                           | 5,615.3                | 0.73                              | 1.21                  |
| 1972              | 20,000             | 697,480                        | 419,756                       | 60.2                           | 5,158.7                | 0.74                              | 1.23                  |
| 1971              | 20,000             | 610,685                        | 374,568                       | 61.3                           | 4,739.9                | 0.78                              | 1.27                  |
| 1970              | 20,000             | 545,198                        | 349,581                       | 64.1                           | 4,379.6                | 0.80                              | 1.25                  |
| 1969              | 20,000             | 495,858                        | 313,085                       | 63.1                           | 4,051.1                | 0.82                              | 1.29                  |
| 1968              | 15,000             | 491,513                        | 296,701                       | 60.2                           | 3,749.2                | 0.76                              | 1.26                  |
| 1967              | 15,000             | 448,709                        | 261,149                       | 58.2                           | 3,485.5                | 0.78                              | 1.33                  |
| 1966              | 15,000             | 401,096                        | 234,150                       | 58.4                           | 3,252.0                | 0.81                              | 1.39                  |
| 1965              | 10,000             | 377,400                        | 209,690                       | 55.6                           | 3,036.3                | 0.80                              | 1.45                  |
| 1964              | 10,000             | 348,981                        | 191,787                       | 55.0                           | 2,844.7                | 0.82                              | 1.48                  |
| 1963              | 10,000             | 313,304                        | 177,381                       | 56.6                           | 2,667.9                | 0.85                              | 1.50                  |
| 1962              | 10,000             | 297,548                        | 170,210                       | 57.2                           | 2,502.0                | 0.84                              | 1.47                  |
| 1961              | 10,000             | 281,304                        | 160,309                       | 57.0                           | 2,353.8                | 0.84                              | 1.47                  |
| 1960              | 10,000             | 260,495                        | 149,684                       | 57.5                           | 2,222.2                | 0.85                              | 1.48                  |
| 1959              | 10,000             | 247,589                        | 142,131                       | 57.4                           | 2,089.8                | 0.84                              | 1.47                  |
| 1958              | 10,000             | 242,445                        | 137,698                       | 56.8                           | 1,965.4                | 0.81                              | 1.43                  |
| 1957              | 10,000             | 225,507                        | 127,055                       | 56.3                           | 1,850.5                | 0.82                              | 1.46                  |
| 1956              | 10,000             | 219,393                        | 121,008                       | 55.2                           | 1,742.1                | 0.79                              | 1.44                  |
| 1955              | 10,000             | 212,226                        | 116,380                       | 54.8                           | 1,639.6                | 0.77                              | 1.41                  |
| 1954              | 10,000             | 203,195                        | 110,973                       | 54.6                           | 1,542.7                | 0.76                              | 1.39                  |
| 1953              | 10,000             | 193,466                        | 105,610                       | 54.6                           | 1,450.7                | 0.75                              | 1.37                  |
| 1952              | 10,000             | 188,142                        | 101,841                       | 54.1                           | 1,363.5                | 0.72                              | 1.34                  |
| 1951              | 10,000             | 178,540                        | 96,713                        | 54.2                           | 1,282.2                | 0.72                              | 1.33                  |
| 1950              | 10,000             | 167,818                        | 91,359                        | 54.4                           | 1,243.9                | 0.74                              | 1.36                  |
| 1949              | 5,000              | 156,786                        | 76,589                        | 48.8                           | 1,203.9                | 0.77                              | 1.57                  |
| 1948              | 5,000              | 153,454                        | 75,320                        | 49.1                           | 1,065.9                | 0.69                              | 1.42                  |
| 1947              | 5,000              | 154,096                        | 76,254                        | 49.5                           | 1,006.1                | 0.65                              | 1.32                  |
| 1946              | 5,000              | 148,458                        | 73,759                        | 49.7                           | 1,058.5                | 0.71                              | 1.44                  |
| 1945              | 5,000              | 157,174                        | 67,021                        | 42.4                           | 929.2                  | 0.59                              | 1.39                  |
| 1944              | 5,000              | 134,662                        | 56,398                        | 41.9                           | 804.3                  | 0.60                              | 1.43                  |
| 1943              | 5,000              | 111,650                        | 48,440                        | 43.4                           | 703.1                  | 0.63                              | 1.45                  |
| 1942              | 5,000              | 89,869                         | 32,837                        | 36.5                           | 616.9                  | 0.69                              | 1.88                  |
| 1941              | 5,000              | 71,209                         | 28,249                        | 39.7                           | 553.5                  | 0.78                              | 1.96                  |
| 1940              | 5,000              | 65,288                         | 26,638                        | 40.8                           | 496.0                  | 0.76                              | 1.86                  |
| 1939              | 5,000              | 57,485                         | 24,650                        | 42.9                           | 452.7                  | 0.79                              | 1.84                  |
| 1938              | 5,000              | 50,791                         | 23,121                        | 45.5                           | 420.5                  | 0.83                              | 1.82                  |
| 1937              | 5,000              | 48,228                         | 22,557                        | 46.8                           | 383.1                  | 0.79                              | 1.70                  |
| 1936              | 5,000              | 50,281                         | 22,330                        | 44.4                           | 343.4                  | 0.68                              | 1.54                  |
| 1935              | 5,000              | 45,125                         | 20,158                        | 44.7                           | 306.0                  | 0.68                              | 1.52                  |
| 1934 <sup>3</sup> | 5,000              | 40,060                         | 18,075                        | 45.1                           | 291.7                  | 0.73                              | 1.61                  |

<sup>1</sup> Starting in 1990, deposits in insured banks exclude those deposits held by Bank Insurance Fund members that are insured by the Savings Association Insurance Fund and include those deposits held by Savings Association Insurance Fund members that are insured by the Bank Insurance Fund.

<sup>2</sup> Estimated insured deposits reflect deposit information as reported in the fourth quarter FDIC Quarterly Banking Profile. Before 1991, insured deposits were estimated using percentages determined from the June 30 Call Reports.

<sup>3</sup> Initial coverage was \$2,500 from January 1 to June 30, 1934.



# Income and Expenses, Savings Association Insurance Fund, by Year, from Beginning of Operations, August 9, 1989, through December 31, 1998

(Dollars in Thousands)

| Year  | Income       |                   |                              |                           | Expenses and Losses |                      |                                |                                       | Funding Transfer from the FSLIC Resolution Fund | Net Income/ (Loss) |
|-------|--------------|-------------------|------------------------------|---------------------------|---------------------|----------------------|--------------------------------|---------------------------------------|---|--------------------|
|       | Total        | Assessment Income | Investment and Other Sources | Effective Assessment Rate | Total               | Provision for Losses | Interest & Other Ins. Expenses | Administrative and Operating Expenses |   |                    |
| Total | \$10,207,462 | \$8,534,451       | \$1,673,011                  |                           | \$511,383           | \$53,177             | \$741                          | \$457,465                             | \$139,498                                       | \$9,835,577        |
| 1998  | 583,859      | 15,352            | 568,507                      | 0.002%                    | 116,629             | 31,992               | 9                              | 84,628                                | 0   | 467,230            |
| 1997  | 549,912      | 13,914            | 535,998                      | 0.004%                    | 69,986              | (1,879)              | 0                              | 71,865                                | 0   | 479,926            |
| 1996  | 5,501,684    | 5,221,560         | 280,124                      | 0.204%                    | (28,890)            | (91,636)             | 128                            | 62,618                                | 0   | 5,530,574          |
| 1995  | 1,139,916    | 970,027           | 169,889                      | 0.234%                    | (281,216)           | (321,000)            | 0                              | 39,784                                | 0   | 1,421,132          |
| 1994  | 1,215,289    | 1,132,102         | 83,187                       | 0.244%                    | 434,303             | 414,000              | 0                              | 20,303                                | 0   | 780,986            |
| 1993  | 923,516      | 897,692           | 25,824                       | 0.250%                    | 46,814              | 16,531               | 0                              | 30,283                                | 0   | 876,702            |
| 1992  | 178,643      | 172,079           | 6,564                        | 0.230%                    | 28,982              | (14,945)             | (5)                            | 43,932                                | 35,446  | 185,107            |
| 1991  | 96,446       | 93,530            | 2,916                        | 0.230%                    | 63,085              | 20,114               | 609                            | 42,362                                | 42,362  | 75,723             |
| 1990  | 18,195       | 18,195            | 0                            | 0.208%                    | 56,088              | 0                    | 0                              | 56,088                                | 56,088  | 18,195             |
| 1989  | 2            | 0                 | 2                            | 0.208%                    | 5,602               | 0                    | 0                              | 5,602                                 | 5,602   | 2                  |

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## FDIC- Insured Institutions Closed During 1998

(Dollars in Thousands)

| Name and Location | Bank Class | Number of Deposit Accounts | Total Assets | Total Deposits | FDIC Disbursements | Estimated Loss <sup>1</sup> | Date of Closing or Acquisition | Receiver/ Assuming Bank and Location |
|-------------------|------------|----------------------------|--------------|----------------|--------------------|-----------------------------|--------------------------------|--------------------------------------|
|-------------------|------------|----------------------------|--------------|----------------|--------------------|-----------------------------|--------------------------------|--------------------------------------|

### Bank Insurance Fund

#### Purchase and Assumption - All Deposits

|                              |    |       |           |           |           |           |          |   |
|------------------------------|----|-------|-----------|-----------|-----------|-----------|----------|---|
| Omni Bank<br>River Rouge, MI | SM | 5,100 | \$38,319  | \$36,322  | \$36,575  | \$2,317   | 04/09/98 | Shore Bank<br>Detroit, MI                   |
| Best Bank<br>Boulder, CO     | NM | 5,500 | \$318,024 | \$285,657 | \$237,198 | \$171,586 | 07/23/98 | Pueblo Bank and Trust Company<br>Pueblo, CO |
| Q Bank<br>Fort Benton, MT    | SM | 2,100 | \$14,057  | \$13,097  | \$12,313  | \$5,073   | 08/07/98 | Heritage State Bank<br>Fort Benton, MT      |

### Savings Association Insurance Fund

No closings during 1998.

Codes for Bank Class: NM = State-chartered bank that is not a member of the Federal Reserve System.  
SM = State-chartered bank that is a member of the Federal Reserve System.

<sup>1</sup> Estimated losses are as of 12/31/98. Estimated losses are routinely adjusted with updated information from new appraisals and asset sales, which ultimately affect the asset values and projected recoveries.

## Estimated Insured Deposits and the Savings Association Insurance Fund, December 31, 1989, through 1998

| Year <sup>1</sup> | Insurance Coverage | (Dollars in Millions)                 |                               |                                |                        | Insurance Fund as a Percentage of |                       |
|-------------------|--------------------|---------------------------------------|-------------------------------|--------------------------------|------------------------|-----------------------------------|-----------------------|
|                   |                    | Est. Deposits in Insured Institutions |                               | Percentage of Insured Deposits | Deposit Insurance Fund | Total Domestic Deposits           | Est. Insured Deposits |
|                   |                    | Total Domestic Deposits               | Insured <sup>2</sup> Deposits |                                |                        |                                   |                       |
| 1998              | \$100,000          | \$751,413                             | \$708,959                     | 94.4                           | \$9,839.8              | 1.31                              | 1.39                  |
| 1997              | 100,000            | 721,503                               | 690,132                       | 95.7                           | 9,368.3                | 1.30                              | 1.36                  |
| 1996              | 100,000            | 708,749                               | 683,090                       | 96.4                           | 8,888.4                | 1.25                              | 1.30                  |
| 1995              | 100,000            | 742,547                               | 711,017                       | 95.8                           | 3,357.8                | 0.45                              | 0.47                  |
| 1994              | 100,000            | 720,823                               | 692,626                       | 96.1                           | 1,936.7                | 0.27                              | 0.28                  |
| 1993              | 100,000            | 726,473                               | 695,158                       | 95.7                           | 1,155.7                | 0.16                              | 0.17                  |
| 1992              | 100,000            | 760,902                               | 729,458                       | 95.9                           | 279.0                  | 0.04                              | 0.04                  |
| 1991              | 100,000            | 810,664                               | 776,351                       | 95.8                           | 93.9                   | 0.01                              | 0.01                  |
| 1990              | 100,000            | 874,738                               | 830,028                       | 94.9                           | 18.2                   | 0.00                              | 0.00                  |
| 1989              | 100,000            | 948,144                               | 882,920                       | 93.1                           | 0.0                    | 0.00                              | 0.00                  |

<sup>1</sup> Starting in 1990, deposits in insured institutions exclude those deposits held by Savings Association Insurance Fund members that are insured by the Bank Insurance Fund and include those deposits held by Bank Insurance Fund members that are insured by the Savings Association Insurance Fund.

<sup>2</sup> Estimated insured deposits reflect deposit information as reported in the fourth quarter FDIC Quarterly Banking Profile. Before 1991, insured deposits were estimated using percentages determined from the June 30 Call Reports.

**Number, Assets, Deposits, Losses, and Loss to Funds of Insured Thrifts Taken Over or Closed Because of Financial Difficulties, 1989 through 1998 <sup>1</sup>**

(Dollars in Thousands)

| Year <sup>2</sup> | Total | Assets      | Deposits    | Estimated Receivership Loss <sup>3</sup> | Loss to Funds <sup>4</sup> |
|-------------------|-------|-------------|-------------|--|----------------------------|
| Total             | 749   | 395,060,996 | 318,363,296 | 74,445,350                               | 83,128,716                 |
| 1998              | 0     | 0           | 0           | 0  | 0                          |
| 1997              | 0     | 0           | 0           | 0  | 0                          |
| 1996              | 1     | 32,576      | 32,745      | 17,501                                   | 17,501                     |
| 1995              | 2     | 435,133     | 418,575     | 37,896                                   | 44,056                     |
| 1994              | 2     | 136,815     | 127,508     | 11,552                                   | 14,679                     |
| 1993              | 10    | 7,178,794   | 5,708,253   | 312,005                                  | 414,796                    |
| 1992              | 59    | 44,196,946  | 34,773,224  | 3,185,539                                | 3,902,863                  |
| 1991              | 144   | 78,898,704  | 65,173,122  | 8,531,463                                | 9,674,862                  |
| 1990              | 213   | 129,662,398 | 98,963,960  | 16,213,405                               | 19,625,597                 |
| 1989 <sup>5</sup> | 318   | 134,519,630 | 113,165,909 | 46,135,989                               | 49,434,362                 |

1 Prior to July 1, 1995, all thrift closings were the responsibility of the Resolution Trust Corporation (RTC). Since the RTC was terminated on December 31, 1995, and all assets and liabilities transferred to the FSLIC Resolution Fund (FRF), all the results of the thrift closing activity from 1989 through 1995 are now reflected on FRF's books. The Savings Association Insurance Fund (SAIF) became responsible for all thrifts closed after June 30, 1995; there has been only one such failure. Additionally, SAIF was appointed receiver of one thrift (Heartland FSLA) on October 8, 1993, because, at that time, RTC's authority to resolve FSLIC-insured thrifts had not yet been extended by the RTC Completion Act.

2 Year is the year of failure, not the year of resolution.

3 The estimated losses represent the projected loss at the fund level from receiverships for unreimbursed subrogated claims of the FRF/SAIF and unpaid advances to receiverships from the FRF.

4 The Loss to Funds represents the total resolution cost of the failed thrifts in the SAIF and FRF-RTC funds, which includes corporate revenue and expense items such as interest expense on Federal Financing Bank debt, interest expense on escrowed funds, and interest revenue on advances to receiverships, in addition to the estimated losses for receiverships.

5 Total for 1989 excludes nine failures of the former FSLIC.

F o r M o r e I n f o r m a t i o n





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FDIC publications, press releases, speeches and Congressional testimony, directives to financial institutions and other documents are available through the Public Information Center. These documents include the *Quarterly Banking Profile*, *Statistics on Banking* and a variety of consumer pamphlets.

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The Office of the Ombudsman responds to inquiries about the FDIC in a fair, impartial and timely manner. It researches questions and complaints from bankers, the public and FDIC employees on a confidential basis. The office also recommends ways to improve FDIC operations, regulations and customer service.

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**Home Page on the Internet:**  
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A wide range of banking, consumer and financial information is available on the FDIC's Internet home page. Information includes the FDIC's Electronic Deposit Insurance Estimator—"EDIE"—which estimates an individual's deposit insurance coverage; the *Institution Directory*—financial profiles of FDIC-supervised institutions; Community Reinvestment Act evaluations and ratings for banks and thrifts supervised by the FDIC; a Web site designed to help detect potentially fraudulent Internet banking activity; a listing of banks' pending applications that are subject to public comment; and Call Reports—banks' reports of condition and income. Readers also can access a variety of consumer pamphlets, FDIC press releases, speeches and other updates on the agency's activities, as well as corporate databases and customized reports of FDIC and banking industry information. Readers will be interested in the FDIC's new Year 2000 Web site and the fully searchable text of "FDIC Law, Regulations and Related Acts."

## Regional Offices

128

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#### DOS:

Examines and supervises state-chartered banks that are not members of the Federal Reserve System. Provides information about sound banking practices.

#### DCA:

Examines FDIC-supervised banks for compliance with consumer protection laws and the Community Reinvestment Act. Informs bankers and the public about deposit insurance and other consumer protections.



### Acting Chairman Hove

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#### Congressional Testimony

**March 10, 1998**

Before the Senate Committee on Banking, Housing, and Urban Affairs, on financial regulatory relief and economic efficiency.

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**April 29, 1998**

Before the House Committee on Banking and Financial Services, on mergers in the financial services industry.

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#### Speeches

**March 3, 1998**

To the Independent Bankers Association of America, on competitive challenges facing the banking industry.

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**May 2, 1998**

To the Conference of State Bank Supervisors, on mergers between large banks and mergers between banks and other financial service providers.

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### Chairman Tanoue

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#### Congressional Testimony

**June 25, 1998**

Before the Senate Committee on Banking, Housing, and Urban Affairs, on financial modernization.

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**July 16, 1998**

Before the House Committee on Banking and Financial Services' Subcommittee on Financial Institutions and Consumer Credit, on regulatory relief.

---

**September 17, 1998**

Before the House Committee on Banking and Financial Services, on addressing the Year 2000 date change.

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**October 1, 1998**

Before the House Committee on Banking and Financial Services, on Long-Term Capital Management, L.P.

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#### Speeches

**September 2, 1998**

To the National Bankers Association, on challenges facing the FDIC.

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**September 27, 1998**

To the American Bankers Association, on the risk-based premium system and risks to the insurance funds.

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**November 19, 1998**

To the Community Bankers Association of New York State, on three deposit insurance-related issues: preparing computer systems for the Year 2000 date change, emerging risks, and refinements being considered for the risk-based premium system.

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These and other statements are available from the Public Information Center listed on Page 127. Some of these statements are also available on the FDIC's Internet home page ([www.fdic.gov](http://www.fdic.gov)).

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F D I C

# 98 Annual Report

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