I. Management's Discussion and Analysis

The Year in Review

The year 2004 marked continued changes within the FDIC, but maintaining stability of the nation's financial services industry remained a primary focus. The FDIC continued to lead and participate in many interagency initiatives in an effort to meet the demands of an ever evolving financial services industry.

During 2004, the FDIC continued its emphasis on reducing regulatory burden, and also enhanced its examination program while promoting measures to improve its efficiency. Studies were conducted in various areas, identifying risks and promoting best practices among the regulatory and banking industries. In 2004, the FDIC actively contributed to efforts to address money laundering and terrorist financing risks as well as other financial crimes such as identity theft.

Highlights of the Corporation's 2004 accomplishments are presented in this section for each of the FDIC's three major business lines – Insurance, Supervision and Consumer Protection, and Receivership Management – as well as its program support functions.

Insurance

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

Deposit Insurance Reform

The FDIC again gave priority attention to enactment of comprehensive deposit insurance reform legislation in 2004.

The FDIC's reform recommendations include:

- Merging the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF).
- Granting the FDIC's Board of Directors the flexibility to manage a combined deposit insurance fund. Under the present system, statutorily mandated methods of managing the size of the BIF and SAIF may cause large premium swings and could force the FDIC to charge the highest premiums during difficult economic times when the industry can least afford it. Currently, safer institutions subsidize riskier institutions unnecessarily, while new entrants and growing institutions avoid paying premiums. To address these problems, the FDIC recommended that Congress give the Board of Directors the discretion to:
    - Manage the combined fund within a range.
    - Price deposit insurance according to risk at all times for all insured institutions.
    - Grant a one-time initial assessment credit to recognize institutions' past contributions to the deposit insurance funds and create an ongoing system of assessment credits and rebates to prevent the fund from growing too large.
- Indexing the level of deposit insurance coverage to ensure that basic account coverage is neither eroded over time by inflation nor made subject to irregular adjustments.

The House passed H.R. 522, the Federal Deposit Insurance Reform Act of 2003, on April 22, 2003, by a vote of 411 to 11. Although the Senate Banking Committee held a hearing on deposit insurance reform in February 2003, it did not act on a deposit insurance bill before the 108th Congress adjourned. The FDIC provided information and analysis to Congress in support of deposit insurance reform legislation. Support was obtained for a proposed assessment credit and rebate system as well as a new deposit insurance pricing system. Enactment of deposit insurance reform will remain a priority of the FDIC during 2005.

Improvements to the FDIC's Loss Reserve Methodology

Discrepancies between projected failed assets and actual assets and projected and actual losses at failed financial institutions were reviewed at Financial Risk Committee meetings in March and September. No deficiencies in the methodology for projecting losses were noted.

During 2004, enhancements to the FDIC's reserving process and methodology were also implemented, in accordance with recommendations from a comprehensive 2003 study. The Financial Risk Committee adopted new guidelines for deviating from actual historical failure rates and enhanced coefficients contained in the research model which is used to develop loss given failure estimates. In addition, a working prototype of an integrated fund model was developed to better measure and manage risk to the deposit insurance funds.

New International Capital Standards

The FDIC continues to actively participate in efforts to align capital standards with advances in financial institutions' risk measurement and management practices, while ensuring that such institutions and the industry as a whole maintain adequate capital and reserves. During 2004, the FDIC was active on a number of global and domestic supervisory and policy groups and subgroups including the Basel Committee on Banking Supervision (BCBS), the Capital Task Force, and the Accord Implementation Group. The FDIC also participated in various U.S. regulatory efforts aimed at interpreting international standards and establishing sound policy and procedures for implementing these standards.

The BCBS published the "International Convergence of Capital Measurement and Capital Standards" in June 2004, which is more commonly referred to as "Basel II" or the "Revised Framework." These broad international standards will provide the underpinnings for a U.S. revised capital rule, which is currently anticipated to be finalized by domestic bank and thrift regulatory authorities in mid-2006 for implementation in January 2008.

Ensuring the adequacy of insured institutions' capital under Basel II remains a key objective for the FDIC. In 2004, the FDIC actively participated in domestic and international policy and implementation efforts to ensure these new rules are designed appropriately. These efforts included the development of examination guidance, which is intended to provide the industry with regulatory perspectives for implementation, and the performance of a fourth quantitative impact study (QIS) begun in 2004 to assess the potential impact of the Revised Framework on financial institution and industry-wide capital levels.

The FDIC invested significant resources on several fronts in 2004 to ensure that the Revised Framework will be compatible with the Corporation's roles as both deposit insurer and supervisor. Significant work was performed, both internationally and domestically, to assure that Basel II will be implemented efficiently, that effective supervisory oversight will continue, and that these new rules will not create unintended and potentially harmful consequences. To that end, the FDIC began to identify, hire and train personnel to ensure that a strong infrastructure will exist to meet the many challenges posed by adoption of the complex risk management standards put forth under Basel II.

Regulatory Burden Reduction Initiatives

During 2004, under the leadership of Vice Chairman John Reich, the federal bank and thrift regulatory agencies continued a cooperative three-year effort to review all of their regulations (129 in all) that impose some burden on the industry. The purpose of the review, which is mandated by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), is to identify and eliminate any outdated, unnecessary or unduly burdensome regulatory requirements, while ensuring safety and soundness and consumer protections remain strong.

For the purposes of this review, the agencies categorized their regulations into 12 separate groups. Every six months, new groups of regulations are published for comment, giving bankers, community groups and others an opportunity to identify regulatory requirements they believe are no longer needed, as well as consumer protections that must be preserved. Comments on the first group of regulations, which included Applications and Reporting, Powers and Activities and International Banking, were solicited in 2003, and were analyzed during 2004.

The agencies issued notices for comment on two more groups of regulations in 2004:

- Lending-related consumer protection regulations, which include Truth-In-Lending (Regulation Z), Equal Credit Opportunity (Regulation B), Home Mortgage Disclosure Act (HMDA); and
- Deposit-related and other consumer protection regulations, which include Privacy of Consumer Financial Information, Truth-In-Savings, and Deposit Insurance Coverage.

The agencies received over 700 responses to the request for comments on these two groups of regulations.

The agencies also held six outreach meetings in 2004, three for bankers and three for consumer and community groups. These outreach sessions were intended to increase industry awareness of the EGRPRA project and obtain feedback.

The FDIC and the other financial regulatory agencies undertook several initiatives in 2004 that are expected to relieve regulatory burden, improve operational efficiencies of banks, or assist financial institutions in assessing potential risk. They published additional interagency guidance and examination procedures on the USA PATRIOT Act. The FDIC also sought comments on proposed changes to its Community Reinvestment Act regulations and its regulations governing certain international activities. (Final regulations in both areas are expected in early 2005.)

The FDIC also redesigned the EGRPRA Web site to make it more comprehensive and user-friendly and redesigned its Financial Institution Letter (FIL) format to make it easier for financial institutions to identify whether the subject of the FIL applies to their specific institution and the area of the institution to which the FIL is most relevant.

In 2005, the agencies will continue to analyze the comments and other feedback that have been received and expect to propose legislative or regulatory changes, where appropriate, to address certain regulatory burdens and needed consumer protections.

Center for Financial Research

The Corporation established the FDIC Center for Financial Research (CFR) in late 2003 to promote research that provides meaningful insights regarding developments in deposit insurance, the financial sector, prudential supervision, risk measurement and management, regulatory policy and related topics that are of interest to the FDIC, the financial services industry, academia and policymakers. The CFR is a partnership between the FDIC and the academic community with prominent scholars actively engaged in administering and carrying out its research program. The CFR carries out its mission through an agenda of research, analysis, forums and conferences that encourage and facilitate an ongoing dialogue incorporating industry, academic and public-sector perspectives.

The CFR supports high-quality original research by sponsoring relevant research program lines and soliciting rigorous analysis of the issues within five program areas. These programs benefit from the leadership of program coordinators who are drawn largely from the outside academic community. Input is also obtained from six prominent economists who serve as Senior Fellows. The CFR sponsors a Visiting Research Fellows Program to provide support for in-residence scholars for defined time periods. In 2004, the CFR funded 17 research proposals, the results of which will be published in the new CFR Working Papers Series. The CFR also engaged leading scholars in banking and finance to collaborate with FDIC staff on subjects of mutual interest.

The CFR and *The Journal for Financial Services Research (JFSR)* sponsored their fourth annual research conference, "Risk Transfer and Governance in the Financial System," in September 2004. The conference, which included 21 presentations selected from more than 60 submissions, attracted more than 100 researchers and included both domestic and international participants. The CFR held two workshops during the year for authors to present their interim results on CFR-sponsored research.

Identifying and Addressing Risks to the Insurance Funds

The FDIC prepares summary analyses each quarter on the condition of large insured financial entities, based primarily on information provided by their primary Federal regulators. These analyses assist the FDIC in identifying risk trends and potential exposure to the insurance funds. Identified risks are highlighted in various reports and communicated throughout the Corporation in both written format and by oral presentations.

All institution-specific concerns identified through this ongoing analytical process in 2004 were referred to FDIC regional offices for appropriate follow-up action. In most cases, these concerns were resolved in connection with the institution's primary Federal regulator.

The FDIC also conducted numerous outreach activities during 2004 on matters of economic and banking risk analysis with community groups, other regulators, and the banking industry. Among them were a series of internal and public roundtables that included a 2004 banking outlook roundtable in New York City, our third annual Washington, DC economic outlook roundtable, and an economics luncheon featuring Dr. Catherine Mann of the Institute for International Economics.

The Corporation also released four issues of FDIC *Outlook* during the year, along with a number of *FYI* electronic bulletins. Featured *Outlook* articles addressed topics such as emerging risks in mortgage and home equity lending, trends in commercial lending, and the challenges to banks facing rural depopulation. *FYI* reports published during the year featured an FDIC assessment of banking industry exposure to debt obligations of government-sponsored enterprises (GSEs) and a series of articles on the evolving nature of banking in America, including a look at the changing role of community banks, bank branching trends, and challenges from changing payment systems. Four quarterly issues of FDIC *State Profiles* were released for each state during 2004, and the results of those reports were discussed at regularly scheduled press briefings.

Members of the RAC Management Committee and Liaisons – Seated (l to r):
Miguel Browne, Steve Fritts, Michael Jackson, and Don Inscoe.
Standing (l to r) :
Bill Stark, Jim Meyer, Sylvia Plunkett, and Tom Dujenski.

FFIEC Central Data Repository

The FDIC continued to provide leadership for an interagency initiative to implement the Central Data Repository (CDR). This effort includes the Federal Reserve Board and the Office of the Comptroller of the Currency. The CDR is designed to consolidate the collection, validation and publication of quarterly bank financial reports. The CDR will be accessible to regulators, financial institutions and the public. This initiative is being undertaken in cooperation with the Call Report software vendors and the banking industry, and will employ new technology that uses XBRL (Extensible Business Reporting Language) data standard to streamline the collection, validation and publication of Call Report data. Originally scheduled for implementation in October 2004, rollout of the CDR was postponed to address industry feedback and allow more time for system testing and enrollment of financial institutions. As a result, a two-phased implementation of the CDR during the second and third quarters of 2005 is now planned.

Risk Analysis Center

The Risk Analysis Center (RAC) was established in 2003 to provide information about current and emerging supervisory issues. The RAC brings together economists, bank examiners, financial analysts and others to monitor and analyze economic, financial, regulatory and supervisory trends, and their potential implications for the continued financial health of the banking industry and the deposit insurance funds. Comprehensive solutions are developed to address risks identified during the process. Guided by the FDIC's National Risk Committee and the RAC Management Committee, the RAC serves as a clearinghouse for information generated by the FDIC's six regional offices and sponsors a number of projects involving risk-related issues.

Two initiatives were implemented in 2004 to improve the dissemination of risk-related information. First, the Supervisory Discussion Room was initiated to provide interactive nationwide audio and video-conferences on various topics. Each session includes a presentation on a bank supervision matter. Second, the Examiner Forum was developed in conjunction with the Field Supervisor (FS) Council to increase examiner awareness of the RAC and to share information about emerging issues among the field examination staff. Both initiatives provide examiners an opportunity to exchange information across regions and with technical specialists in the Washington office.

RAC activities also include regular monitoring and analysis of economic and financial developments and communication of these issues with FDIC staff and management. Staff conducts a weekly conference call to discuss recent developments, and daily Economic Data Releases are sent by email to FDIC subscribers summarizing intra-day economic news. The RAC website also serves as a clearinghouse for internal analyses of emerging risks. Initial findings on emerging issues are often followed by more in-depth analysis in formal RAC projects.

Resolving Institution Failures

See Receivership Management Section (page 19)

Supervision and Consumer Protection

Supervision and consumer protection are cornerstones of the FDIC's efforts to ensure the stability of and public confidence in the nation's financial system. At year-end 2004, the Corporation was the primary federal regulator for 5,272 FDIC-insured, state-chartered institutions that are not members of the Federal Reserve System (generally referred to as "state non-member" institutions). Through safety and soundness, consumer compliance and Community Reinvestment Act (CRA) examinations of these FDIC-supervised institutions, the FDIC assesses their operating condition, management practices and policies, and their compliance with applicable laws and regulations. The FDIC also educates bankers and consumers on matters of interest and addresses consumers' questions and concerns.

Safety and Soundness Examinations

During 2004, the Corporation conducted all 2,515 statutorily required safety and soundness examinations. The number and total assets of FDIC-supervised institutions identified as "problem" institutions (defined as having a composite CAMELS[1] rating of "4" or "5") decreased during 2004. As of December 31, 44 institutions with total assets of $5.3 billion were identified as problem institutions compared to 73 institutions with total assets of $8.2 billion on December 31, 2003. These changes represent a decrease of 39.7 percent and 35.4 percent, respectively, in the number and assets of problem institutions. During 2004, 57 institutions were removed from problem institution status due to composite rating upgrades, mergers, consolidations or sales, and 28 were newly identified as problem institutions. The FDIC is required to conduct follow-up examinations of all designated problem institutions within 12 months of the last examination. As of December 31, 2004, all follow-up examinations for problem institutions had been performed on schedule.

Compliance and Community Reinvestment Act (CRA) Examinations

The FDIC conducted 1,459 comprehensive compliance-CRA examinations, 673 compliance-only examinations,[2] and four CRA-only examinations in 2004, compared to 1,610 joint compliance-CRA examinations, 307 compliance-only examinations, and two CRA-only examinations in 2003. The FDIC conducted all joint and comprehensive examinations within established time frames. As of December 31, 2004, five institutions were assigned a "4" rating for compliance, and no institutions were rated "5." Of the five institutions rated "4" as of December 31, 2004, four are within the 12 month window following issuance of an enforcement action.

1 The CAMELS composite rating represents the adequacy of Capital, the quality of Assets, the capability of Management, the quality and level of Earnings, the adequacy of Liquidity, and the Sensitivity to market risk, and ranges from "1" (strongest) to "5" (weakest).

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

Of these four, two entered into Memorandums of Understanding with the FDIC and two are subject to outstanding Cease and Desist Orders. A Cease and Desist Order for the fifth institution will likely be issued during the first quarter of 2005.

Examination Program Efficiencies

The FDIC continued in 2004 to implement measures to improve examination efficiency by maximizing the use of risk-focused examination procedures at well-managed banks. Based on experience with the Maximum Efficiency Risk-Focused Institution Target (MERIT) Program implemented in 2002, the FDIC raised the threshold for well-rated, well-capitalized banks qualifying for streamlined examinations under the MERIT Program to $1 billion, up from $250 million. Use of the MERIT Program allows the FDIC to direct more examination resources to institutions posing the most risks to the insurance funds. The FDIC also implemented more risk-focused examinations for the trust and information technology specialty areas. The FDIC continued to emphasize the revised compliance examination approach implemented during the second half of 2003. During 2004, the FDIC convened six focus groups with bankers across the country to discuss their experience with the revised compliance examination process. The bankers strongly supported the new process, reporting that it had resulted in a more efficient examination and that compliance examiners provided more constructive feedback than in the past.

FDIC Examinations 2002-2004

	2004	2003	2002
Safety and Soundness:			
State Nonmember Banks	**2,276**	2,182	2,290
Savings Banks	**236**	231	229
Savings Associations	**0**	0	0
National Banks	**0**	5	10
State Member Banks	**3**	3	5
Subtotal - Safety and Soundness Examinations	**2,515**	2,421	2,534
CRA/Compliance Examinations:			
Compliance-Community Reinvestment Act	**1,459**	1,610	1,334
Compliance-only	**673**	307	493
CRA-only	**4**	2	13
Subtotal CRA/Compliance Examinations	**2,136**	1,919	1,840
Specialty Examinations:			
Trust Departments	**534**	501	524
Data Processing Facilities	**2,570**	2,304	1,681
Subtotal-Specialty Examinations	**3,104**	2,805	2,205
Total	**7,755**	7,145	6,579

In keeping with other recent strategic initiatives to enhance supervisory processes, the FDIC conducted a pilot program to test a new approach to bank supervision. The primary purpose of the "relationship manager program" pilot was to determine the extent to which designation of a relationship manager for each bank would enhance risk-focused assessments and improve communications with financial institutions.

The pilot explored alternatives to the traditional point-in-time examination by allowing supervisory activities to be conducted over the appropriate 12- or 18-month supervisory cycle at selected institutions, based on their risk profiles. Relationship managers developed supervisory plans for their designated banks and served as the institution's local primary point-of-contact. Benefits of the pilot included ongoing "real time" assessments, as well as improved communications with financial institutions. Preliminary results of the pilot were favorable. Results will be further evaluated in 2005 to determine the feasibility of implementing some or all aspects of the program nationwide.

New Supervisory Journal

The FDIC released in June the inaugural issue of *Supervisory Insights*, a professional journal providing a forum for discussing how bank regulation and policy are put into practice in the field, sharing best practices, and communicating about the emerging issues bank supervisors are facing. A second issue was published in December. *Supervisory Insights* is available on the FDIC's internal and external Web sites. The journal, which will be published twice yearly, includes regular features, such as "Accounting News" and "From the Examiner's Desk," as well as articles discussing areas of current supervisory focus at the FDIC.

Shared National Credit Modernization

The Shared National Credit (SNC) program is an interagency effort designed to provide a review and credit quality assessment of many of the largest and most complex (syndicated) bank credits. The purpose of the program is to gain efficiencies and consistencies in the review of credits shared by multiple institutions under a formal lending agreement. The program is governed by an interagency agreement between the Federal Reserve Board, the FDIC, and the Office of the Comptroller of the Currency (OCC).

During 2004, the agencies initiated a SNC Data Collection Modernization project (SNC Modernization). The project seeks to enhance and streamline this effective supervision program by standardizing the SNC data collection system, applying more advanced credit risk analytics and benchmarking techniques across bank portfolios, and providing participating banks with feedback on their SNC portfolios across those metrics. In December, the agencies published a *Notice for Public Comment* in the *Federal Register* requesting the industry's feedback on the SNC Modernization project. The notice describes the changes to the reporting system the agencies contemplate and identifies new data elements the agencies propose to collect. In the notice, the agencies present a series of questions to elicit comment on the expanded program and to help the agencies refine the design of the expanded data collection system.

Homeland Security

The financial sector is a critical component of the infrastructure in the United States, and the FDIC has taken a leadership role in assisting part of the financial sector in preparing for emergencies. As a member of the Financial and Banking Information Infrastructure Committee (FBIIC), the FDIC sponsored a series of outreach meetings in 21 cities across the United States in 2004 on *Protecting the Financial Sector: A Public and Private Partnership*. These meetings provided financial sector leaders with the opportunity to communicate with senior government officials, law enforcement members, and emergency management and private sector leaders about protecting the financial sector. Additional outreach meetings will be scheduled for 2005.

Bank Secrecy Act

The FDIC is also fully committed to assisting in efforts designed to thwart the inappropriate use of the banking system through activities conducted by criminals and terrorists. Our supervisory program, in conjunction with strong law enforcement efforts, creates an environment where criminals and terrorists who use the U.S. financial system to fund their operations will risk being discovered.

Since the passage of the USA PATRIOT Act (Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001), the FDIC has been actively engaged in a number of Bank Secrecy Act (BSA), anti-money laundering (AML), and counter-financing of terrorism (CFT) initiatives. During the past year, the FDIC contributed to joint industry and interagency working groups for the development of rules and interpretive guidance; incorporated rules and guidance into examination procedures and industry resources; refined the process for referring BSA violations and other significant matters to the U.S. Department of the Treasury's FinCEN; assisted in global AML and CFT efforts; dedicated more staff to BSA/AML oversight; provided BSA/AML/CFT training to all risk management professionals; and participated in numerous industry outreach sessions.

In September 2004, the FDIC, the other Federal banking agencies, and FinCEN entered into an information-sharing Memorandum of Understanding to enhance communication and coordination to help financial institutions identify, detect, and interdict terrorist financing and money laundering. The FDIC also issued 20 formal actions and entered into 83 informal agreements that contained provisions regarding BSA compliance.

International Stability

The FDIC serves as a member of the Consultative Group (CG) with respect to Middle East North Africa Partnership for Financial Excellence (PFE) initiative sponsored by the State Department (State) and the Department of the Treasury (Treasury). Under the PFE, the federal banking agencies in the U.S. (the FDIC, the Federal Reserve and the OCC) are working with Treasury, State and the U.S. Agency for International Development (USAID) in developing a training initiative to assist in the development of bank supervision in the Middle East and North Africa (MENA) region. The CG consists of representatives from the bank supervisory bodies in the MENA region, training institutions and banker associations in that region, and the U.S. supervisory and regulatory community. The CG serves as the advisory body and coordinating entity to facilitate the design, development and implementation of the training initiative. The objective of this initiative is to help foster economic growth in the region through the implementation of sound financial supervisory systems. The federal banking agencies are delivering technical assistance programs to meet needs in the MENA region. The FDIC is scheduled to deliver training focused on bank supervision and resolutions in 2005.

As a member of the Association of Supervisors of Banks of the Americas (ASBA) Strategic Planning Implementation Committee, the FDIC helped develop specific action plans for ASBA's 2004 – 2008 strategic plan. This plan will help ASBA deliver more relevant and timely support to its member countries. The strategic plan is focused on ensuring ASBA member countries effectively implement legal and regulatory frameworks, as well as bank supervisory policies, procedures and programs that are in line with the Basel core principles.

The FDIC fulfilled 16 technical assistance missions in 2004. Beneficiaries of these missions included Morocco, Kyrgyz Republic, Iraq, Georgia, Russia, Jordan, Argentina, Serbia, Romania, several countries in Latin America, and countries involved in the Partnership for Financial Excellence Program in the Middle East and North Africa.

In 2004, the FDIC also held 51 meetings with representatives from foreign countries. The visitors usually represented a country's central bank or deposit insurance agency. The most frequent visitors were: China (7), Korea (6), Russia (4), Indonesia (3), Jamaica (3), Taiwan (3), and Japan (3).

Accounting Policy

During 2004, the FDIC was active in addressing several complex accounting issues of interest to depository institutions. In February, the FDIC, in conjunction with the other financial institution regulators, issued guidance on the proper accounting and regulatory reporting for certain types of deferred compensation arrangements. In order to address the industry's concerns about potential changes in the accounting for allowances for loans and lease losses, the FDIC joined other financial institution regulators in March to advise the industry on the status of the American Institute of Certified Public Accountants' work on this important subject and to remind institutions of the current accounting and regulatory reporting guidance in this area. In addition, in an effort to avoid adverse changes in the accounting for loan participations, the FDIC worked extensively with the Financial Accounting Standards Board (FASB) to ensure FASB fully understood the treatment of loan participations in receiverships for its consideration and further deliberation on the proper accounting for this critical lending activity.

Financial Education and Community Development

During 2004, the Corporation continued to expand the scope and impact of its efforts to increase the availability of financial services to low- and moderate-income populations, as well as to those outside the financial mainstream.

The Corporation has worked diligently to form partnerships with financial institutions, bank trade associations, non-profit organizations, community and consumer-based groups and federal, state and local agencies to promote financial education. In 2004, the FDIC added over 200 partners to its *Money Smart* alliance, increasing its total to over 900 partnerships nationally. Through its *Money Smart* financial education program, the FDIC has provided training to an estimated 8,300 volunteer instructors, reached more than 294,000 consumers, disseminated an additional 20,000 copies of the *Money Smart* curriculum, and seen the establishment of more than 40,000 bank accounts. The *Money Smart* curriculum is available in five languages: English, Spanish, Chinese, Korean, and Vietnamese. The FDIC launched a new interactive computer-based version of *Money Smart* in English and Spanish in September 2004. The target to conduct and participate in 125 outreach and technical assistance activities in 2004 was exceeded.

Leaders gather at Commission's first meeting (l to r): Federal Reserve Board Chairman Alan Greenspan, FDIC Chairman Donald E. Powell, National Credit Union Administration Chairman Dennis Dollar and Treasury Secretary John Snow.

The FDIC is one of 20 agencies that are members of the Financial Literacy Education Commission, which was established by Congress in 2003 to educate Americans about the importance of personal finances. The FDIC chairs one of two subcommittees formed by the Commission, a subcommittee to develop a national toll-free hotline (1-888-mymoney) that consumers can use to obtain information on personal finance topics. The Commission launched the hotline in late 2004.

During 2004, the FDIC also continued to lead a Chicago-based pilot project called the New Alliance Task Force (NATF), which is focused on increasing access to bank products and services for Latino immigrants. NATF is a broad-based coalition of 63 member organizations, comprised of the Mexican Consulate, banks, community-based organizations, federal bank regulatory agencies, government agencies, and representatives from the secondary market and private mortgage insurance companies. In 2004, NATF-member banks opened 50,000 new accounts throughout the Midwest, totaling about $100 million in new deposits, with an average account balance of $2,000.

Consumer Privacy and Identity Theft

The FDIC has taken a leading role in helping banks combat identity theft. In November 2004, the FDIC published a study entitled *Stop, Thief! Putting an End to Account-Hijacking Identity Theft.* The study took an in-depth look at identity theft, focusing on account hijacking (the unauthorized use of deposit accounts). The study found account hijacking fraud could be significantly reduced if banks upgraded the security measures they use to authenticate customers who access their accounts remotely via computers and used specialized software to proactively detect and defend against account hijacking. The study also concluded that increased consumer education and information-sharing could reduce identity theft. The FDIC is currently investigating the most appropriate ways to follow up on the study's findings.

The FDIC conducted a study on offshore outsourcing following Chairman Powell's March 4, 2004, testimony before the House Subcommittee on Oversight and Investigations on Financial Services and the Senate Banking Committee. The purpose of the study was to identify risks to consumer privacy and identity theft from foreign outsourcing. The study also identified best practices that financial institutions can use to mitigate the risk inherent in foreign outsourcing relationships.

The study recommended that the banking agencies expand the scope of examination procedures to include identification of undisclosed third-party contracting arrangements and conduct an analysis of the feasibility of using the FFIEC as a central location for the Bank Service Company Act notices filed by financial institutions. This information could then be used for analysis, monitoring and tracking by the supervisory agencies. The FDIC is working with the other banking agencies to implement these recommendations.

The FDIC is one of several federal agencies charged with implementing the provisions of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), which substantially amended the Fair Credit Reporting Act, particularly in the areas of consumer access to and quality of credit information, privacy, and identity theft. The FACT Act:

- preserves uniform national standards for the content of consumer report information and creditor access to such information,
- improves consumer access to credit information,

- improves the quality of reported credit information,
- protects privacy,
- combats identity theft, and
- promotes financial literacy.

Consistent with the privacy requirements of the FACT Act, the FDIC worked with other federal agencies to issue draft rules in 2004: (1) permitting creditors to obtain, use and share medical information only to the degree necessary to facilitate legitimate operational needs; and (2) providing consumers with the ability to limit the circumstances under which affiliated financial institutions may use certain information in connection with marketing activities. These rules will be issued in final form once the agencies fully consider the comments received in response to the proposals. In the meantime, the FDIC is training its examiners on the concepts underlying these rules, and is developing examination procedures to evaluate industry compliance.

Consistent with the identity theft provision of the FACT Act, the FDIC worked with other federal agencies in 2004 to propose rules that would require banks to implement a written identity theft protection program which includes procedures to evaluate red flags that might indicate identity theft. The FDIC, with the other agencies, also finalized rules requiring institutions to properly dispose of consumer information derived from credit reports in order to prevent identity theft and other fraud. The rules on disposal of consumer information become effective on July 1, 2005.

Curbing Unfair and Deceptive Practices

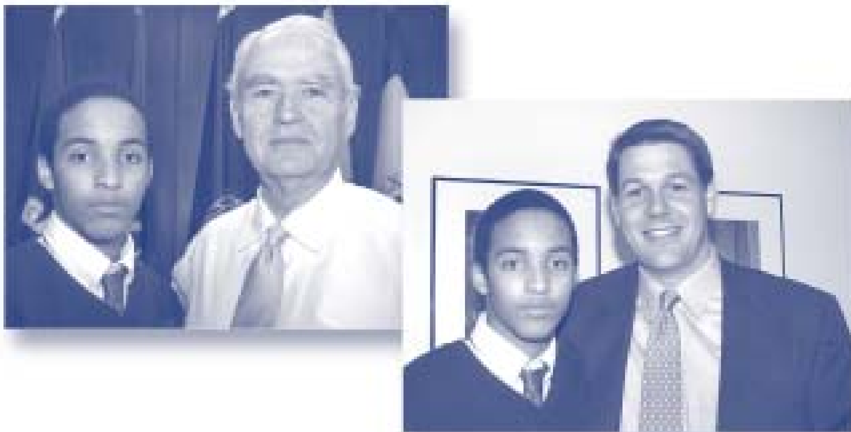
In March 2004, the FDIC and the Federal Reserve Board (FRB) jointly published guidance for state-chartered institutions on unfair or deceptive acts or practices prohibited by Section 5 of the Federal Trade Commission (FTC) Act. This guidance explains how institutions may avoid engaging in practices that might be viewed as unfair or deceptive. The FDIC also joined with the FFIEC agencies to propose guidance on overdraft protection programs in June 2004. The proposed guidance discusses:

- approaches to providing consumers with protection against account overdrafts;
- existing and potential concerns about offering and administering overdraft protection services;
- key legal issues, including compliance with the FTC Act and other applicable federal and state laws;
- safety and soundness considerations, such as whether institutions offering overdraft protection services have adopted adequate policies and procedures to address the credit, operational and other risks associated with these services; and
- best practices in use or recommended by the industry, including those relating to marketing overdraft protection services and communicating with customers about the features of such programs.

The agencies received about 300 comments on the proposed guidance. We expect the final guidance to be issued in 2005.

Consumer Complaints and Inquiries

The FDIC investigates and responds to complaints and inquiries from consumers, financial institutions and other parties about potential violations of consumer protection and fair lending laws, as well as deposit insurance matters. The FDIC's centralized Consumer Response Center (CRC) is responsible for investigating all types of consumer complaints about FDIC-supervised institutions and for answering inquiries about consumer protection laws and banking practices. During 2004, the FDIC received 8,804 complaints, of which 3,791 were against state-chartered nonmember banks. Approximately 41 percent of the state nonmember bank consumer complaints concerned credit card accounts, with the most frequent complaints involving loan denials, billing disputes and account errors, terms and conditions, collection practices, reporting of erroneous information, identity theft, and credit card fees and service charges. The FDIC also responded to 2,947 deposit insurance and 5,087 consumer protection inquiries from consumers and members of the banking community. The FDIC responded to over 90 percent of written complaints on a timely basis.



High school senior Christopher Perry (with Chairman Don Powell, left, and Chief of Staff Jodey Arrington, right) said "he left with a positive outlook on the role of the FDIC and its duty to insure depositors' money."

Deposit Insurance Education

An important part of the FDIC's role in insuring deposits and protecting the rights of depositors is its responsibility to ensure that bankers and consumers have access to accurate information about FDIC deposit insurance rules. To that end, the FDIC has an expansive deposit insurance education program consisting of seminars for bankers, electronic tools for calculating deposit insurance coverage, and written and electronic information targeting both bankers and consumers. During 2004, the FDIC completed a digital video for bank employees and customers explaining how FDIC deposit insurance works and issued a new edition of our Electronic Deposit Insurance Estimator (EDIE) for Bankers. The video, which is available on DVD and can also be viewed through the FDIC's Web site, provides an overview of deposit insurance coverage rules and requirements, with specific emphasis on the most common account ownership categories used by individuals and families. The EDIE software update met a 2004 performance target to provide improved resources to bankers on deposit insurance rules. It allows bankers to calculate their customers' insurance coverage for nearly all types of deposit accounts an individual or business may have at an insured bank or savings association. Consumers can also access EDIE directly through the FDIC's Web site.

In 2004, the FDIC continued to expand its educational tools for consumers by issuing two new brochures for bank customers. *Insuring Your Deposits* describes insurance coverage rules for deposit accounts most commonly owned by individuals and families. *Your Insured Deposits - FDIC's Guide to Deposit Insurance Coverage*, an update of the 1999 version, provides an in-depth explanation of the FDIC's account ownership categories and includes the FDIC's new rules for insurance coverage of living trust accounts that became effective on April 1, 2004.

The FDIC also conducted 38 deposit insurance seminars for financial institution employees, consumer organizations, and bank regulatory agencies. These seminars, which were conducted in a variety of formats, including internet, phone conference, and classroom, provided an in-depth review of how FDIC insurance works, including the FDIC's rules for coverage of different types of deposit accounts.

Office of the Ombudsman (OO) Services to the Banking Industry

The OO was established by federal statute to serve as a confidential, neutral, and independent resource and liaison for bankers with the FDIC on regulatory matters. The OO ensures the fair and consistent application of FDIC rules and regulations, and the fair treatment of institutions throughout the FDIC's examination, assessment, application, enforcement, rule-making and other processes. The OO works with financial institutions and the FDIC to informally resolve problems and disputes at the earliest possible stages. During 2004, bankers and members of the public contacted the OO, voicing questions and seeking problem or complaint resolution. Cumulatively, these contacts provided the FDIC with an important perspective on general and specific matters of importance, concern, or uncertainty to bankers.

Receivership Management

The FDIC has the unique mission of protecting the depositors of insured banks and savings associations. Since the FDIC's inception over 70 years ago, no depositor has ever experienced a loss of insured deposits at an FDIC-insured institution due to a failure. The FDIC protects insured depositors by prudently managing the BIF and the SAIF and using the assets of the funds to pay insured deposits at the time of the institution failure. Once an institution is closed by its chartering authority – the state for state-chartered institutions, the OCC for national banks, or the Office of Thrift Supervision (OTS) for federal savings associations – the FDIC is responsible for the resolution of the failed bank or savings association. FDIC staff gathers data about the troubled institution, estimates the potential loss due to its failure, solicits and evaluates bids from all known qualified and interested bidders, and then recommends the least costly resolution transaction to the FDIC's Board of Directors.

Resolving Financial Institution Failures

During 2004, the FDIC resolved three BIF-insured institution failures and one SAIF-insured institution failure. The SAIF - insured institution, Dollar Savings Bank, Newark, New Jersey, with total assets of $15 million, was closed on February 14, and depositors received their insured funds by check. Guaranty National Bank of Tallahassee, Tallahassee, Florida, with total assets of $77 million, was closed on March 12. All of Guaranty's deposits and a large portion of its assets were sold to another FDIC-insured institution. Reliance Bank, White Plains, New York, with total assets of $27 million, was closed on March 19.

Liquidation Highlights 2002-2004

Dollars in billions

	2004	2003	2002
Total Resolved Banks	3	3	10
Assets of Resolved Banks	$ 0.15	$ 1.10	$ 2.50
Total Resolved Savings Associations	1	0	1
Assets of Resolved Savings Associations	$ 0.01	$ 0.00	$ 0.05
Net Collections from Assets in Liquidation•	$ 0.38	$ 1.70	$ 1.84
Total Assets in Liquidation•	$ 0.61	$ 0.81	$ 1.24
Total Dividends Paid•	$ 0.38	$ 1.06	$ 2.12

•Includes activity from thrifts resolved by the former Federal Savings and Loan Insurance Corporation and the Resolution Trust Corporation.

All of Reliance's deposits and a large portion of its assets were also sold to another FDIC - insured institution. The Bank of Ephraim, Ephraim, Utah, with total assets of $46 million, was closed on June 25. In all cases, the target time frame was met for giving depositors access to their funds. Ephraim's insured deposits were sold to another FDIC-insured institution. (See the accompanying table above for details about liquidation activities.)

During 2004, the FDIC completed investigations and decisions regarding closure or pursuit of claims for all five receiverships that had failed within the prior 18 months. This exceeded the performance target of reaching decisions on closure or pursuit of professional liability claims for 80 percent of failed institutions within 18 months of the failure date.

Protecting Insured Depositors Through Asset Marketing

The FDIC's ability to attract healthy FDIC-insured institutions to assume deposits and purchase the assets of failed banks and savings associations ensures that depositors have prompt access to their insured deposits, minimizes the disruption to the customers and the community, and allows a fair portion of the failed institution's assets to be returned to the private sector almost immediately. Assets remaining after the resolution transaction are liquidated by the FDIC in an orderly manner, and the proceeds are used to pay creditors and uninsured depositors (depositors whose accounts exceed the $100,000 deposit insurance limits), and to reimburse the insurance fund that funded the resolution transaction. In 2004, the FDIC again met its goal of marketing 85 percent of a failed institution's marketable assets within 90 days of the institution's failure.

At the President's Quality Award Ceremony (l to r): Deputy OMB Director Clay Johnson, FDIC CFO Steve App, DRR's Sharon Allen, Kevin Sheehan, Director Mitchell Glassman, Dan Walker, Nancy Champagne, Richard Salmon, OPM Director Kay Coles James, and FDIC Deputy to the Chairman John Brennan.

Customer Service Center

In order to help consumers needing assistance with matters arising from failed financial institutions, the FDIC operates a Customer Service Call Center with staff dedicated to handling records research and collateral releases. During 2004, the FDIC staff responded to 36,791 inquiries. The records research staff reviews the historical records of failed financial institutions in order to answer customer questions on deposit accounts, loan transaction histories, tax suits for delinquent real estate and other issues.

The collateral release staff researches and determines ownership of collateral securing loans of failed financial institutions in order to provide a release of lien, assignment or reconveyance to the borrower. This staff successfully handled 13,494 collateral release inquiries in 2004.

The Customer Service Call Center handled 76,217 calls asking for information or assistance. The FDIC Customer Service Center also supported the Federal Emergency Management Agency (FEMA) in its effort to help the people affected by hurricanes in Florida and other parts of the country. More than 100 FDIC employees assisted FEMA in fielding calls and processing FEMA applications associated with these emergencies.

Receivership Terminations

The FDIC, as receiver, manages the receivership estate and the subsidiaries of failed financial institutions with the goal of achieving an expeditious and orderly termination. The oversight and prompt termination of receiverships help to preserve value for the uninsured depositors and creditors by reducing overhead and other holding costs. For that reason, the FDIC has established a target of terminating 75 percent of receiverships within three years of the failure date. This goal was met at year-end 2004, with only one of four 2001 receiverships still active. The single remaining receivership could not be terminated due to the existence of ongoing professional liability litigation and other impediments. These cases continue to be vigorously pursued through appropriate negotiations and litigation proceedings. In 2004, there were 30 pre–2001 receiverships terminated; 59 remain to be terminated.

Effective Management of Strategic Resources

The FDIC must effectively manage and utilize a number of critical strategic resources in order to carry out its mission successfully, particularly its human, financial, and information technology (IT) resources. Major accomplishments in improving the Corporation's operational efficiency and effectiveness are outlined below. Although the FDIC is not subject to the President's Management Agenda, many of these efforts are consistent with that agenda.

Human Capital Management

The FDIC's employees are its most important strategic resource. For that reason, it seeks to continue to be the employer of choice within the financial regulatory community and to operate a human resources program that attracts, develops, evaluates, rewards and retains a high quality, results-oriented workforce. This was a difficult challenge over the past 12 years because the Corporation was in a continuous downsizing mode as it completed the residual workload from the banking and thrift crises of the late 1980s and early 1990s. FDIC staffing declined from approximately 23,000 (including employees assigned to the Resolution Trust Corporation) in 1992 to fewer than 5,100 at year-end 2004.

During 2004, the Corporation undertook a comprehensive analysis of its future staffing needs and formulated a human capital strategy to guide the FDIC through the rest of this decade. This strategy is based upon the implementation of a new Corporate Employee Program that will become the foundation for the establishment of a smaller more adaptable permanent workforce that reflects a more collaborative and corporate approach to meeting critical mission functions. This workforce will be capable of adapting quickly to significant unexpected events or changes in workload priorities in the future. The FDIC's future workforce will also require a somewhat different mix of skill sets than are available in the current workforce. The Corporation initiated steps in late 2004 to begin reshaping its workforce to be consistent with these concepts, including changes to current training programs administered by its Corporate University. The Corporation also began the development of a new human capital framework that, when implemented, will provide a methodology for future workforce planning and succession management.

The FDIC will require more flexibility in its management of human resources in order to realize its vision of its future workforce. To that end, the Corporation worked with the Office of Personnel Management to obtain expanded delegations of administrative authority. It also submitted to the Congress in late 2004 proposed legislation that would provide the FDIC with additional personnel authorities that are tied directly to the FDIC's unique mission responsibilities. These included independent hiring authority, greater flexibility in the use of term appointments, the ability to re-employ annuitants and waive dual compensation restrictions, authority to establish a separate appeals process for disciplinary actions, and the ability to hire experts and consultants in the same manner as other federal agencies.

During the past year, the Corporation continued to emphasize the linkage of individual pay to concrete accomplishment and contributions. Approximately 400 managers and supervisors were converted to a new Corporate Manager Program in April 2004. This program is similar to the Executive Manager classification and pay program instituted in 2002 and replaces the old program of fixed annual pay increases with a new pay and bonus program in which pay increases and bonuses vary by individual and are not guaranteed. More than 1,000 non-bargaining unit employees were also converted to a new Contributions-Based Compensation Program that provides a wider range of possible rewards than the Corporate Success Award program established in 2002.

The Corporation also initiated a new buyout and early retirement program in late 2004. This program is targeted to reduce identified staffing surpluses and to support the realignment of the current workforce, consistent with identified future workforce needs. The Corporation also announced planned reductions-in-force in 2005 and 2006, if necessary, to eliminate employee surpluses and support realignment of the FDIC workforce.

Reducing Costs and Improving Financial Management

The FDIC's operating expenses are largely paid from the insurance funds, and the Corporation continuously seeks to improve its operational efficiency in fulfillment of its fiduciary responsibilities to the funds. To that end, the Corporation engages annually in a rigorous planning and budgeting process to ensure that budgeted resources are properly aligned with workload. That is particularly true with respect to staffing, since personnel costs constitute well over 60 percent of the Corporation's annual administrative expenses. In late 2004, the FDIC Board of Directors approved management recommendations to reduce authorized staffing by 674 positions, to 4,750, by year-end 2005.

Authorized year-end 2005 staffing is substantially lower than previous authorized staffing levels for the resolutions and receivership business line as well as the IT and administrative support functions. Staffing reductions were approved for the Division of Resolutions and Receiverships and the Legal Division following a lengthy analysis of current and projected future workload in the resolutions and receivership management area and reflect the smaller number of financial institution failures for the past several years. Staffing reductions in the Division of Information Resources Management and the Division of Administration reflect improved business processes, savings from contract consolidation, and outsourcing of functions where cost effective.

The FDIC adopted significant changes in 2004 to the sourcing strategy for obtaining contractor support for its IT functions. These changes incorporate the concept of partnering with the private sector and other federal agencies; the use of performance-based, results-driven contracts; the consolidation of nearly 100 support contracts into several large multi-year, all-encompassing contracts; and the appointment of full-time professional oversight managers to manage and administer these contracts. The structure of the new contracts places the emphasis on contractor performance and links contractor compensation to results achieved rather than costs incurred. The Board of Directors approved the consolidation of contracts supporting both the IT infrastructure and applications support.

Several years ago, the Corporation separated its investment expenses from its annual operating budget in order to ensure a more rigorous approach to the approval and management of major investment initiatives. The single most significant current initiative is the construction of additional FDIC office and multi-purpose buildings adjacent to the existing facilities at Virginia Square. This project will eliminate the need for the Corporation to lease commercial space in downtown Washington, DC, and will substantially reduce future facility costs. The project remains on target for occupancy in the first quarter of 2006. Management processes have been implemented to ensure adherence to the project budget and schedule. Construction of the new building will provide estimated cost savings of approximately $78 million (net present value) over 20 years, when compared to the projected costs associated with the current headquarters leasing arrangements.

Members of the CIO Council (l to r):
Seated, CIO Council Chair Mike Bartell and Sandra Thompson.
Standing: (l to r): Jerry Russomano, Eric Spitler, Gail Verley, Rus Rau, Ann Bridges Steely and Doug Jones.
Not shown: Ron Bieker, Maureen Sweeney, Janet Roberson, and Gail Patelunas.

Improving the FDIC's Use of Information Technology

The Corporation established a new Chief Information Office (CIO) Council in February 2004. The overall mission of the Council is to serve as an executive-level advisory group to the CIO, and to help shape Corporate IT strategy and activities. Establishing the CIO Council is part of a multi-pronged approach to re-engineering the Corporation's IT program. The CIO Council advises the CIO on all aspects of adoption and use of IT at the FDIC. Accomplishing the Corporation's strategic goals and business objectives depends on achieving successful results from IT initiatives. One of the first initiatives of the Council was to conduct an analysis of FDIC's current applications portfolio. An estimated 30 existing applications were retired in 2004, with a larger number of retirements expected to occur over the next year.

The FDIC also greatly expanded its use of its e-government portal, FDIC*connect* (a secure Web site that allows FDIC-insured institutions to conduct business and exchange information with the FDIC, other federal regulatory agencies and various state banking departments), in 2004. FDIC*connect* will enable the FDIC to comply with the Government Paperwork Elimination Act of 1998 (GPEA) and address Presidential guidelines that direct government agencies to establish electronic alternatives to current paper processes where feasible. Nearly 44 percent of FDIC-insured institutions have registered to use FDIC*connect*.

In 2004, the FDIC expanded the capabilities of FDIC*connect* to allow institutions to submit applications seeking extensions of time for completing a transaction or condition related to previously approved applications; prior FDIC consent to reduce or retire capital stock or capital notes or debentures; and approval to make golden parachute payments or excess non-discriminatory severance plan payments. In November, the FDIC Board approved use of FDIC*connect* as the vehicle for all insured financial institutions to receive their quarterly insurance assessment invoices and eliminated the requirement for institutions to sign and return correct certified statements, thus eliminating burden on the institutions.