



August 9, 2006

MEMORANDUM TO:       The Board of Directors

FROM:                   Steven O. App  
                              Deputy to the Chairman and  
                              Chief Financial Officer

                              Frederick S. Selby  
                              Director, Division of Finance

SUBJECT:               Second Quarter 2006 CFO Report to the Board

The attached report highlights the Corporation's financial activities and results for the six-month period ending June 30, 2006.

**Executive Summary**

- The DIF fund balance as of June 30, 2006, increased by approximately 2 percent to \$49.6 billion from year-end 2005. The DIF reported comprehensive income of \$967 million for the first half of 2006 compared to \$518 million for the same period in 2005. This increase of \$449 million is primarily due to the recognition of exit fees earned of \$346 million and a decrease in the unrealized loss on AFS securities of \$105 million.
- In a July 2006 notice of proposed rulemaking, the FDIC proposed a base schedule of risk-based assessment rates ranging from 2 to 40 basis points. The FDIC has proposed to continue allowing the Board to adjust rates uniformly up to a maximum of five basis points higher or lower than the base rates without the need for further notice-and-comment rulemaking, provided that any single adjustment from one quarter to the next cannot move rates by more than five basis points. If the Board sets actual rates equal to the base rates, net assessment revenue for 2007 is estimated to range from \$250 million to \$300 million (compared to \$61 million earned in 2005) after applying the one-time assessment credit.
- The DIF's investment portfolio primary reserve declined by approximately \$2.7 billion (18.6 percent) during the first six months of 2006. This is the result of staff implementing an investment strategy that takes account of the relatively healthy banking and thrift industries and the likelihood for this environment to persist prospectively.
- For the six months ending June 30, 2006, expenditures under the Corporate Operating Budget ran 8 percent below budget and expenditures under the Investment Budget ran 27 percent below budget. The variance with respect to the Corporate Operating Budget was primarily the result of limited spending on resolutions and receivership activities in the Receivership Funding component of the budget through the second quarter. Detailed quarterly reports are provided separately to the Board for those projects included in the Investment Budget, either by the Capital Investment Review

Committee for all information technology projects or by the Division of Administration for the Virginia Square – Phase II project.

- Approximately \$3.2 million (35 percent) of the \$9.05 million supplemental budget approved by the Board of Directors in March for the implementation of deposit insurance reform was spent through June 30, 2006.

The following is an assessment of each of the three major finance areas: financial statements, investments, and budget.

<b>Trends and Outlook</b>	
Financial Results	Comments
<b>I. Financial Statements</b>	<ul style="list-style-type: none"> <li>• Reforms enacted under the Federal Deposit Insurance Reform Act of 2005 will lead to significant changes in the risk-based assessment system beginning in 2007. In a July 2006 notice of proposed rulemaking, the FDIC proposed a base schedule of risk-based assessment rates ranging from 2 to 40 basis points. The FDIC has proposed to continue allowing the Board to adjust rates uniformly up to a maximum of five basis points higher or lower than the base rates without the need for further notice-and-comment rulemaking, provided that any single adjustment from one quarter to the next cannot move rates by more than five basis points. If the Board sets actual rates equal to the base rates, net assessment revenue for 2007 is estimated to range from \$250 million to \$300 million (compared to \$61 million earned in 2005) after applying the one-time assessment credit. Should strong insured deposit growth continue, the reserve ratio is likely to continue falling from its most recent reported level of 1.23 percent (as of March 31, 2006). Therefore, absent a significant slowdown in insured deposit growth and depending on the Board’s decision regarding the advisability of allowing lower reserve ratio levels to prevail, there is a possibility that the Board may adopt actual rates for 2007 later this year that are higher than the base rates.</li> </ul>
<b>II. Investments</b>	<ul style="list-style-type: none"> <li>• The DIF portfolio’s par value increased 1.6 percent during the first half of 2006. Moreover, while the securities that were purchased during the first half of the year had lower yields than maturing securities, this factor was more than offset by higher yielding overnight investments. Consequently, the DIF portfolio’s yield increased by seven basis points during the first half, rising to 4.89 percent from 4.82 percent.</li> <li>• Expectations are for Treasury market yields to continue to rise, but just modestly. This, coupled with a growing DIF portfolio balance, should lead to increased interest revenue over the long run. Over the short run, increasing yields will accelerate the erosion of existing net unrealized gains on available-for-sale (AFS) securities. Moreover, regardless of changes in yields, existing net unrealized gains will be reduced due to the passage of time.</li> </ul>

<b>Trends and Outlook</b>	
Financial Results	Comments
<b>III. Budget</b>	<ul style="list-style-type: none"> <li>• Approximately \$457 million was spent in the Ongoing Operations component of the 2006 Corporate Operating Budget, which was \$12 million (3 percent) below the budget for the six months ending June 30, 2006. Expenses in the Outside Services – Personnel expense category were nearly \$15 million below the year-to-date budget, and expenses in the Salaries &amp; Compensation category were approximately \$3 million over the year-to-date budget.</li>   <li>• Approximately \$8 million was spent in the Receivership Funding component of the 2006 Corporate Operating Budget, which was about \$29 million (78 percent) below the budget for the six months ending June 30, 2006. Expenses in the Outside Services – Personnel category were \$23 million (76 percent) below the year-to-date budget due to limited receivership and resolution activity during the first half of the year.</li> </ul>

**I. Corporate Fund Financial Statement Results** (See pages 9 - 10 for detailed data and charts.)

**Deposit Insurance Fund (DIF)**

- The DIF reported comprehensive income of \$967 million for the first half of 2006 compared to \$518 million for the same period in 2005. This increase of \$449 million is primarily due to the recognition of exit fees earned of \$346 million and a decrease in the unrealized loss on AFS securities of \$105 million. Total expenses and losses increased nominally by \$7 million primarily as a result of a \$20 million decrease in operating expenses offset by a \$24 million increase in provision for insurance losses.
  
- The DIF fund balance as of June 30, 2006 increased by approximately 2 percent to \$49.6 billion from year-end 2005.
  
- DIF reported an unrealized loss on AFS securities of \$134 million for the first half of 2006 compared to \$239 million for the same period last year. This significantly lower unrealized loss resulted from a smaller average increase in AFS portfolios' market yields during the first half of 2006, a smaller total market value of AFS securities for the first half of 2006, and a lower average duration for the AFS securities during the first half of 2006.

**FSLIC Resolution Fund (FRF)**

- FRF's comprehensive loss was \$53 million for the first half of 2006, compared to a \$335 million loss for the same period last year. This decrease in the loss is primarily due to: 1) FRF payments for the Goodwill settlements of \$382 million in the first half of 2005 vs. \$179 million in the first half of 2006, and 2) the net effect of a \$99 million payment for a Guarini litigation settlement and the reversal of a \$154 million loss reserve in the second quarter of 2006 for this same case.
  
- During the second quarter of 2006, FRF paid a Goodwill settlement of \$110 thousand and two Guarini judgments/settlements totaling \$169 million. For the past six quarters, FRF has paid a

total of approximately \$1 billion in Goodwill and Guarini judgments/settlements (\$804 million and \$246 million, respectively). The FRF payments for the Goodwill settlements were funded by the U.S. Treasury through a separate, indefinite appropriation; however, the FRF does fund the Guarini litigation payments.

## **II. Investments Results** (See pages 11 – 12 for detailed data and charts.)

### **DIF**

- During the first half of 2006, the par value of the DIF investment portfolio increased by \$713 million or by 1.59 percent—from \$44.904 billion on December 31, 2005, to \$45.617 billion on June 30, 2006 (almost half of this increase was due to the depositing of the SAIF Exit Fee portfolio into the DIF, in accordance with the recently enacted deposit insurance reform legislation).
- The DIF investment portfolio's total return for the first six months of 2006 was 0.52 percent, approximately 61 basis points higher than the return of the benchmark, the Merrill Lynch 1 - 10 Year U.S. Treasury Index (Index), which earned -0.09 percent during the same period. The outperformance relative to the benchmark can be attributed to three factors. First, the DIF investment portfolio's conventional securities have a slightly lower average duration than those in the Index, and consequently, as yields increased over the course of the first half of 2006, the DIF portfolio's conventional securities slightly outperformed the Index. Second, during this period, the DIF's Treasury Inflation-Protected Securities (TIPS) portfolio also outperformed the Index's conventional securities. And third, during much of the first half of 2006, the DIF's overnight investment balances typically exceeded 4 percent of the DIF's portfolio. Besides overnight investments now realizing very attractive returns given the flat yield curve, in a rising yield environment, longer-term securities experience price declines. Accordingly, on a total return basis, overnight investments outperformed the longer-maturity conventional Treasury securities included in the Index during this period.
- During the second quarter of 2006, staff purchased new securities with a total par value of \$2.050 billion, a weighted average maturity (WAM) of 10.56 years, a weighted average modified duration of 7.29 years, and a weighted average yield to maturity (YTM) of 5.21 percent. On June 30, 2006, the effective duration of the DIF portfolio was 2.88 years, an increase of 0.35 years from December 31, 2005. With higher Treasury market yields available, staff has been purchasing primarily longer-maturity securities so far this year.
- The DIF's primary reserve declined by approximately \$2.7 billion (18.6 percent) during the first six months of 2006. This is the result of staff implementing an investment strategy that takes account of the relatively healthy banking and thrift industries and the likelihood for this environment to persist prospectively.

### **The Treasury Market**

- During the second quarter of 2006, conventional Treasury yields increased across all maturity sectors, with the largest rises occurring on shorter-dated maturities, reflecting the impact of the two federal funds target rate increases during the quarter. The largest increases were posted by securities with maturities of three-months to one-year, with yields up 37 to 43 basis points. The two-year note yield, which is also sensitive to actual as well as anticipated changes in the

federal funds rate, increased by 33 basis points. Intermediate- to longer-maturity Treasury security yields also increased over the course of the second quarter; the five-year Treasury note increased 28 basis points, while the ten-year Treasury note increased by 29 basis points. The Treasury yield curve ended the quarter very flat and slightly inverted; on June 30, 2006, the ten-year to two-year yield curve spread was a negative two basis points (compared to a positive three basis point spread at end of the first quarter). From a historical perspective, the curve remains significantly flatter; over the past five years, this spread has averaged 150 basis points.

- During the second quarter 2006, real yields on the shortest-maturity TIPS increased dramatically, with one-year yields up 95 basis points, and two-year yields up 42 basis points, again, largely reflecting the federal funds target rate increases. These real yield increases represented a reversal of the first quarter's TIPS yield curve shift, when shorter-dated TIPS real yields fell. Real yields on longer-maturity TIPS also increased during the second quarter, but more modestly, with yield increases of 18 to 23 basis points on securities with remaining maturities of five to ten years.

### **Prospective Strategies**

- The current DIF investment strategy provides the flexibility to purchase a wide range of different Treasury securities with varying maturities, depending on Treasury market conditions and developments during the third quarter of 2006. Similar to the first and second quarter 2006 investment strategies, if higher yields become available—either as a result of an upward shift in the yield curve or because of potential yield volatility—the third quarter 2006 strategy provides the flexibility to purchase comparatively higher-yielding, longer-maturity Treasury securities.
- The DIF portfolio's primary reserve target floor balance will remain at \$10 billion for the third quarter of 2006, while the target limit for AFS securities will rise slightly (see attached Approved Investment Strategy).
- Approximately 60 percent, or \$26 billion, of the Deposit Insurance Fund's (DIF) Investments in U.S. Treasury obligations other than overnight investments will mature by 2009. Currently, Treasury yields generally exceed the yield-to-maturity on DIF's securities that will mature by 2009. If Treasury yields remain stable or continue to rise, proceeds from the maturing securities and coupon payments could be reinvested at higher yields, which would result in higher interest earned on investment securities (see first graph on page 9).

### **III. Budget Results** (See pages 13 - 14 for detailed data.)

#### **Modifications to Approved Budgets/Authorized Staffing**

During the second quarter of 2006, the Chief Financial Officer (CFO) approved four modifications to the 2006 Corporate Operating Budget and/or authorized staffing in accordance with authority delegated to him by the Board of Directors in the 2006 Budget Resolution:

- Authorized staffing for the Division of Administration (DOA) was increased by 13 positions. Authorized DOA staffing was reduced from 448 to 310 (138 positions) between 2005 and 2006, but as DOA's staffing began to approach this reduced authorization, DOA management determined that it had over-estimated the staffing reduction that could be

made without adversely affecting the division's ability to handle its current workload. Accordingly, ten occupied positions that had been previously identified as surplus were restored, and three new positions were added to augment staffing in the human resources area. No additional funds will be required in 2006 for this staffing increase since most of the affected staff were budgeted for the full year, even though they were surplus, because of potential separation entitlements.

- Twelve authorized positions (and the incumbent employees) and \$1,611,241 in funding for salaries and compensation and travel were transferred from the Ongoing Operations budget of the Division of Supervision and Consumer Protection (DSC) to the Division of Insurance and Research (DIR). This transfer was made in conjunction with the transfer of the International and Large Bank Section from DSC to DIR to provide analytical skills needed in connection with the implementation of deposit insurance reform.
- The Ongoing Operations budget of the Corporate University was reduced by \$2,646,760 in conjunction with a decision by the Corporate University Governing Board to defer implementation of the Professional Learning Accounts (PLA) program until 2007. Concurrently, individual division and office budgets were increased by a total of \$1,257,943 to provide funds for training and related travel for the second half of 2006, and \$1,388,817 (the full amount of the increased funding for training and travel that was approved to implement the PLA program in mid-2006) was reallocated to the Corporate-Unassigned budget. These funds will be available to meet unbudgeted funding requirements that arise during the remainder of the year.
- A total of \$539,241 was reallocated from the Ongoing Operations budget of the Division of Receiverships and Resolutions (DRR) to the Division of Information Technology (DIT) to provide additional funding for completion of the inception phase of the Claims Administration System planning project.

### **Status of Spending for the Implementation of Deposit Insurance Reform**

The Board of Directors approved in March a \$9.05 million increase in the 2006 Corporate Operating Budget for unbudgeted expenses related to the implementation of deposit insurance reform. This included \$6.5 million for system changes, \$2.25 million for the printing and distribution of revised deposit insurance brochures for banks and the public, and \$0.3 million to fill two new staff positions in the Division of Insurance and Research (DIR). The status of these funds through June 30, 2006, was as follows:

- Approximately \$1.8 million was spent for the printing and distribution of updated deposit insurance brochures. The size of this printing was smaller than originally planned because further updates to these brochures are expected to be required next year, once all rulemaking for deposit insurance reform has been completed. Funds for 2007 printing and distribution costs will be included in the 2007 Corporate Operating Budget request submitted later this year.
- Approximately \$1.4 million was spent for system development and enhancement activities related to deposit insurance reform as of June 30, 2006. DIR and DIT estimate that about \$5.7 million of the \$6.5 million in 2006 funding approved for this purpose will be spent this year. Funding for continuing systems development and enhancement activities to be

undertaken next year in support of deposit insurance reform will be included in the 2007 Corporate Operating Budget request submitted later this year.

- No funds have yet been spent for additional staff to support deposit insurance pricing. DIR is awaiting the completion of rulemaking activities before determining what additional skills will be needed.

## **Spending Variances**

Significant spending variances by major expense category and division/office are discussed below. Significant spending variances for the six months ending June 30, 2006, are defined as those that either (1) exceed the YTD budget for a major expense category or division/office by an amount that exceeds \$2 million and represents more than 3 percent of the major expense category or total division/office budget; or (2) are under the YTD budget for a major expense category or division/office by an amount that exceeds \$3 million and represents more than 5 percent of the major expense category or total division/office budget.

### **Significant Spending Variances by Major Expense Category**

#### Ongoing Operations

There was only one major expense category in which a significant spending variance occurred through the second quarter in the Ongoing Operations component of the Corporate Operating Budget:

- Outside Services-Personnel expenditures were \$15 million, or 21 percent, less than budgeted, largely due to delays in starting several IT projects; delays and postponements of financial literacy and consumer education outreach programs; and lower-than-anticipated expenses for the new national administrative services contract.

#### Receivership Funding

The Receivership Funding component includes funding for budgeted non-personnel expenses that are incurred in conjunction with an institution failure and the subsequent management and disposition of the assets and liabilities of the ensuing receivership. There was only one major expense category in which a significant spending variance occurred through the second quarter in the Receivership Funding component of the Corporate Operating Budget:

- Outside Services-Personnel expenditures were \$23 million, or 76 percent, less than budgeted, primarily due to a continued reduction in receivership and resolution workload. The workload from prior-year failures has been largely completed and has not been replaced by workload from new failures in the past two years.

## Significant Spending Variances by Division/Office<sup>1</sup>

There were three organizations that had significant spending variances through the second quarter:

- The Division of Resolutions and Receiverships spent \$22 million, or 44 percent, less than budgeted. This was primarily due to the declining resolution and receivership management workload and a corresponding need for less contract support than budgeted through the second quarter.
- The Legal Division spent \$8 million, or 17 percent, less than budgeted. This was also due to the declining resolution and receivership management workload, which was reflected primarily in reduced outside counsel expenses.
- The Division of Information Technology spent \$8 million, or 9 percent, less than budgeted, including under spending of \$6 million for Ongoing Operations and \$2 million for approved Investment projects. The variance in Ongoing Operations was primarily due to delays in starting several IT projects. The Investment Budget variance resulted from lower-than-estimated expenditures for the Asset Servicing Technology Enhancement Project (ASTEP) through the second quarter. The unused budget authority for the ASTEP investment project will continue to be available for future use, if needed.

### Other Matters

In accordance with the requirements of the 2006 Budget Resolution, an analysis of 2006 funding requirements for employee salaries and fringe benefits was completed during the second quarter, following the implementation of new 2006 pay and fringe benefit rates. That analysis determined that those costs had been under-estimated by approximately \$14 million during the preparation of the 2006 Corporate Operating Budget. The CFO would have ordinarily approved a corresponding increase in the approved 2006 Corporate Operating Budget to address this funding shortfall, in accordance with authority delegated to him in the 2006 Budget Resolution. However, current projections indicate that the funds budgeted for Salaries and Compensation will, in fact, be sufficient to cover this shortfall because of a higher-than-projected number of vacancies within the Corporation thus far in 2006. The CFO will review the Salary and Compensation budget again in October to make a final determination as to whether a budget change is necessary. Regardless of the outcome of that analysis, the Board should be aware that 2007 budget estimates for Salary and Compensation will increase by more than the planned 4.2 percent average employee salary increase in order to more accurately reflect projected salary and benefit costs.

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<sup>1</sup> Information on division/office variances reflects variances in both the Corporate Operating and Investment Budgets.

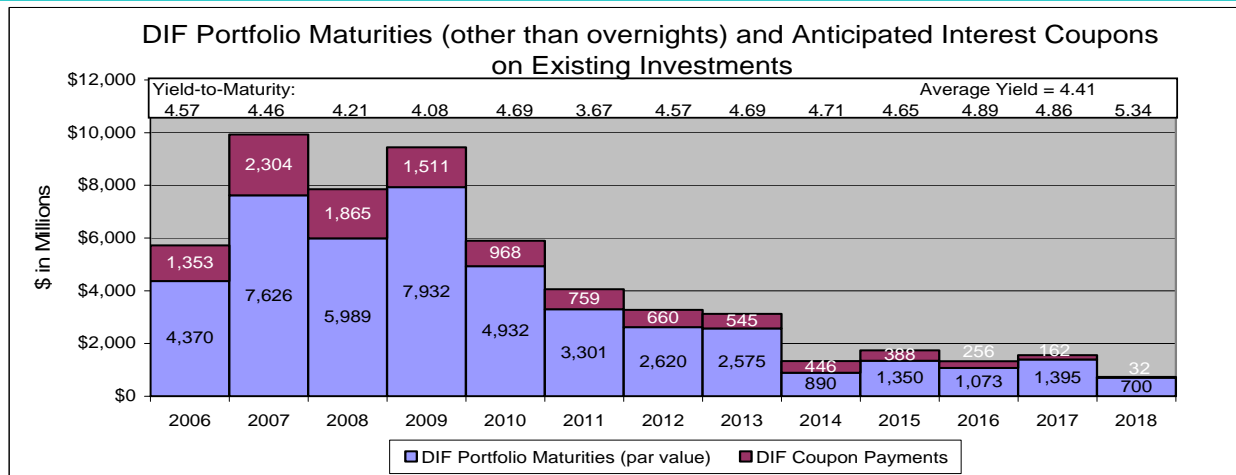


# FDIC CFO REPORT TO THE BOARD – Second Quarter 2006

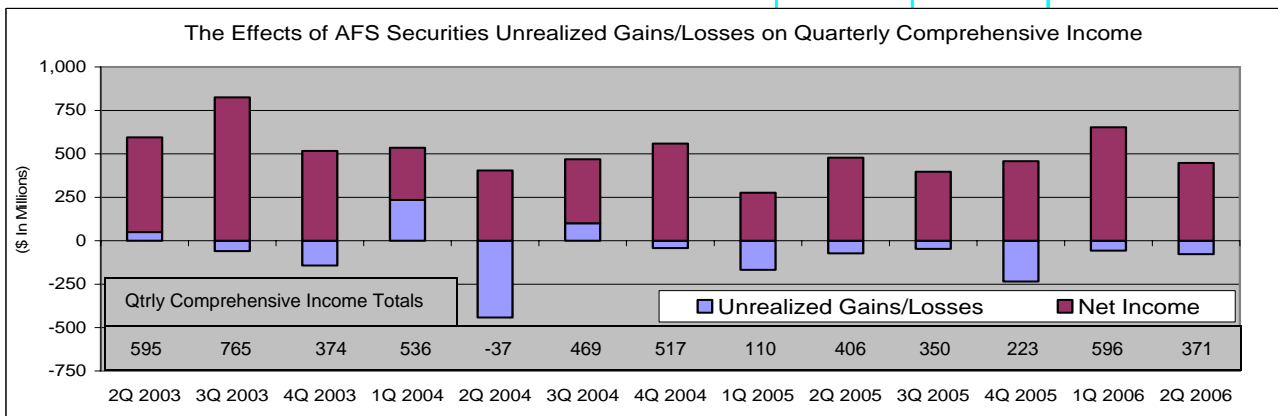
## Fund Financial Results

(\$ in millions – All data is unaudited)

Balance Sheet	Deposit Insurance Fund				
	Jun-06	Dec-05	Change	% Change	Jun-05
Cash & cash equivalents - unrestricted	\$ 749	\$ 3,209	(2,460)	(77%)	\$ 1,311
Cash & other assets - restricted for SAIF member exit fees	0	342	(342)	(100%)	335
Investment in U.S. Treasury obligations, net	47,690	44,240	3,450	8%	45,425
Interest receivable on investments and other assets, net	768	738	30	4%	756
Receivables from resolutions, net	466	534	(68)	(13%)	661
Property, buildings and other capitalized assets, net	370	378	(8)	(2%)	373
<b>Total Assets</b>	<b>\$ 50,043</b>	<b>\$ 49,441</b>	<b>602</b>	<b>1%</b>	<b>\$ 48,861</b>
Accounts payable and other liabilities	269	297	(28)	(9%)	298
Contingent Liabilities: future failures	10	5	5	100%	2
Contingent Liabilities: litigation losses & other	200	200	0	0%	201
SAIF member exit fees & investment proceeds held in escrow	0	342	(342)	(100%)	335
<b>Total Liabilities</b>	<b>\$ 479</b>	<b>\$ 844</b>	<b>(365)</b>	<b>(43%)</b>	<b>\$ 836</b>
FYI: Unrealized gain on available-for-sale securities	273	407	(134)	(33%)	688
<b>FUND BALANCE</b>	<b>\$ 49,564</b>	<b>\$ 48,597</b>	<b>967</b>	<b>2%</b>	<b>\$ 48,025</b>

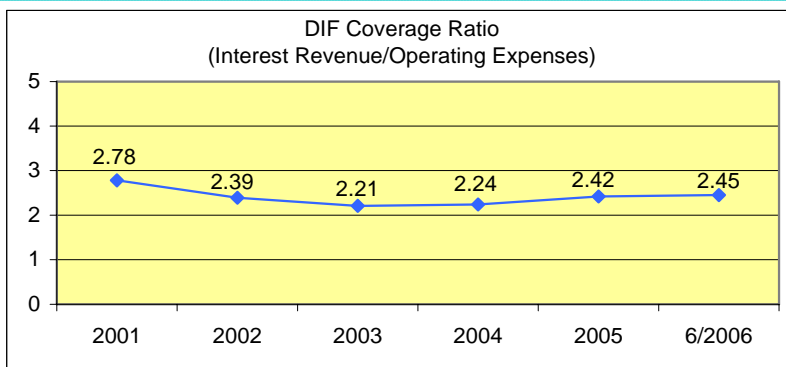


Income Statement	Deposit Insurance Fund			
	Jun-06	Dec-05	Jun-05	Year-Over-Year Change
Assessments earned	\$ 12	\$ 61	\$ 29	(17)
Interest earned on investment securities	1,143	2,342	1,131	12
Exit fees earned <sup>1</sup>	346	0	0	346
Other revenue	19	18	9	10
<b>Total Revenue</b>	<b>\$ 1,520</b>	<b>\$ 2,421</b>	<b>\$ 1,169</b>	<b>351</b>
Operating expenses (includes depreciation expense)	466	966	486	(20)
Provision for insurance losses	(52)	(160)	(76)	24
Other expenses	5	4	2	3
<b>Total Expenses &amp; Losses</b>	<b>\$ 419</b>	<b>\$ 810</b>	<b>\$ 412</b>	<b>7</b>
<b>Net Income</b>	<b>\$ 1,101</b>	<b>\$ 1,611</b>	<b>\$ 757</b>	<b>344</b>
Unrealized (loss) on available-for-sale securities	(134)	(521)	(239)	105
<b>YTD Comprehensive Income</b>	<b>\$ 967</b>	<b>\$ 1,090</b>	<b>\$ 518</b>	<b>449</b>



<sup>1</sup> Due to the enactment of the Federal Deposit Insurance Reform Conforming Amendments Act of 2005, the restriction on SAIF-member exit fees was removed and the exit fees plus earned interest were recognized as income of the DIF as of 3/31/06.

Income Statement - (continued)



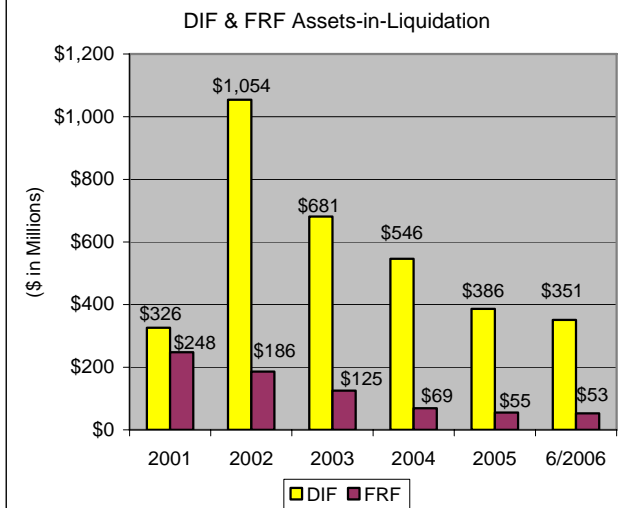
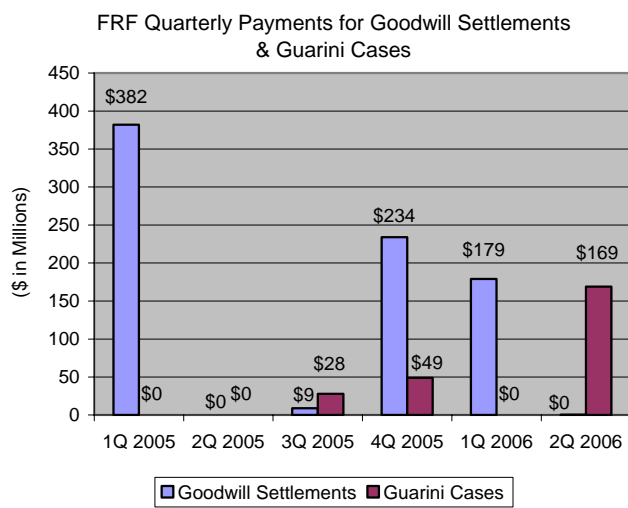
Statements of Cash Flows

Deposit Insurance Fund

	Jun-06	Dec-05	Jun-05	Year-Over-Year Change
<b>Net Income</b>	\$ 1,101	\$ 1,611	\$ 757	344
Amortization of U.S. Treasury obligations (unrestricted)	302	834	463	(161)
TIPS Inflation Adjustment	(94)	(345)	(153)	59
Depreciation on property and equipment	26	55	24	2
Provision for insurance losses	(52)	(160)	(76)	24
Net change in operating assets and liabilities	(276)	404	192	(468)
<b>Net Cash Provided by Operating Activities</b>	\$ 1,007	\$ 2,399	\$ 1,207	(200)
Investments matured and sold	2,430	10,050	5,105	(2,675)
Investments purchased (includes purchase of property and equipment)	(5,919)	(11,741)	(7,510)	1,591
<b>Net Cash (Used) by Investing Activities</b>	\$ (3,489)	\$ (1,691)	\$ (2,405)	(1,084)
Net Increase (Decrease) in Cash and Cash Equivalents	(2,482)	708	(1,198)	(1,284)
Cash and Cash Equivalents at beginning of year	3,231	2,523	2,523	708
<b>Cash and Cash Equivalents - Ending</b>	\$ 749	\$ 3,231	\$ 1,325	(576)

FSLIC Resolution Fund (FRF)

	Jun-06	Dec-05	Jun-05	Year-Over-Year Change
Cash and cash equivalents	\$ 3,506	\$ 3,602	\$ 3,581	(75)
Accumulated deficit, net	(123,684)	(123,631)	(123,140)	(544)
Resolution Equity	3,502	3,376	3,625	(123)
Total revenue	\$ 80	\$ 122	\$ 58	22
Operating expenses	8	25	10	(2)
Expenses for Goodwill/Guarini litigation	348	718	382	(34)
Net (loss)	(53)	(826)	(335)	282



## Deposit Insurance Fund Portfolio Summary

(in millions)

	6/30/06	12/31/05	Change
Par Value	\$45,617	\$44,904	\$713
Amortized Cost	\$48,164	\$47,038	\$1,126
Market Value	\$47,839	\$47,610	\$229
Primary Reserve <sup>1</sup>	\$11,590	\$14,246	(\$2,656)
Primary Reserve Target Floor	\$10,000	\$10,500	(\$500)
Primary Reserve % of Total Portfolio	23.9%	29.5%	(5.6%)
Year-to-Date Total Return (Portfolio)	0.52%	2.01%	NA
Year-to-Date Total Return (Benchmark) <sup>2</sup>	(0.09%)	1.58%	NA
Total Return Variance (in basis points)	61	43	NA
Yield-to-Maturity <sup>3</sup>	4.89%	4.82%	0.07%
Weighted Average Maturity (in years)	3.78	3.29	0.49
Effective Duration (in years) <sup>4</sup>			
Total Portfolio	2.88	2.53	0.35
Available-for-Sale Securities	1.59	1.85	(0.26)
Held-to-Maturity Securities	3.27	2.97	0.30

<sup>1</sup> Primary Reserve is the total market value (including accrued interest) of overnight investments, available-for-sale securities, and held-to-maturity securities maturing within three months.

<sup>2</sup> The benchmark is the total return of the Merrill Lynch 1-10 Year U.S. Treasury Index.

<sup>3</sup> The yield-to-maturity includes the potential yield of Treasury Inflation-Protected Securities (TIPS), which assume an average year-over-year increase in CPI of 2.2%.

<sup>4</sup> For each TIPS, a 60% factor is applied to its real yield duration to arrive at an estimated effective duration.

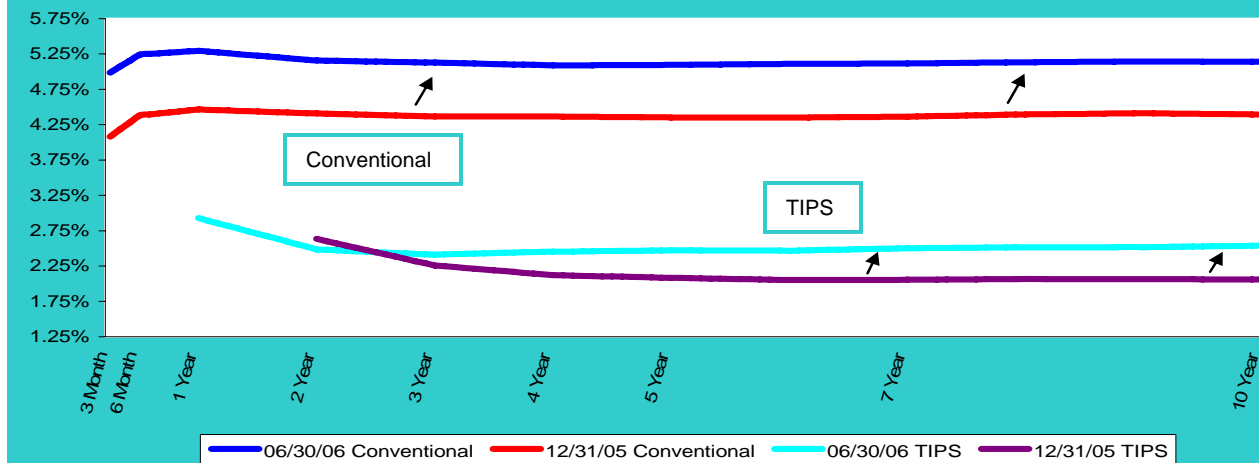
## National Liquidation Fund (NLF) Investment Portfolio Summary

(Dollar Values in Millions)

	6/30/06	12/31/05	Change
Book Value <sup>5</sup>	\$351	\$489	(\$138)
Yield-to-Maturity	5.25%	4.33%	0.92%
Weighted Average Maturity (in days)	25	40	(15)

<sup>5</sup> Due to the short-term nature of the NLF, the portfolio's Book and Market Values are identical for reporting purposes.

## U.S. Treasury Security Yield Curves



# Approved Investment Strategy

## DEPOSIT INSURANCE FUND

### Current Strategy as of 2nd Quarter 2006

Maintain a \$150 million target floor overnight investment balance.

Strategically invest all available funds in excess of the target overnight investment balance, which may include purchasing conventional Treasury securities within the zero- to twelve-year maturity sector, purchasing Treasury Inflation-Protected Securities (TIPS) within the two- to ten-year maturity sector, and/or purchasing callable Treasury securities with final maturities not to exceed twelve years, subject to the following limitations:

- TIPS should not total more than \$9.0 billion (adjusted par value) by quarter end;
- Available-for-sale (AFS) securities should not total more than \$9.2 billion (par value) by quarter end; and
- All newly purchased AFS securities should have maturities of six years or less.

Moreover, staff will strive to maintain a \$10 billion target floor primary reserve balance.

### Strategy Changes for 3rd Quarter 2006

AFS securities target limit increased from \$9.2 billion to \$9.4 billion.

## NATIONAL LIQUIDATION FUND

### Current Strategy as of 2nd Quarter 2006

Maintain a \$30 million target floor overnight investment balance.

Strategically invest the remaining funds in the zero- to 12-month maturity sector.

### Strategy Changes for 3rd Quarter 2006

None

**Executive Summary of 2006 Budget and Expenditures  
by Major Expense Category  
Through June 30, 2006  
(Dollars in Thousands)**

Major Expense Category	YTD Budget	YTD Expenditures	% of Budget Used	Variance
<b>Corporate Operating Budget</b>				
<i>Ongoing Operations</i>				
Salaries & Compensation	\$311,775	\$314,966	101%	\$3,191
Outside Services - Personnel	70,869	56,238	79%	(14,631)
Travel	23,115	23,777	103%	662
Buildings	37,907	36,894	97%	(1,013)
Equipment	13,587	12,543	92%	(1,044)
Outside Services - Other	6,166	7,689	125%	1,523
Other Expenses	4,833	4,406	91%	(427)
<b>Total Ongoing Operations</b>	<b>\$468,252</b>	<b>\$456,513</b>	<b>97%</b>	<b>(\$11,739)</b>
<i>Receivership Funding</i>				
Salaries & Compensation	\$1,710	\$10	1%	(\$1,700)
Outside Services - Personnel	30,673	7,419	24%	(23,254)
Travel	2,828	507	18%	(2,321)
Buildings	1,150	120	10%	(1,030)
Equipment	113	1	1%	(112)
Outside Services - Other	272	16	6%	(256)
Other Expenses	759	141	19%	(618)
<b>Total Receivership Funding</b>	<b>\$37,505</b>	<b>\$8,214</b>	<b>22%</b>	<b>(\$29,291)</b>
<b>Total Corporate Operating Budget</b>	<b>\$505,757</b>	<b>\$464,727</b>	<b>92%</b>	<b>(\$41,030)</b>
<b>Investment Budget <sup>1</sup></b>	<b>\$20,323</b>	<b>\$14,871</b>	<b>73%</b>	<b>(\$5,452)</b>
<b>Grand Total</b>	<b>\$526,080</b>	<b>\$479,598</b>	<b>91%</b>	<b>(\$46,482)</b>

1) Budgets for investment projects are approved on a multi-year basis; the "Year-to-Date Budget" amount reflects the 2006 spending estimates for approved projects. Detailed quarterly reports on the status of those projects are provided separately to the Board by the Capital Investment Review Committee for all information technology projects and by DOA for the Virginia Square - Phase II project.

**Executive Summary of 2006 Budget and Expenditures  
by Budget Component and Division/Office  
Through June 30, 2006  
(Dollars in Thousands)**

Division/Office	YTD Budget	YTD Expenditures	% of Budget Used	Variance
<b><i>Corporate Operating Budget</i></b>				
Supervision & Consumer Protection	\$186,991	\$185,368	99%	(\$1,623)
Information Technology	78,209	72,258	92%	(5,951)
Administration	82,173	80,922	98%	(1,251)
Resolutions & Receiverships	49,249	27,288	55%	(21,961)
Legal	45,581	37,720	83%	(7,861)
Insurance & Research	16,031	16,296	102%	265
Finance	13,479	13,712	102%	233
Inspector General	12,715	11,029	87%	(1,686)
Corporate University	11,803	11,615	98%	(188)
Executive Support <sup>1</sup>	6,717	6,589	98%	(128)
Executive Offices <sup>2</sup>	1,809	1,926	106%	117
Government Litigation	1,000	4	0%	(996)
<b>Total, Corporate Operating Budget</b>	<b>\$505,757</b>	<b>\$464,727</b>	<b>92%</b>	<b>(\$41,030)</b>
<b><i>Investment Budget</i> <sup>3</sup></b>				
Information Technology	\$6,088	\$4,049	67%	(\$2,039)
Administration <sup>4</sup>	12,280	10,013	82%	(2,267)
Resolutions & Receiverships	257	249	97%	(8)
Insurance & Research	1,653	588	36%	(1,065)
Finance <sup>5</sup>	7	(28)	(400%)	(35)
Corporate University	38	0	0%	(38)
<b>Total, Investment Budget</b> <sup>3</sup>	<b>\$20,323</b>	<b>\$14,871</b>	<b>73%</b>	<b>(\$5,452)</b>
<b><i>Combined Division/Office Budgets</i></b>				
Supervision & Consumer Protection	\$186,991	\$185,368	99%	(\$1,623)
Information Technology	84,297	76,307	91%	(7,990)
Administration <sup>4</sup>	94,453	90,935	96%	(3,518)
Resolutions & Receiverships	49,506	27,537	56%	(21,969)
Legal	45,581	37,720	83%	(7,861)
Insurance & Research	17,684	16,884	95%	(800)
Finance	13,486	13,684	101%	198
Inspector General	12,715	11,029	87%	(1,686)
Corporate University	11,841	11,615	98%	(226)
Executive Support <sup>1</sup>	6,717	6,589	98%	(128)
Executive Offices <sup>2</sup>	1,809	1,926	106%	117
Government Litigation	1,000	4	0%	(996)
<b>Grand Total</b>	<b>\$526,080</b>	<b>\$479,598</b>	<b>91%</b>	<b>(\$46,482)</b>

1) Executive Support includes the Offices of Diversity and Economic Opportunity, Public Affairs, Ombudsman, Legislative Affairs, and Enterprise Risk Management.

2) Executive Offices include the Chairman, Vice Chairman, Board of Directors, Chief Operating Officer, and Chief Financial Officer.

3) Budgets for investment projects are approved on a multi-year basis; the "Year-to-Date Budget" amount reflects the 2006 spending estimates for approved projects. Detailed quarterly reports on the status of those projects are provided separately to the Board by the Capital Investment Review Committee for all information technology projects and by DOA for the Virginia Square - Phase II project.

4) The budget for the Virginia Square - Phase II investment project is included in the totals of the Division of Administration.

5) The credit balance in the YTD Expenditures column for the Division of Finance is a result of a \$32,000 correction for expenditures incorrectly charged to the ASTEP project in 2005.