I. Management's Discussion and Analysis

Operations of the Corporation – The Year in Review

As the FDIC marked its 70th anniversary in 2003, it continued to ensure the stability of the nation's financial services industry – the Corporation's original mandate in 1933. Much has changed for the FDIC over seven decades, including the tools it uses to conduct bank examinations, the way it markets failed bank assets, and the manner in which it assesses risk to the deposit insurance funds. However, what has remained constant are the reliability of deposit insurance and the public's confidence in the FDIC and the nation's financial system.

During 2003, the FDIC continued to strive to meet the challenges of an ever-evolving banking industry – challenges associated with globalization, advances in technology and industry consolidation. The FDIC provided leadership on important economic and policy issues, working to enact deposit insurance reform legislation, and holding symposia for policymakers, regulators and others to engage in dialogue on significant public policy concerns. It also continued to monitor emerging risks to the deposit insurance funds, while improving its internal operations to better meet the challenges of the future.

Highlights of the Corporation's 2003 accomplishments are presented below for each of its three major business lines – Insurance, Supervision and Consumer Protection, and Receivership Management.

Insurance

The FDIC insures bank and savings association deposits. As insurer, the FDIC must continually evaluate how changes in the economy, the financial markets and the banking system affect the adequacy and the viability of the deposit insurance funds. During 2003, the FDIC sought to enhance its risk analysis and management, promote sound public policies, and resolve failed institutions in a timely manner.

Enhanced Risk Analysis and Management

The FDIC employs a robust, integrated risk analysis process that was strengthened by several initiatives in 2003. The Risk Analysis Center (RAC) was established in March. Located at the FDIC's headquarters in Washington, DC, the RAC brings together economists, bank examiners, financial analysts, and others involved in assessing risks to the banking industry and the insurance funds. Under the auspices of the RAC, individuals from these various disciplines work together 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 this process.

The principle of a coordinated approach to analyzing and addressing risks also extends to Regional Risk Committees (RRCs), which have operated for a number of years, but were formally chartered in January 2003. Each of the FDIC's six regional offices has an RRC that meets regularly, engaging individuals from various disciplines to analyze and address the unique risks facing the region.

Art Murton, Mike Zamorski, Mitchell Glassman, and Chairman Powell officially open the RAC.

In January 2003, the National Risk Committee (NRC) was chartered to provide a forum for executive leadership to consider and coordinate risk management activities across the FDIC. The RAC and RRCs provide data and reports to the NRC to support policy and resource allocation decisions of the NRC. Among other things, the NRC is responsible for ensuring that the FDIC takes appropriate actions to address identified risks and that these risks and FDIC's actions are effectively communicated to internal and external audiences.

Improved Financial Risk Management Practices

In 2003, the FDIC hired an independent, outside consultant to review the FDIC's financial risk management practices. This review focused particularly on the methodology and processes used by the interdivisional Financial Risk Committee (FRC), which is responsible for recommending quarterly the amount of the BIF and SAIF contingent liability for anticipated bank and thrift failures. The final report, *Strengthening Financial Risk Management at the FDIC*, reflects the FDIC's commitment to ensuring that our methods and procedures remain effective and represent industry best practices. The report provided meaningful suggestions to enhance the overall accuracy, robustness and transparency of the FDIC's contingent loss-reserving process. It also laid out a road map to follow in developing next-generation tools and organizational practices for managing risk at the FDIC.

The consultant's recommendations span three overlapping time periods (Horizons 1, 2, and 3). The FDIC implemented Horizon 1 recommendations in September 2003. The results of the implementation of these recommendations are reflected in our audited 2003 financial statements. The Horizon 1 recommendations include:

- Limiting subjective deviations from average expected failure rates to a range around the recent, historical average, and developing explicit guidelines for when the FRC may elect to deviate from the average,
- Incorporating the asset and liability compositions of failing banks and thrifts into expected loss rates, and
- Adopting a set of more formal operating procedures for the FRC.

The FDIC will implement Horizon 2 recommendations throughout 2004. The Horizon 2 recommendations include:

- Accelerating development of a new integrated model for financial risk management. The FDIC has already developed a prototype loss distribution model that will be the centerpiece of the integrated fund model and will be used by the FRC in 2004 to establish the contingent liability for anticipated failures. A paper describing the prototype model was presented at the *Finance and Banking: New Perspectives* conference in December 2003, and
- Building a more integrated risk management organization by enhancing outputs, operations and feedback mechanisms of the FRC and RAC.

Horizon 3 improvements include building capabilities such as real-time risk management, programs for hedging or reinsurance, and the ability to rapidly conduct scenario analyses. The FDIC will annually assess whether to implement Horizon 3 capabilities.

FDIC Center for Financial Research

The Corporation established the Center for Financial Research (CFR) in late 2003 to promote research that would provide meaningful insights into developments in deposit insurance, the financial services 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 will be a partnership between the FDIC and the academic community with prominent scholars actively engaged in overseeing and directing its research program. The CFR will carry out its mission through an agenda of research, analysis, forums and conferences that encourages and facilitates an ongoing dialogue that incorporates industry, academic and public-sector perspectives. The CFR will support high-quality original research by sponsoring relevant research program lines and soliciting rigorous analysis of the issues within five program areas. These programs will be under the leadership of program coordinators who are drawn largely from the outside academic community. Input will also be obtained from six prominent economists who will serve as Senior Fellows.

The CFR will sponsor a Visiting Research Fellows Program to provide support for residence scholars for defined time periods. The CFR will also organize visits and encourage interaction and collaboration between outside scholars and FDIC staff on subjects of mutual interest.

New International Capital Standards

The FDIC continues to actively participate in the Basel Committee on Banking Supervision's (BCBS) efforts to update and revise the 1988 Basel Capital Accord. Such revisions are necessary to align capital standards with advances in banks' risk measurement and management practices, while continuing to assure that these banks maintain adequate capital reserves. In addition to the BCBS, the FDIC is active on a number of global supervisory groups, including the Capital Task Force, the Accord Implementation Group, the Risk Management Group, and various subgroups and task forces that seek to enhance risk management practices.

The FDIC invested significant resources on several fronts during 2003 to ensure that the new capital rules, when final, will be compatible with the Corporation's roles as both deposit insurer and supervisor. Significant work has been performed, both internationally and domestically, to assure that the new Accord is implemented efficiently, that effective supervisory oversight will continue, and that these new rules will not create unintended and potentially harmful consequences.

Ensuring the adequacy of capital requirements under the new Accord was the FDIC's main priority during 2003. The FDIC published a study suggesting that over time and on average, risk-based capital requirements under the new Accord would probably decline substantially relative to the 1988 Accord. In 2004, the FDIC will seek to ensure that any reductions in capital requirements reflect bank risk profiles rather than specific statistical modeling assumptions. The BCBS has established a goal of issuing a final rule in mid-2004, with implementation slated for January 2007.

Deposit Insurance Reform

The FDIC continued to give priority attention to enactment of comprehensive deposit insurance reform legislation throughout 2003. Legislation containing major elements of the deposit insurance reform proposals developed by the FDIC over the past three years was introduced in both the House of Representatives and the Senate. FDIC Chairman Powell testified in support of deposit insurance reform proposals on February 26 before the Senate Banking Committee and on March 4 before the House Financial Services Committee.

The FDIC's recommendations, which were summarized in the testimony, 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 correct these problems, the FDIC recommended that the 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 and for all insured institutions.
    - Grant a one-time initial assessment credit to recognize institutions' past contributions to the fund and create an ongoing system of assessment credits to prevent the fund from growing too large.
- Indexing deposit insurance coverage to ensure that basic account coverage is not eroded over time by inflation.

The House passed H.R. 522, the Federal Deposit Insurance Reform Act of 2003, on April 2 by a vote of 411 to 11. Although the Senate Banking Committee held a hearing on deposit insurance reform in February, it did not act on a deposit insurance bill during the year. Enactment of deposit insurance reform will remain a priority of the FDIC during 2004.

FFIEC Central Data Respository
The FDIC provided leadership for a new interagency initiative with the Federal Reserve Board and the Office of the Comptroller of the Currency under the auspices of the FFIEC, to consolidate the collection, editing and publication of quarterly bank financial reports into a Central Data Repository (CDR). The CDR will be implemented during the fourth quarter of 2004 and will be accessible to regulators, financial institutions and the public. This initiative will be undertaken in cooperation with the industry and will employ cutting-edge technology based on the Extensible Business Reporting Language (XBRL) standard to define data standards and streamline the collection and validation of the data. The first reports are expected to be filed under the new system beginning with the September 2004 Call Report.

Future of Banking Study
The FDIC conducted a study on the future of banking during 2003 that focused on underlying trends in the economy and the banking industry, and their implications for different sectors of the industry and for bank regulators in the future. FDIC analysts explored policy issues that included the mixing of banking and commerce, regulatory reorganization, consumer privacy, the role of banks in light of the increased importance of non-bank competitors, and the potential effects of financial services industry consolidation on small business and local economies. As part of the study, FDIC analysts met with representatives from the banking industry and the regulatory community throughout the year to discuss their views on the direction of the industry. The results of the study will be presented at a conference in 2004 and published following this conference. The FDIC's Advisory Committee on Banking Policy, formed in 2002 to provide advice and recommendations relating to the FDIC's mission, will also be reviewing the study.

Determined to cut red tape and reduce regulatory burden are (l to r), OTS Director James Gilleran, Jim McLaughlin of the American Bankers Association, Harry Doherty of America's Community Bankers, FDIC Vice Chairman John Reich and Ken Guenther of the Independent Community Bankers of America.

Reduced Regulatory Burden
On June 3, 2003, under the leadership of FDIC's Vice Chairman John Reich, the federal thrift and bank regulatory agencies launched 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 regulatory requirements that are outdated, unnecessary or unduly burdensome. As a former community banker, Vice Chairman Reich understands bankers' concerns regarding the extent of regulatory burden and believes that, with the assistance of bankers, meaningful changes can be made. For the purposes of this review, the agencies categorized their regulations into 12 separate groups. Every six months, new groups of regulations will be published for comment, giving bankers and others an opportunity to identify regulatory requirements they believe are no longer needed. The agencies will then analyze the comments and propose amendments to their regulations where appropriate.

On June 15, 2003, the agencies issued the first three groups of regulations for comment: Applications and Reporting, Powers and Activities, and International Banking. During the 90-day comment period, 17 letters were received containing more than 150 individual recommendations for burden reduction. Staff is reviewing and analyzing all of these recommendations with an eye towards reducing regulatory burden wherever possible. If necessary, legislative changes may be proposed.

As a part of the regulatory burden reduction effort, the FDIC hosted five banker outreach meetings during 2003 to facilitate industry awareness of the EGRPRA project and to listen to bankers' comments, complaints and suggestions on regulatory burden. These meetings were attended by more than 250 bankers. Chairman Powell, Vice Chairman Reich, Federal Reserve Board Governor Mark Olson and Comptroller John D. Hawke were featured speakers at the meetings. Project staff from each of the federal banking regulatory agencies as well as regional representatives of the major industry trade groups attended each of the meetings. Outreach sessions were held in Orlando, St. Louis, Denver, San Francisco and New York.

Ten major regulatory issues emerged from the outreach sessions that appeared to be of the greatest concern to bankers:

- Bank Secrecy Act, including Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs)
- USA PATRIOT Act and "Know Your Customer" Requirements
- Withdrawal Limits on Money Market Deposit Accounts (Regulation D)
- Home Mortgage Disclosure Act (HMDA)
- Community Reinvestment Act (CRA)
- Truth-in-Lending Act (Regulation Z) and the Real Estate Settlement Procedures Act (RESPA)
- Three-Day Right of Rescission
- Extensions of Credit to Insiders (Regulation O)
- Flood Insurance
- Privacy Notices

The EGRPRA project will give particular attention to these concerns as it moves forward.

The FDIC maintains an interagency web site on EGRPRA: www.egrpra.gov. This site contains the agendas and discussion topics from the outreach meetings, as well as a summary of the issues raised and potential solutions offered by the participants. Comments received during the first comment period are also posted on the web site.

Resolution of Failed Institutions

During 2003, the FDIC resolved three financial institution failures. These failed institutions had a total of $1.10 billion in assets and $908.6 million in deposits. Within one business day after each failure, the FDIC had issued payout checks to insured depositors, or worked with open institutions to ensure that depositors had access to their insured funds. (See the accompanying table on page 18 for details about liquidation activities.)

Supervision and Consumer Protection

Supervision and consumer protection are the cornerstones of the FDIC's efforts to ensure the stability of and public confidence in the nation's financial system. At year-end 2003, the Corporation was the primary federal regulator for 5,340 FDIC-insured, state-chartered institutions that are not members of the Federal Reserve System (generally referred to as "State Nonmember" institutions). Through safety and soundness, consumer compliance, and Community Reinvestment Act (CRA) examinations of these FDIC-supervised institutions, the FDIC assesses their operating condition, management practices and policies as well as their compliance with applicable laws and regulations. The FDIC also educates bankers and consumers on matters of interest to bank customers and addresses consumers' questions and concerns.

Safety and Soundness Examinations

During 2003, the Corporation conducted 2,421 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 2003. As of December 31, 2003, 73 institutions with total assets of $8.2 billion had been identified as problem institutions, compared to 84 institutions with total assets of $12.8 billion on December 31, 2002. These changes represent a decrease of 13.1 percent and 35.9 percent in the number and assets of problem institutions, respectively. During 2003, 58 institutions were removed from problem institution status due to composite rating upgrades, mergers, consolidations or sales, and 47 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, 2003, all follow-up examinations for problem institutions had been performed on schedule.

[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).

Compliance and Community Reinvestment Act (CRA) Examinations

The FDIC conducted 1,610 comprehensive compliance-CRA examinations, 307 compliance-only examinations[2], and two CRA-only examinations in 2003, compared to 1,334 comprehensive compliance-CRA examinations, 493 compliance-only examinations, and 13 CRA-only examinations in 2002. One institution was assigned a composite "4" rating for compliance as of year-end 2003. None were assigned a composite "5" rating. The "4" rated institution has entered into a Memorandum of Understanding (MOU) with the FDIC to correct compliance issues. The ratings for institutions with CRA-only examinations were rated "Satisfactory." (See the accompanying table for details about the FDIC Examinations.)

FDIC Examinations 2001-2003

	2003	2002	2001
Safety and Soundness:			
State Nonmember Banks	**2,182**	2,290	2,300
Savings Banks	**231**	229	241
Savings Associations	**0**	0	0
National Banks	**5**	10	16
State Member Banks	**3**	5	9
Subtotal - Safety and Soundness Examinations	**2,421**	2,534	2,566
CRA/Compliance Examinations:			
Compliance-Community Reinvestment Act	**1,610**	1,334	709
Compliance-only	**307**	493	1,465
CRA-only	**2**	13	5
Subtotal CRA/Compliance Examinations	**1,919**	1,840	2,179
Specialty Examinations:			
Trust Departments	**501**	524	466
Data Processing Facilities	**2,304**	1,681	1,625
Subtotal-Specialty Examinations	**2,805**	2,205	2,091
Total	**7,145**	6,579	6,836

Examination Program Efficiencies

The FDIC continues to implement measures to improve efficiency by maximizing the use of risk-focused examination procedures at well-managed banks that meet certain criteria. The Maximum Efficiency, Risk-Focused, Institution Targeted (MERIT) Program provides for the use of risk-focused safety and soundness examination procedures at FDIC-supervised institutions with assets of $250 million or less that are well-managed, well-capitalized and meet other program criteria. This program helps ensure that the FDIC's resources are focused on those institutions that pose the greatest risk to the insurance funds, while preserving the integrity of the examination process.

The FDIC refocused its compliance examination approach during the second half of 2003. The revised process evaluates a financial institution's compliance management system through a review of policies and procedures and discussions with staff from the institution. Examiners place emphasis on how well the institution's own compliance management system is working to identify emerging risks, monitor changes to laws and regulations, ensure employees understand their responsibilities, incorporate compliance into business operations, review those operations to ensure compliance with applicable laws and regulations, and take effective corrective actions when necessary. Based on risks identified in the compliance management system, examiners pinpoint areas for further evaluation using transaction testing.

USA PATRIOT Act

Since the enactment 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 participated in numerous interagency working groups to draft revisions to the Bank Secrecy Act as required by the USA PATRIOT Act and to develop interpretive guidance for the financial services industry. In May 2003, the FDIC, in conjunction with other regulatory agencies, jointly issued a final rule to implement Section 326 of the USA PATRIOT Act. Section 326 requires financial institutions to implement a customer identification program to verify the identity of customers opening new accounts. The FDIC has taken steps to educate its examination staff and members of the banking industry on the USA PATRIOT Act at outreach events, training conferences and seminars. To assist financial institutions in their efforts to comply with the Bank Secrecy Act and the USA PATRIOT Act, the FDIC publicly released its examination procedures for the Bank Secrecy Act in October 2003.

[2] Compliance-only examinations are conducted for most institutions at or near the mid-point between comprehensive CRA-compliance examinations under the Gramm-Leach-Bliley Act of 1999, which amended the Community Reinvestment Act of 1977. CRA examinations at small 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."

To facilitate industry cooperation with law enforcement authorities in their ongoing investigation of terrorist activities through the implementation of Section 314(a) of the USA PATRIOT Act, the FDIC also worked with other federal banking regulators to incorporate point-of-contact information as a required item in the Call Report, beginning with the March 2003 Call Report. The FDIC is the only banking regulator to use this mechanism thus far to provide current point-of-contact information to the Financial Crimes Enforcement Network (FinCEN) to aid in its distribution of Section 314(a) information-sharing requests.

The Director's Corner

The FDIC and the other banking agencies frequently publish and issue guidance for insured institutions and their officers and directors to use to fulfill their responsibilities. This useful and practical information was made available during the first quarter of 2003, when the FDIC established the "Director's Corner" on its external Web site. This site includes items such as Interagency Policy Statements, Supervisory Guidance, and Financial Institution Letters on the topics of Corporate Governance Practices, Auditing and Internal Controls, Accounting Practices and the Allowance for Loan and Lease Losses, and other areas of interest to bank directors.

Payday Lending

In January 2003, the FDIC published for public review and comment draft examination guidelines for state nonmember institutions that offer payday loans. More than 1,000 comments were received and considered prior to implementing final guidelines in July 2003. Necessitated by the high-risk nature of the business line and the substantial growth of the product, the final guidelines identify the key safety and soundness and consumer protection issues that examiners will consider when evaluating payday lending during examinations. The FDIC's guidelines, while similar in many respects to those issued by other financial institution regulatory agencies, are more explicit on the applicability of the expanded interagency guidance to sub-prime lending programs, capital requirements, allowance for loan and lease losses, classifications, accounting for accrued interest and fees and recoveries, and lending concentrations.

***Money Smart* Financial Literacy Program**

One of the Corporation's top priorities in 2003 was the continued promotion of financial education through its *Money Smart* Program. The FDIC was awarded the prestigious *Service to America Business and Commerce* medal in October 2003 for its efforts in promoting financial literacy using the *Money Smart* curriculum. These medals honor people and organizations that have shown a strong commitment to public service and have made a significant contribution in their field of government that is innovative, high-impact and critical for the nation.

Since its introduction in July 2001, the *Money Smart* program has generated a great deal of interest. Primarily designed to help adults with little or no banking experience develop positive relationships with insured depository institutions, the program has been widely cited in over 100 national and local publications. Requests for the program have been received from Mexico, Thailand and Canada. During 2003, the FDIC continued to expand

DSC *Money Smart* team members (l to r): Pam Bronson, Joan Lok, Kip Child, Jacqui Gordon, Cathie Davis, Teresa Perez, Jim Pilkington, and Clinton Vaughn join Chairman Powell and team leader Nelson Hernandez on stage to accept the Service to America Business and Commerce medal.

Defense Secretary Donald Rumsfeld and FDIC Chairman Donald Powell agree, at a meeting at the Pentagon, to make *Money Smart* training available to 1.4 million servicemen and servicewomen worldwide.

the public's access to *Money Smart* by translating the program into Chinese and Korean and expanding membership in the *Money Smart* Alliance. By year-end 2003, the FDIC had trained over 5,000 volunteer instructors, taught over 100,000 consumers and supplied more than 111,000 copies of the *Money Smart* training curriculum to various groups, including government, community, financial and faith-based organizations.

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. As of December 31, 2003, the FDIC had received 8,026 complaints, of which 4,047 were against state-chartered nonmember banks. Approximately fifty percent of the state nonmember bank consumer complaints concerned credit card accounts. The most frequent complaints involved loan denials, billing disputes and account errors, terms and conditions, collection practices, reporting of erroneous information, and credit card fees and service charges. The FDIC's centralized Consumer Response Center (CRC) is responsible for investigating all types of consumer complaints about FDIC-supervised institutions and for answering consumer inquiries about consumer protection laws and banking practices.

During 2003, the FDIC received over 100,000 inquiries from consumers and members of the banking community. The FDIC Central Call Center serves as the primary telephone point of contact for questions on deposit insurance coverage from the banking community and the public. (For more information on the Call Center, which can be reached at 1-877-ASK-FDIC, or 1-877-275-3342, toll free, see page 129.)

Corporate Governance

The FDIC has long recognized the importance of good corporate governance in maintaining the integrity and stability of the nation's banking system. The Sarbanes-Oxley Act of 2002 (Act) imposes new reporting, corporate governance, and auditor independence requirements on companies including insured depository institutions and bank and thrift holding companies with securities registered under the federal securities laws. In response to questions about the applicability of the Act to insured depository institutions that are not public companies, the FDIC issued comprehensive guidance in March 2003, describing significant provisions of the Act and related rules of implementation adopted by the Securities and Exchange Commission. The guidance explained how adopting sound corporate governance practices outlined in the Act may benefit banking organizations, including those that are not public companies, and how several of the Act's requirements mirror existing banking agency policy guidance related to corporate governance.

Receivership Management

The FDIC has the unique mission of protecting the depositors of insured banks and savings associations. Since 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 make insured depositors whole at the time of institution failure. Once an institution is closed by its chartering authority – the state for state-chartered institutions, the OCC for national banks, or the 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 potential acquirers, and then recommends the least costly resolution transaction to the FDIC's Board of Directors.

Protecting Insured Depositors Through Asset Marketing

The FDIC's ability to attract healthy FDIC-insured institutions to assume deposits and to 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, uninsured depositors (depositors whose accounts exceed the $100,000 deposit insurance limits), and reimburse the insurance fund that funded the resolution transaction. In 2003, 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.

Liquidation Highlights 2001-2003

Dollars in billions

	2003	2002	2001
Total Resolved Banks	3	10	3
Assets of Resolved Banks	$ 1.10	$ 2.50	$ .05
Total Resolved Savings Associations	0	1	1
Assets of Resolved Savings Associations	$ 0	$ .05	$ 2.18
Net Collections from Assets in Liquidation•	$ 1.70	$ 1.84	$ .31
Total Assets in Liquidation•	$ .81	$ 1.24	$ .57
Total Dividends Paid•	$ 1.06	$ 2.12	$ .46

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

During 2003, the FDIC resolved three BIF-insured institution failures. Southern Pacific Bank, Torrance, California, with total assets of $1.052 billion, was closed on February 7. Southern Pacific's insured deposits and a large portion of its assets were sold to another FDIC-insured institution. First National Bank of Blanchardville, Blanchardville, Wisconsin, with total assets of $35.5 million, failed on May 9, and all insured deposits were sold to another FDIC-insured institution. Pulaski Savings Bank, Philadelphia, Pennsylvania, with total assets of $8.9 million, failed on November 14, and all insured deposits were sold to another FDIC-insured institution. (See the accompanying table above for details about liquidation activities.)

The FDIC initiated a number of projects in 2003 to better manage and leverage its resources to meet potential challenges in the resolution of future financial institution failures. These projects are in the areas of processing depositor claims, franchise and asset marketing, asset valuation and sales, asset servicing, receivership operations and management, information systems, planning and communication, cost containment, and field operations.

Lessons Learned Symposium

The FDIC, in association with the SW Graduate School of Banking and Southern Methodist University's Cox School of Business, presented the *Lessons Learned from Recent Bank Failures* symposium on October 24. This conference served as a forum for academics, regulators and industry participants to present analyses and to debate the causes and costs of recent bank failures. Presentations and discussions centered on the root causes of recent bank failures, the impact of new banking activities on bank failures, and the costs of recent bank failures.

Customer Service Center

In order to help consumers needing assistance with matters arising from failed financial institutions, the FDIC also operates a Customer Service Center with staff dedicated to handling records research and collateral releases. During 2003, FDIC staff responded to nearly 86,000 inquiries and was recognized for Outstanding Customer Service provided through expanded e-Government initiatives at the President's Quality Awards for their innovative work and rapid response time in this area. 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 over 17,000 collateral release inquiries in 2003. Finally, the Customer Service Call Center handled over 85,000 calls asking for information or assistance.

Terminations

The FDIC, as receiver, manages the receivership estate and the subsidiaries of failed insured 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. The goal would have been achieved in 2003 except for outstanding professional liability claims and other impediments. At year-end 2003, three receiverships remained active from the seven receiverships established following institution failures in 2000. These three receiverships could not be terminated due to the existence of ongoing professional liability litigation and non-asset defensive litigation. These cases continue to be vigorously pursued through appropriate negotiations and litigation proceedings.

Operational Efficiency and Effectiveness

Although the FDIC is not subject to the President's Management Agenda (PMA), it has given priority attention to continuing efforts to improve operational efficiency and effectiveness, consistent with the PMA. Major initiatives pursued in this area during 2003 are outlined below.

Managing Human Capital

The FDIC has been downsizing its workforce for a decade, as the residual workload from the banking and thrift crises has gradually been completed. FDIC staffing, including staff assigned to the Resolution Trust Corporation, has declined from approximately 23,000 in 1993 to about 5,300 at the end of 2003. In mid-2003, a reduction in force was implemented to address 43 identified surplus positions that remained following aggressive efforts in 2002 and early 2003 to align staffing with current workload through voluntary measures. Like other organizations, the Corporation will continue to review its work processes and employ technology and other means to improve operational efficiency, potentially resulting in excess positions. The Corporation expects to be able to address future surplus positions, in most instances, through a continuing process of carefully managing resources.

The demands placed on the Corporation by a rapidly changing external environment require a more dynamic and strategic approach to managing the Corporation's human capital in order to ensure that the FDIC has

At their official induction as Deans of the FDIC Corporate University (l to r): Erica Cooper, School of Leadership Development; Fred Carns, School of Insurance; Nancy Hall, School of Supervision and Consumer Protection; James Wigand, School of Resolutions and Receiverships; and Miguel Torrado, School of Corporate Operations. CLO Dave Cooke joined in welcoming the new Deans.

the skills and staff necessary to fulfill its mission in the future. The Corporation is in the process of revamping its compensation program to place greater emphasis on performance-based incentives. A new executive classification and pay program was implemented in 2003 that ties all future pay increases to performance against specific measurable objectives. The Corporation also implemented a new Corporate Success Award program that differentiates annual pay increases for the rest of the workforce on the basis of performance. A comprehensive review of the Corporation's human resource management processes identified opportunities to provide increased flexibility in both the recruitment and retention of employees and the management of employee performance. Implementation of the recommendations from that review began in 2003 and will continue in 2004. In addition, the Corporation began to analyze staffing alternatives to ensure that it continues to have the skills it needs in its workforce as it deals with a large number of retirements expected over the next five to seven years.

Key Positions Filled – Chief Economist, Chief Accountant, and Chief Information Officer

In February 2003, the FDIC named the Corporation's Chief Economist and Chief Accountant. The Chief Economist will develop and communicate the FDIC's perspective on a wide range of economic and risk management issues. The Chief Accountant will spearhead FDIC accounting policy development (for banks in the U.S. and abroad), establish regulatory financial reporting requirements, and review depository institutions' accounting for specific transactions. The Chief Accountant will also participate in developing the FDIC's regulations and supervisory policies on capital adequacy and auditing programs and oversee the FDIC's securities registration and disclosure function under federal securities laws. In November 2003, the FDIC filled the vacant Chief Information Officer (CIO) position. The CIO will play a crucial role in overseeing the transformation of the Corporation's Division of Information Resources Management into a more agile and customer-focused strategic partner.

Corporate University

In June 2003, the FDIC Chairman appointed the agency's first Chief Learning Officer to head the new Corporate University (CU). The CU represents a departure from traditional training approaches and will provide a continual learning environment for FDIC employees. It will use numerous tools and techniques to prepare them for a changing banking, economic and regulatory landscape. The CU provides opportunities for employees to enhance their sense of corporate identity while learning more about the FDIC's major program areas of Insurance, Supervision and

Consumer Protection, and Receivership Management. Further, the CU will be a leader in leveraging technology to improve the efficiency and effectiveness of all Corporate training.

Information Technology Initiatives

To keep pace with an ever-evolving financial services industry, the FDIC is utilizing technology to bring stakeholders information in a more timely, secure manner. Efforts have focused on improving the FDIC's public web site, securing ways to facilitate electronic communication with stakeholders, and streamlining examination efforts through more efficient means of collecting and disseminating data. The FDIC also completed in 2003 a comprehensive review of its Information Technology (IT) program. That review evaluated the cost and performance of the current IT program, identified future skill requirements and alternative sourcing strategies, and recommended a new organizational and staffing structure to begin to transform the IT organization into a strategic partner with the Corporation's major business units over the next two to three years.

Significant IT-related accomplishments in 2003 include:

- Considerable progress was made in the development and implementation of a new Enterprise Architecture (EA) to guide the Corporation's future IT efforts. By following the EA program, the FDIC will be able to deploy new systems more quickly, reduce risks normally inherent in large-scale systems, and forecast system development budgets and schedules more accurately, thus reducing system development and support costs. The EA program will also emphasize security and enhance e-government capabilities.
- The FDIC's public Web site (www.fdic.gov) was redesigned to make use of the agency's online services faster and easier for bankers, financial analysts, consumers and others. Products and services available on the Web site include resources for bankers about their requirements for safe operations and compliance with consumer protection laws, data about individual banks and the banking industry, useful information for consumers about deposit insurance and rights as depositors and borrowers, and updates on FDIC press releases.
- FDIC achieved several successes with FDIC*connect*, a secure Web site developed to facilitate electronic communication with insured financial institutions. During 2003, twelve business transactions were activated to enable institutions to conduct business online with the FDIC. These transactions included filing of new branch applications by insured institutions, collection of information for the 2003 summary of deposits, public retrieval of beneficial ownership reports, and access to bank assessment invoices.
- In June 2003, FDIC implemented the Assessment Information Management System (AIMS II), which calculates, collects and accounts for the quarterly assessment premiums paid by financial institutions. The FDIC issues over 9,000 invoices quarterly and captures a full history of assessment-related transactions. The assessment function is vital to the FDIC, and the improvements realized by putting this system in place have made the Corporation more efficient. Assessment invoices are now made available to insured institutions using FDIC*connect*.
- FDIC partnered with several external organizations to emphasize the importance of robust information security programs to financial institutions. These organizations included the Federal Bureau of Investigation, the Financial and Banking Information Infrastructure Committee, Financial Crimes Enforcement Network, and the Critical Infrastructure Protection Project of George Mason University School of Law. In partnership with these organizations, the FDIC sponsored a series of cyber-security symposia and helped to identify and develop a set of best practices for cyber-security for use in financial institutions.

Improved Information Security

In response to a reportable condition on information security weaknesses identified in the GAO's audit of the Corporation's 2002 financial statements, the FDIC continued to give priority attention in 2003 to its information security management program. Major program accomplishments in 2003 included the following:

- Updated policies on contractor and outside agency security were issued, and contractor security requirements were added to the Acquisition Policy Manual. Security audits of local outside contractor sites were also conducted.
- Security performance measures were identified and tracked through quarterly performance reports to senior FDIC management.

The annual Federal Information Security Management Act audit conducted by the OIG noted significant improvement in the FDIC's information security program during the prior 12 months. The audit assigned an overall "limited assurance" rating, but identified only one area that was assigned a "minimal/no assurance" rating, down from three in 2002. Efforts to improve all areas of information security will continue in 2004.

Financial Highlights

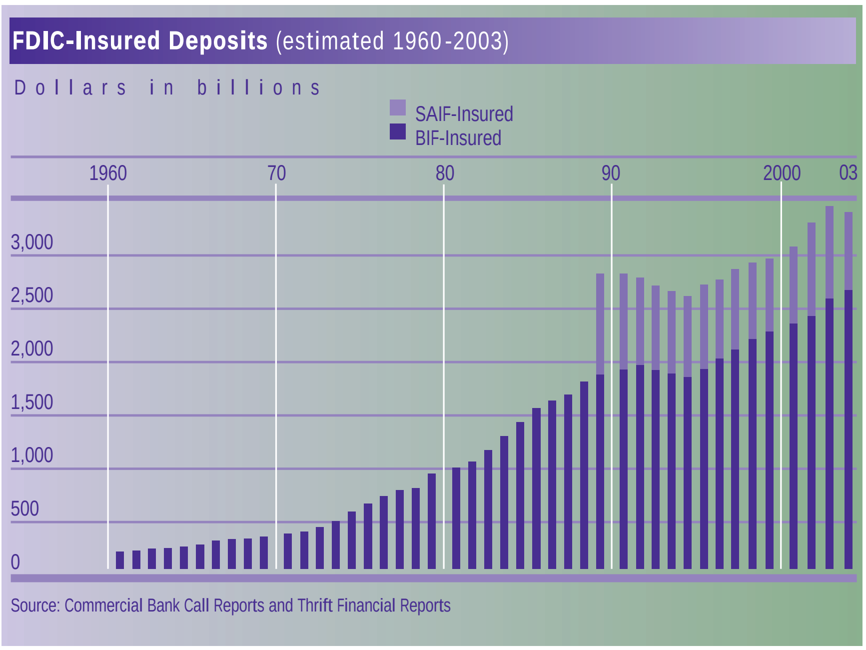
Deposit Insurance Fund Performance

The FDIC administers two deposit insurance funds – the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) – and manages the FSLIC Resolution Fund (FRF), which fulfills the obligations of the former Federal Savings and Loan Insurance Corporation (FSLIC) and the former Resolution Trust Corporation (RTC). The following summarizes the condition of the FDIC's insurance funds. (See the accompanying tables on FDIC-Insured Deposits, Insurance Fund Reserve Ratios and Risk-Related Premiums on the following pages.)

The BIF reported comprehensive income (net income plus current period unrealized gains/losses on available-for-sale securities) of $1.7 billion for the twelve months ending December 31, 2003, compared to $1.6 billion for the same period in the prior year. During 2003, estimated losses for future and actual failures, as well as litigation, decreased by $832 million, and operating expenses decreased by $16 million. However, these decreases in losses and expenses were partially offset by significant reductions in unrealized gains on available-for-sale securities ($576 million) and lower interest revenue on U.S. Treasury obligations ($162 million). As of December 31, 2003, the fund balance was $33.8 billion, up from $32.1 billion at year-end 2002.

BIF's contingent liability for anticipated failures declined by $830 million, or 82 percent, to $178 million for the year. This overall reduction in the reserves is primarily the result of improvements in the loss reserve methodology and an improvement in the financial condition of a few large troubled institutions.

The SAIF reported comprehensive income of $493 million for the twelve months, ending December 31, 2003, compared to $812 million for the same period in the prior year. This difference of $318 million was primarily due to a decrease in unrealized gains on available-for-sale securities of $198 million, a slight reduction in interest revenue of $32 million, and a reduction in the estimated losses for future failures of $55 million. As of December 31, 2003, the fund balance was $12.2 billion, up from $11.7 billion at year-end 2002.



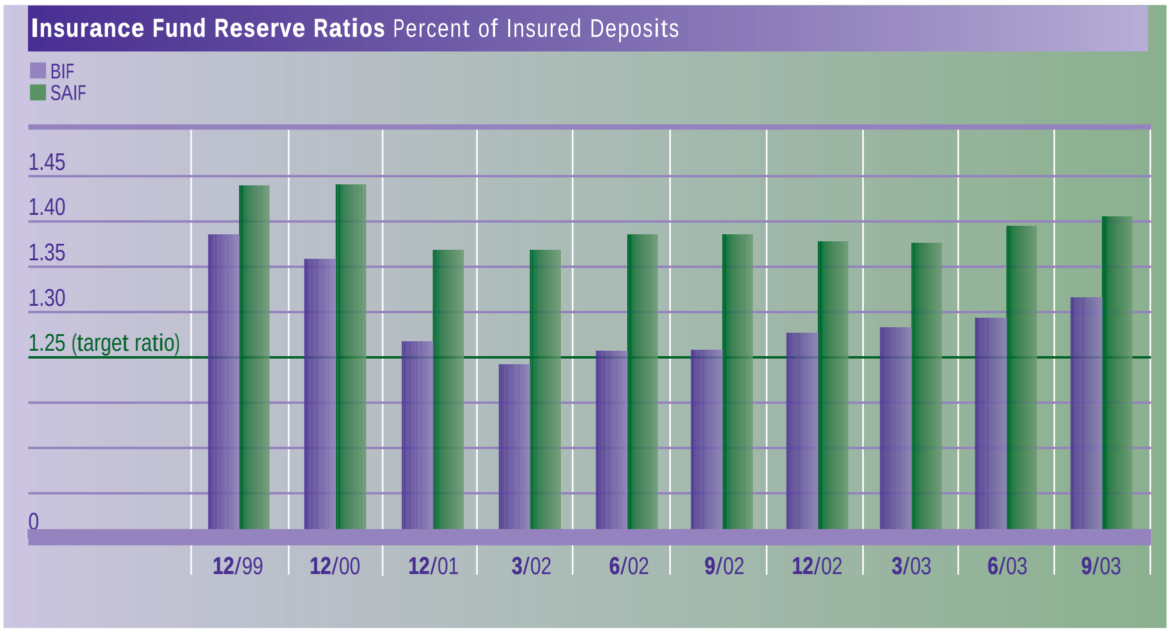
SAIF's contingent liability for anticipated failures decreased by $87 million, or 96 percent, to $3 million for the year. The overall reduction is the result of improvements in the loss reserve methodology and the improved financial condition of a few large troubled institutions. As of December 31, 2003, SAIF's current liabilities totaled less than one percent of the fund balance.

Operating Expenses

Corporate Operating Budget expenses totaled $1,008.2 million in 2003, including $968.6 million for ongoing operations and $39.6 million for receivership funding. These expenses represented approximately 98 percent of the approved budget for ongoing operations and 53 percent of the approved budget for receivership funding. Receivership funding expenses were down significantly from 2002 because of the smaller number of insured institution failures.

The Board of Directors approved a 2004 Corporate Operating Budget of approximately $1.1 billion, including just over $1.0 billion for ongoing operations. The level of approved spending in the 2004 budget remains virtually the same as that in 2003 due to continuing efforts to identify operational efficiencies and control costs. The Corporate Operating Budget includes funding for a number of major new initiatives, including the Corporate University and the Center for Financial Research.

The 2004 budget includes, for the first time, estimated funding requirements ($35 million) for litigation expenses projected to be incurred on behalf of the FDIC by the U.S. Department of Justice. These expenses have not previously been included in the annual Corporate Operating Budget, but were expensed directly to the appropriate receivership accounts. This change will increase the transparency of the Corporation's financial reporting.



Investment Spending

The FDIC has a disciplined process for reviewing proposed new capital investment projects and managing the implementation of approved projects. Most of the projects in the current investment portfolio are major IT systems initiatives.

Proposed projects are carefully reviewed to ensure that they are consistent with the Corporation's enterprise architecture and include an appropriate return on investment for the insurance funds. The process also enables the FDIC to be aware of risks to the major capital investment projects and facilitates appropriate, timely intervention to address these risks throughout the development process. An investment portfolio performance review of the major capital investments is provided to the FDIC Board of Directors quarterly. During 2003, the Board of Directors approved two new investment projects: (1) Legal Information Management System - $3.2 million and (2) Asset Servicing Technology Enhancement Project - $31.8 million.

Risk-Related Premiums

The following tables show the number and percentage of institutions insured by the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF), according to risk classifications effective for the first semiannual assessment period of 2003. Each institution is categorized based on its capitalization and a supervisory subgroup rating (A, B, or C), which is generally determined by on-site examinations. Assessment rates are basis points, cents per $100 of assessable deposits, per year.

BIF Supervisory Subgroups•

	A	B	C
Well Capitalized:			
Assessment Rate	0	3	17
Number of Institutions	7,400 (91.8%)	470 (5.8%)	82 (1.0%)
Adequately Capitalized:			
Assessment Rate	3	10	24
Number of Institutions	82 (1.0%)	8 (0.1%)	13 (0.2%)
Undercapitalized:			
Assessment Rate	10	24	27
Number of Institutions	0 (0.0%)	2 (0.0%)	1 (0.0%)

SAIF Supervisory Subgroups▪

	A	B	C
Well Capitalized:			
Assessment Rate	0	3	17
Number of Institutions	1,092 (91.5%)	81 (6.8%)	13 (1.1%)
Adequately Capitalized:			
Assessment Rate	3	10	24
Number of Institutions	4 (0.3%)	1 (0.1%)	3 (0.3%)
Undercapitalized:			
Assessment Rate	10	24	27
Number of Institutions	0 (0.0%)	0 (0.0%)	0 (0.0%)

• BIF data exclude SAIF-member "Oakar" institutions that hold BIF-insured deposits. The assessment rate reflects the rate for BIF-assessable deposits, which remained the same throughout 2002.

▪ SAIF data exclude BIF-member "Oakar" institutions that hold SAIF-insured deposits. The assessment rate reflects the rate for SAIF-assessable deposits, which remained the same throughout 2002.