

## 4. FINANCIAL STATEMENTS AND NOTES

## DEPOSIT INSURANCE FUND (DIF)

**Federal Deposit Insurance Corporation**  
**Deposit Insurance Fund Balance Sheet at December 31**  
**DOLLARS IN THOUSANDS**

	2011	2010
<b>Assets</b>		
Cash and cash equivalents	\$3,277,839	\$27,076,606
Cash and investments - restricted - systemic risk (Note 16) <i>(Includes cash/cash equivalents of \$1,627,073 at December 31, 2011 and \$5,030,369 at December 31, 2010)</i>	4,827,319	6,646,968
Investment in U.S. Treasury obligations, net (Note 3)	33,863,245	12,371,268
Trust preferred securities (Note 5)	2,213,231	2,297,818
Assessments receivable, net (Note 9)	282,247	217,893
Receivables and other assets - systemic risk (Note 16)	1,948,151	2,269,422
Interest receivable on investments and other assets, net	488,179	259,683
Receivables from resolutions, net (Note 4)	28,548,396	29,532,545
Property and equipment, net (Note 6)	401,915	416,065
<b>Total Assets</b>	<b>\$75,850,522</b>	<b>\$81,088,268</b>
<b>Liabilities</b>		
Accounts payable and other liabilities	\$374,164	\$514,287
Unearned revenue - prepaid assessments (Note 9)	17,399,828	30,057,033
Liabilities due to resolutions (Note 7)	32,790,512	30,511,877
Debt Guarantee Program liabilities - systemic risk (Note 16)	117,027	29,334
Deferred revenue - systemic risk (Note 16)	6,639,954	9,054,541
Postretirement benefit liability (Note 13)	187,968	165,874
<i>Contingent liabilities for:</i>		
Anticipated failure of insured institutions (Note 8)	6,511,321	17,687,569
Systemic risk (Note 16)	2,216	119,993
Litigation losses (Note 8)	1,000	300,000
<b>Total Liabilities</b>	<b>64,023,990</b>	<b>88,440,508</b>
<i>Commitments and off-balance-sheet exposure (Note 14)</i>		
<b>Fund Balance</b>		
Accumulated Net Income (Loss)	11,560,990	(7,696,428)
<b>Accumulated Other Comprehensive Income</b>		
Unrealized gain on U.S. Treasury investments, net (Note 3)	47,697	26,698
Unrealized postretirement benefit loss (Note 13)	(33,562)	(18,503)
Unrealized gain on trust preferred securities (Note 5)	251,407	335,993
<b>Total Accumulated Other Comprehensive Income</b>	<b>265,542</b>	<b>344,188</b>
<b>Total Fund Balance</b>	<b>11,826,532</b>	<b>(7,352,240)</b>
<b>Total Liabilities and Fund Balance</b>	<b>\$75,850,522</b>	<b>\$81,088,268</b>

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

## DEPOSIT INSURANCE FUND (DIF)

**Federal Deposit Insurance Corporation****Deposit Insurance Fund Statement of Income and Fund Balance for the Years Ended December 31****DOLLARS IN THOUSANDS**

	2011	2010
<b>Revenue</b>		
Assessments (Note 9)	\$13,498,587	\$13,610,436
Interest on U.S. Treasury obligations	127,621	204,871
Systemic risk revenue (Note 16)	(131,141)	(672,818)
Other revenue (Note 10)	2,846,929	237,425
<b>Total Revenue</b>	<b>16,341,996</b>	<b>13,379,914</b>
<b>Expenses and Losses</b>		
Operating expenses (Note 11)	1,625,351	1,592,641
Systemic risk expenses (Note 16)	(131,141)	(672,818)
Provision for insurance losses (Note 12)	(4,413,629)	(847,843)
Insurance and other expenses	3,996	3,050
<b>Total Expenses and Losses</b>	<b>(2,915,423)</b>	<b>75,030</b>
<b>Net Income</b>	<b>19,257,419</b>	<b>13,304,884</b>
<b>Other Comprehensive Income</b>		
Unrealized gain (loss) on U.S. Treasury investments, net	20,999	(115,429)
Unrealized postretirement benefit loss (Note 13)	(15,059)	(15,891)
Unrealized (loss) gain on trust preferred securities (Note 5)	(84,587)	335,993
<b>Total Other Comprehensive (Loss) Income</b>	<b>(78,647)</b>	<b>204,673</b>
<b>Comprehensive Income</b>	<b>19,178,772</b>	<b>13,509,557</b>
<b>Fund Balance - Beginning</b>	<b>(7,352,240)</b>	<b>(20,861,797)</b>
<b>Fund Balance - Ending</b>	<b>\$11,826,532</b>	<b>\$(7,352,240)</b>

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

## DEPOSIT INSURANCE FUND (DIF)

## Federal Deposit Insurance Corporation

## Deposit Insurance Fund Statement of Cash Flows for the Years Ended December 31

## DOLLARS IN THOUSANDS

	2011	2010
<b>Operating Activities</b>		
<b>Net Income:</b>	<b>\$19,257,419</b>	<b>\$13,304,884</b>
Adjustments to reconcile net income to net cash (used by) operating activities:		
Amortization of U.S. Treasury obligations	388,895	(5,149)
Treasury Inflation-Protected Securities inflation adjustment	(25,307)	(23,051)
Depreciation on property and equipment	77,720	68,790
Loss on retirement of property and equipment	1,326	620
Provision for insurance losses	(4,413,629)	(847,843)
Unrealized Loss on postretirement benefits	(15,059)	(15,891)
<b>Change in Operating Assets and Liabilities:</b>		
(Increase) Decrease in assessments receivable, net	(64,354)	62,617
(Increase) in interest receivable and other assets	(227,962)	(34,194)
(Increase) in receivables from resolutions	(5,802,003)	(16,607,671)
Decrease in receivables - systemic risk	321,271	1,029,397
(Decrease) Increase in accounts payable and other liabilities	(140,123)	240,949
Increase in postretirement benefit liability	22,094	20,922
(Decrease) in contingent liabilities - systemic risk	(117,777)	(1,289,957)
(Decrease) in contingent liabilities - litigation losses	(276,000)	0
Increase (Decrease) in liabilities due to resolutions	2,278,635	(4,199,849)
Increase in Debt Guarantee Program liabilities - systemic risk	87,693	27,318
(Decrease) in unearned revenue - prepaid assessments	(12,657,206)	(12,670,068)
(Decrease) Increase in deferred revenue - systemic risk	(2,399,644)	1,203,936
<b>Net Cash (Used by) Operating Activities</b>	<b>(3,704,011)</b>	<b>(19,734,240)</b>
<b>Investing Activities</b>		
Provided by:		
Maturity of U.S. Treasury obligations	12,976,273	21,558,000
Used by:		
Purchase of property and equipment	(64,896)	(96,659)
Purchase of U.S. Treasury obligations	(36,409,429)	(30,143,138)
<b>Net Cash (Used by) Investing Activities</b>	<b>(23,498,052)</b>	<b>(8,681,797)</b>
<b>Net (Decrease) in Cash and Cash Equivalents</b>	<b>(27,202,063)</b>	<b>(28,416,037)</b>
<b>Cash and Cash Equivalents - Beginning</b>	<b>32,106,975</b>	<b>60,523,012</b>
<b>Unrestricted Cash and Cash Equivalents - Ending</b>	<b>3,277,839</b>	<b>27,076,606</b>
<b>Restricted Cash and Cash Equivalents - Ending</b>	<b>1,627,073</b>	<b>5,030,369</b>
<b>Cash and Cash Equivalents - Ending</b>	<b>\$4,904,912</b>	<b>\$32,106,975</b>

# NOTES TO THE FINANCIAL STATEMENTS

## DEPOSIT INSURANCE FUND

December 31, 2011 and 2010

### 1. Legislation and Operations of the Deposit Insurance Fund

#### OVERVIEW

The Federal Deposit Insurance Corporation (FDIC) is the independent deposit insurance agency created by Congress in 1933 to maintain stability and public confidence in the nation's banking system. Provisions that govern the operations of the FDIC are generally found in the Federal Deposit Insurance (FDI) Act, as amended (12 U.S.C. 1811, *et seq.*). In carrying out the purposes of the FDI Act, the FDIC, as administrator of the Deposit Insurance Fund (DIF), insures the deposits of banks and savings associations (insured depository institutions). In cooperation with other federal and state agencies, the FDIC promotes the safety and soundness of insured depository institutions by identifying, monitoring and addressing risks to the DIF. Commercial banks, savings banks and savings associations (known as "thrifts") are supervised by either the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve Board.

The FDIC, through administration of the DIF, is responsible for protecting insured bank and thrift depositors from loss due to institution failures. The FDIC is required by section 13 of the FDI Act to resolve troubled institutions in a manner that will result in the least possible cost to the DIF. This section permits an exception if a systemic risk determination demonstrates that compliance with the least-cost test would have serious adverse effects on economic conditions or financial stability and that any action or assistance pursued under the systemic risk determination would avoid or mitigate such adverse effects. A systemic risk determination under this statutory provision can only be

triggered by the Secretary of the Treasury, in consultation with the President, and upon the written recommendation of two-thirds of both the FDIC Board of Directors and the Board of Governors of the Federal Reserve System. Until passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) on July 21, 2010 (see "Recent Legislation" below), a systemic risk determination would have permitted open bank assistance to an individual insured depository institution (IDI). As explained below, such open bank assistance is no longer available. The systemic risk provision requires the FDIC to recover any related losses to the DIF through one or more special assessments from all IDIs and, with the concurrence of the Secretary of the Treasury, depository institution holding companies (see Note 16).

The FDIC is also the administrator of the FSLIC Resolution Fund (FRF). The FRF is a resolution fund responsible for the sale of remaining assets and satisfaction of liabilities associated with the former Federal Savings and Loan Insurance Corporation (FSLIC) and the former Resolution Trust Corporation. The DIF and the FRF are maintained separately by the FDIC to support their respective functions.

Pursuant to the enactment of the Dodd-Frank Act, the FDIC is the manager of the Orderly Liquidation Fund (OLF). Established as a separate fund in the U.S. Treasury (Treasury), the OLF is inactive and unfunded until the FDIC is appointed as receiver for a covered financial company (a failing financial company, such as a bank holding company or nonbank financial company for which a systemic risk determination has been made as set forth in section 203 of the Dodd-Frank Act). At the commencement of an orderly liquidation of a covered

financial company, the FDIC may borrow funds required by the receivership from the Treasury, up to the Maximum Obligation Limitation for each covered financial company and in accordance with an Orderly Liquidation and Repayment Plan. Borrowings will be repaid to the Treasury with the proceeds of asset sales. If such proceeds are insufficient, any remaining shortfall must be recovered from assessments imposed on financial companies as specified in the Dodd-Frank Act.

## RECENT LEGISLATION

The Dodd-Frank Act (Public Law 111-203) provides comprehensive reform of the supervision and regulation of the financial services industry. Under this legislation, the FDIC's responsibilities include 1) liquidating failing systemically important financial firms in an orderly manner as manager of the newly created OLF; 2) issuing regulations, jointly with the Federal Reserve Board (FRB), requiring that nonbank financial companies supervised by the FRB and bank holding companies with assets equal to or exceeding \$50 billion provide the FRB, the FDIC, and the Financial Stability Oversight Council (FSOC) a plan for their rapid and orderly resolution in the event of material financial distress or failure; 3) serving as a voting member of the FSOC; 4) undertaking backup examination authority for nonbank financial companies supervised by the FRB and bank holding companies with at least \$50 billion in assets; 5) bringing backup enforcement actions against depository institution holding companies if their conduct or threatened conduct poses a risk of loss to the DIF; and 6) providing federal oversight of state-chartered thrifts, beginning upon the transfer of such authority from the Office of Thrift Supervision (which occurred on July 21, 2011).

The Dodd-Frank Act limits the systemic risk determination authority under section 13 of the FDI Act to IDIs for which the FDIC has been appointed receiver. As amended by the Dodd-Frank Act, the FDI Act now requires that any action taken or assistance provided pursuant to a systemic risk determination must be for

the purpose of winding up the IDI in receivership. Under Title XI of the Dodd-Frank Act, the FDIC is granted new authority to establish a widely available program to guarantee obligations of solvent IDIs or solvent depository institution holding companies (including affiliates) upon the systemic determination of a liquidity event during times of severe economic distress. This program would not be funded by the DIF but rather by fees and assessments paid by all participants in the program. If fees are insufficient to cover losses or expenses, the FDIC must impose a special assessment on participants as necessary to cover the shortfall. Any excess funds at the end of the liquidity event program would be deposited in the General Fund of the Treasury.

The Dodd-Frank Act also made changes related to the FDIC's deposit insurance mandate. These changes include a permanent increase in the standard deposit insurance amount to \$250,000 (retroactive to January 1, 2008) and unlimited deposit insurance coverage for noninterest-bearing transaction accounts for two years, from December 31, 2010, to the end of 2012. Additionally, the legislation changed the assessment base from a deposits-based formula to one based on assets and established new reserve ratio requirements (see Note 9).

## OPERATIONS OF THE DIF

The primary purposes of the DIF are to 1) insure the deposits and protect the depositors of IDIs and 2) resolve failed IDIs upon appointment of the FDIC as receiver, in a manner that will result in the least possible cost to the DIF (unless a systemic risk determination is made).

The DIF is primarily funded from deposit insurance assessments. Other available funding sources, if necessary, are borrowings from the Treasury, the Federal Financing Bank (FFB), Federal Home Loan Banks, and IDIs. The FDIC has borrowing authority of \$100 billion from the Treasury and a Note Purchase Agreement with the FFB, not to exceed \$100 billion, to enhance the DIF's ability to fund both deposit insurance and Temporary Liquidity Guarantee Program (TLGP) obligations.

A statutory formula, known as the Maximum Obligation Limitation (MOL), limits the amount of obligations the DIF can incur to the sum of its cash, 90 percent of the fair market value of other assets, and the amount authorized to be borrowed from the Treasury. The MOL for the DIF was \$114.4 billion and \$106.3 billion as of December 31, 2011 and 2010, respectively.

## OPERATIONS OF RESOLUTION ENTITIES

The FDIC is responsible for managing and disposing of the assets of failed institutions in an orderly and efficient manner. The assets held by receiverships, pass-through conservatorships, and bridge institutions (collectively, resolution entities), and the claims against them, are accounted for separately from DIF assets and liabilities to ensure that proceeds from these entities are distributed in accordance with applicable laws and regulations. Accordingly, income and expenses attributable to resolution entities are accounted for as transactions of those entities. Resolution entities are billed by the FDIC for services provided on their behalf.

## 2. Summary of Significant Accounting Policies

### GENERAL

These financial statements pertain to the financial position, results of operations, and cash flows of the DIF and are presented in conformity with U.S. generally accepted accounting principles (GAAP). As permitted by the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, the FDIC prepares financial statements in conformity with standards promulgated by the Financial Accounting Standards Board (FASB). These statements do not include reporting for assets and liabilities of resolution entities because these entities are legally separate and distinct, and the DIF does not have any ownership interests in them. Periodic and final

accountability reports of resolution entities are furnished to courts, supervisory authorities, and others upon request.

### USE OF ESTIMATES

Management makes estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Where it is reasonably possible that changes in estimates will cause a material change in the financial statements in the near term, the nature and extent of such potential changes in estimates have been disclosed. The more significant estimates include the assessments receivable and associated revenue; the allowance for loss on receivables from resolutions (including shared-loss agreements); liabilities due to resolutions; the estimated losses for anticipated failures, litigation, and representations and warranties; guarantee obligations for the TLGP and structured transactions; the valuation of trust preferred securities; and the postretirement benefit obligation.

### CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid investments consisting primarily of U.S. Treasury Overnight Certificates.

### INVESTMENT IN U.S. TREASURY OBLIGATIONS

DIF funds are required to be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States. The Secretary of the Treasury must approve all such investments in excess of \$100,000 and has granted the FDIC approval to invest DIF funds only in U.S. Treasury obligations that are purchased or sold exclusively through the Bureau of the Public Debt's Government Account Series program.

The DIF's investments in U.S. Treasury obligations are classified as available-for-sale. Securities designated as available-for-sale are shown at fair value. Unrealized gains and losses are reported as other comprehensive income. Realized gains and losses are included in the Statement of

Income and Fund Balance as components of net income. Income on securities is calculated and recorded on a daily basis using the effective interest or straight-line method depending on the maturity of the security.

## REVENUE RECOGNITION FOR ASSESSMENTS

Assessment revenue is recognized for the quarterly period of insurance coverage based on an estimate. The estimate is derived from an institution's risk-based assessment rate and assessment base for the prior quarter adjusted for the current quarter's available assessment credits, certain changes in supervisory examination ratings for larger institutions, and a modest assessment base growth factor. At the subsequent quarter-end, the estimated revenue amounts are adjusted when actual assessments for the covered period are determined for each institution (see Note 9).

## CAPITAL ASSETS AND DEPRECIATION

The FDIC buildings are depreciated on a straight-line basis over a 35- to 50-year estimated life. Leasehold improvements are capitalized and depreciated over the lesser of the remaining life of the lease or the estimated useful life of the improvements, if determined to be material. Capital assets depreciated on a straight-line basis over a five-year estimated useful life include mainframe equipment; furniture, fixtures, and general equipment; and internal-use software. Personal computer equipment is depreciated on a straight-line basis over a three-year estimated useful life.

## REPORTING ON VARIABLE INTEREST ENTITIES

FDIC receiverships engaged in structured transactions, some of which resulted in the issuance of note obligations that were guaranteed by the FDIC in its corporate capacity (see Note 8, Contingent Liabilities for: FDIC Guaranteed Debt of Structured Transactions). As the guarantor of note obligations for several structured transactions, the FDIC in its corporate capacity is the holder of a variable interest in a number of variable interest entities

(VIEs). The FDIC conducts a qualitative assessment of its relationship with each VIE as required by Accounting Standards Codification (ASC) Topic 810, *Consolidation*, modified by Accounting Standards Update (ASU) No. 2009-17, *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*. These assessments are conducted to determine if the FDIC in its corporate capacity has 1) power to direct the activities that most significantly impact the economic performance of the VIE and 2) an obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. When a variable interest holder has met both of these characteristics, the enterprise is considered the primary beneficiary and must consolidate the VIE. In accordance with the provisions of ASC 810, an assessment of the terms of the legal agreement for each VIE was conducted to determine whether any of the terms had been activated or modified in a manner which would cause the FDIC in its corporate capacity to be characterized as a primary beneficiary. In making that determination, consideration was given to which, if any, activities were significant to each VIE. Often, the right to service collateral, to liquidate collateral, or to unilaterally dissolve the limited liability company (LLC) or trust was determined to be the most significant activity. In other cases, it was determined that the structured transactions did not include such significant activities and that the design of the entity was the best indicator of which party was the primary beneficiary. The results of each analysis identified a party other than the FDIC in its corporate capacity as the primary beneficiary.

The conclusion of these analyses was that the FDIC in its corporate capacity has not engaged in any activity that would cause the FDIC in its corporate capacity to be characterized as a primary beneficiary to any VIE with which it was involved at December 31, 2011 and 2010. Therefore, consolidation is not required for the 2011 and 2010 DIF financial statements. In the future, the FDIC in its corporate capacity may become the primary beneficiary upon the activation of provisional contract rights that



extend to the Corporation if payments are made on guarantee claims. Ongoing analyses will be required in order to monitor consolidation implications under ASC 810.

The FDIC's involvement with VIEs, in its corporate capacity, is fully described in Note 8.

## RELATED PARTIES

The nature of related parties and a description of related-party transactions are discussed in Note 1 and disclosed throughout the financial statements and footnotes.

## DISCLOSURE ABOUT RECENT RELEVANT ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements have been deemed to be not applicable or material to the financial statements as presented.

## RECLASSIFICATION

Reclassifications have been made in 2010 financial statements to conform to the presentation used in 2011.

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

As of December 31, 2011 and 2010, investments in U.S. Treasury obligations, net, were \$33.9 billion and \$12.4 billion, respectively. As of December 31, 2011 and 2010, the DIF held \$5.0 billion and \$2.0 billion, respectively, of Treasury Inflation-Protected Securities (TIPS), which are indexed to increases or decreases in the Consumer Price Index for All Urban Consumers (CPI-U).

**Total Investment in U.S. Treasury Obligations, Net at December 31, 2011**

DOLLARS IN THOUSANDS

MATURITY	YIELD AT PURCHASE <sup>a</sup>	FACE VALUE	NET CARRYING AMOUNT	UNREALIZED HOLDING GAINS	UNREALIZED HOLDING LOSSES	FAIR VALUE
<b>U.S. Treasury notes and bonds</b>						
Within 1 year	0.27%	\$24,500,000 <sup>b</sup>	\$24,889,547	\$17,842	\$(93)	\$24,907,296
After 1 year through 5 years	0.93%	3,900,000	3,923,428	38,778	0	3,962,206
<b>U.S. Treasury Inflation-Protected Securities</b>						
Within 1 year	0.51%	1,200,000	1,537,664	659	(8)	1,538,315
After 1 year through 5 years	-0.92%	3,050,000	3,464,909	0	(9,481)	3,455,428
<b>Total</b>		<b>\$32,650,000</b>	<b>\$33,815,548</b>	<b>\$57,279</b>	<b>\$(9,582)<sup>c</sup></b>	<b>\$33,863,245</b>

(a) For TIPS, the yields in the above table are stated at their real yields at purchase, not their effective yields. Effective yields on TIPS include a long-term annual inflation assumption as measured by the CPI-U. The long-term CPI-U consensus forecast is 1.8 percent, based on figures issued by the Congressional Budget Office and *Blue Chip Economic Indicators* in early 2011.

(b) Includes one Treasury note totaling \$1.8 billion which matured on Saturday, December 31, 2011. Settlement occurred on the next business day, January 3, 2012.

(c) All unrealized losses occurred as a result of temporary changes in market interest rates. These unrealized losses occurred over a period of less than a year. Unrealized losses related to the TIPS have converted to unrealized gains by January 31, 2012, and unrealized losses related to the U.S. Treasury notes and bonds existed on just one security that matured with no unrealized loss on January 31, 2012, and thus the FDIC does not consider these securities to be other than temporarily impaired at December 31, 2011.

**Total Investment in U.S. Treasury Obligations, Net at December 31, 2010**

DOLLARS IN THOUSANDS

MATURITY	YIELD AT PURCHASE <sup>a</sup>	FACE VALUE	NET CARRYING AMOUNT	UNREALIZED HOLDING GAINS	UNREALIZED HOLDING LOSSES	FAIR VALUE
<b>U.S. Treasury notes and bonds</b>						
Within 1 year	0.73%	\$3,000,000	\$3,052,503	\$2,048	\$(31)	\$3,054,520
<b>U.S. Treasury Inflation-Protected Securities</b>						
Within 1 year	3.47%	1,375,955	1,375,967	1,391	0	1,377,358
After 1 year through 5 years	2.41%	615,840	621,412	22,381	0	643,793
<b>U.S. Treasury bills</b>						
Within 1 year	0.19%	7,300,000	7,294,688	909	0	7,295,597
<b>Total</b>		<b>\$12,291,795</b>	<b>\$12,344,570</b>	<b>\$26,729</b>	<b>\$(31)<sup>b</sup></b>	<b>\$12,371,268</b>

(a) For TIPS, the yields in the above table are stated at their real yields at purchase, not their effective yields. Effective yields on TIPS include a long-term annual inflation assumption as measured by the CPI-U. The long-term CPI-U consensus forecast is 1.8 percent, based on figures issued by the Congressional Budget Office and *Blue Chip Economic Indicators* in early 2010.

(b) All unrealized losses occurred as a result of temporary changes in market interest rates. The unrealized loss on one security occurred over a period of less than a year and converted to an unrealized gain by January 31, 2011, and thus the FDIC does not consider the security to be other than temporarily impaired at December 31, 2010.

#### 4. Receivables from Resolutions, Net

##### Receivables from Resolutions, Net at December 31

DOLLARS IN THOUSANDS

	2011	2010
Receivables from closed banks	\$121,369,428	\$115,896,763
Allowance for losses	(92,821,032)	(86,364,218)
<b>Total</b>	<b>\$28,548,396</b>	<b>\$29,532,545</b>

The receivables from resolutions include payments made by the DIF to cover obligations to insured depositors (subrogated claims), advances to resolution entities for working capital, and administrative expenses paid on behalf of resolution entities. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. Estimated future payments on losses incurred on assets sold to an acquiring institution under a shared-loss agreement (SLA) are factored into the computation of the expected repayment. Assets held by DIF resolution entities (including structured transaction-related assets; see Note 8) are the main source of repayment of the DIF's receivables from resolutions.

As of December 31, 2011, there were 426 active receiverships, including 92 established in 2011. As of December 31, 2011 and 2010, DIF resolution entities held assets with a book value of \$71.4 billion and \$80.4 billion, respectively (including \$50.5 billion and \$53.4 billion, respectively of cash, investments, receivables due from the DIF, and other receivables). Ninety-nine percent of the current asset book value of \$71.4 billion is held by resolution entities established since 2008.

Estimated cash recoveries from the management and disposition of assets that are used to determine the allowance for losses are based on asset recovery rates from several sources including actual or pending institution-

specific asset disposition data, failed institution-specific asset valuation data, aggregate asset valuation data on several recently failed or troubled institutions, sampled asset valuation data, and empirical asset recovery data based on failures as far back as 1990. Methodologies for determining the asset recovery rates incorporate estimating future cash recoveries, net of applicable liquidation cost estimates, and discounting based on market-based risk factors applicable to a given asset's type and quality. The resulting estimated cash recoveries are then used to derive the allowance for loss on the receivables from these resolutions.

For failed institutions resolved using a whole bank purchase and assumption transaction with an accompanying SLA, the projected future shared-loss payments, recoveries, and monitoring costs on the covered assets sold to the acquiring institution under the agreement are considered in determining the allowance for loss on the receivables from these resolutions. The shared-loss cost projections are based on the covered assets' intrinsic value which is determined using financial models that consider the quality, condition and type of covered assets, current and future market conditions, risk factors and estimated asset holding periods. For year-end 2011 financial reporting, the shared-loss cost estimates were updated for the majority (85% or 235) of the 278 active shared-loss agreements; the remaining 43 were already based on recent loss estimates. The updated shared-loss cost projections for the larger agreements were primarily based on new third-party valuations estimating the cumulative loss of covered assets. The remaining agreements were stratified by receivership age. A random sample of banks within each age stratum was selected for new third-party loss estimations, and valuation results from the sample banks were aggregated and extrapolated to banks within the like age stratum based on asset type and performance status.

Note that estimated asset recoveries are regularly evaluated during the year, but remain subject to uncertainties because of potential changes in economic and market conditions. Continuing economic uncertainties could cause the DIF's actual recoveries to vary significantly from current estimates.

### WHOLE BANK PURCHASE AND ASSUMPTION TRANSACTIONS WITH SHARED-LOSS AGREEMENTS

Since the beginning of 2008, the FDIC resolved 281 failures using whole bank purchase and assumption resolution transactions with accompanying SLAs on assets purchased by the financial institution acquirer. The acquirer typically assumes all of the deposits and purchases essentially all of the assets of a failed institution. The majority of the commercial and residential loan assets are purchased under an SLA, where the FDIC agrees to share in future losses and recoveries experienced by the acquirer on those assets covered under the agreement. SLAs are used by the FDIC to keep assets in the private sector and to minimize disruptions to loan customers.

Losses on the covered assets are shared between the acquirer and the FDIC in its receivership capacity of the failed institution when losses occur through the sale, foreclosure, loan modification, or write-down of loans in accordance with the terms of the SLA. The majority of the agreements cover a five- to 10-year period with the receiver covering 80 percent of the losses incurred by the acquirer and the acquiring bank covering 20 percent. Prior to March 26, 2010, most SLAs included a threshold amount, above which the receiver covered 95 percent of the losses incurred by the acquirer. As mentioned above, the estimated shared-loss liability is accounted for by the receiver and is included in the calculation of the DIF's allowance for loss against the corporate receivable from the resolution. As shared-loss claims are asserted and proven, DIF receiverships satisfy these shared-loss payments using available liquidation funds and/or by drawing on amounts due from the DIF for funding the deposits assumed by the acquirer (see Note 7).

As of December 31, 2011, 249 receiverships have made shared-loss payments totaling \$16.2 billion. In addition, DIF receiverships are estimated to pay an additional amount of \$26.6 billion over the duration of these SLAs on \$135.0 billion in total remaining covered assets.

### CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the DIF to concentrations of credit risk are receivables from resolutions. The repayment of the DIF's receivables from resolutions is primarily influenced by recoveries on assets held by DIF receiverships and payments on the covered assets under SLAs. The majority of the \$155.9 billion in remaining assets in liquidation (\$20.9 billion) and current shared-loss covered assets (\$135.0 billion) are concentrated in commercial loans (\$83.1 billion), residential loans (\$52.5 billion), securities (\$3.4 billion), and structured transaction-related assets as described in Note 8 (\$14.2 billion). Most of the assets in these asset types originated from failed institutions located in California (\$43.7 billion), Florida (\$18.1 billion), Illinois (\$13.2 billion), Puerto Rico (\$13.1 billion), Georgia (\$12.8 billion) and Alabama (\$12.7 billion).

## 5. Trust Preferred Securities

Pursuant to a systemic risk determination, the Treasury, the FDIC, and the Federal Reserve Bank of New York executed terms of a guarantee agreement on January 15, 2009 with Citigroup to provide loss protection on a pool of approximately \$301.0 billion of assets that remained on the balance sheet of Citigroup. In consideration for its portion of the shared-loss guarantee at inception, the FDIC received \$3.025 billion of Citigroup's preferred stock. All shares of the preferred stock were subsequently converted to Citigroup Capital XXXIII trust preferred securities (TruPs) with a liquidation amount of \$1,000 per security and a distribution rate of 8 percent per annum payable quarterly. The principal amount is due in 2039.

On December 23, 2009, Citigroup terminated the guarantee agreement, citing improvements in its financial condition. The FDIC incurred no loss from the guarantee prior to the termination of the agreement. In connection with the early termination of the agreement, the FDIC agreed to reduce its portion of the \$3.025 billion in TruPs by \$800 million. However, pursuant to an agreement between the Treasury and the FDIC, the Treasury agreed to return \$800 million in TruPs on behalf of the FDIC from its portion of Citigroup TruPs holdings received as a result of the shared-loss agreement. The FDIC has retained the \$800 million of Citigroup TruPs as security in the event payments are required to be made by the DIF for guaranteed debt instruments issued by Citigroup and its affiliates under the TLGP (see Note 16). The FDIC will transfer an aggregate liquidation amount of \$800 million in TruPs to the Treasury, plus any related interest, less any payments made or required to be made under the TLGP within five days of the date on which no Citigroup debt remains outstanding under the TLGP. The fair value of these TruPs and related interest are recorded as systemic risk assets (see Note 16).

The remaining \$2.225 billion (liquidation amount) of TruPs held by the FDIC is classified as available-for-sale debt securities in accordance with FASB ASC Topic 320, *Investments – Debt and Equity Securities*. At December 31, 2011, the fair value of the TruPs was \$2.213 billion (see Note 15). An unrealized holding gain of \$251 million is included in accumulated other comprehensive income.

## 6. Property and Equipment, Net

### Property and Equipment, Net at December 31 DOLLARS IN THOUSANDS

	2011	2010
Land	\$37,352	\$37,352
Buildings (including leasehold improvements)	316,129	312,173
Application software (includes work-in- process)	130,718	122,736
Furniture, fixtures, and equipment	159,120	144,661
Accumulated depreciation	(241,404)	(200,857)
<b>Total</b>	<b>\$401,915</b>	<b>\$416,065</b>

The depreciation expense was \$78 million and \$69 million for 2011 and 2010, respectively.

## 7. Liabilities Due to Resolutions

As of December 31, 2011 and 2010, the DIF recorded liabilities totaling \$32.7 billion and \$30.4 billion to resolution entities representing the agreed-upon value of assets transferred from the receiverships, at the time of failure, to the acquirers/bridge institutions for use in funding the deposits assumed by the acquirers/bridge institutions. Ninety-one percent of these liabilities are due to failures resolved under whole-bank purchase and assumption transactions, most with an accompanying SLA. The DIF satisfies these liabilities either by directly sending cash to the receivership to fund shared-loss and other expenses or by offsetting receivables from resolutions when the receivership declares a dividend.

In addition, there was \$80 million in unpaid deposit claims related to multiple receiverships as of December 31, 2011 and 2010. The DIF pays these liabilities when the claims are approved.

## 8. Contingent Liabilities for:

### ANTICIPATED FAILURE OF INSURED INSTITUTIONS

The DIF records a contingent liability and a loss provision for DIF-insured institutions that are likely to fail, absent some favorable event such as obtaining additional capital or merging, when the liability is probable and reasonably estimable. The contingent liability is derived by applying expected failure rates and loss rates to institutions based on supervisory ratings, balance sheet characteristics, and projected capital levels.

The banking industry continued recovering in 2011. The industry recorded total net income of \$119.5 billion for all of 2011, an increase of nearly 40 percent from 2010 net income. The improvement in industry earnings continued to be driven by declining loan loss provisions, with full-year provisions at their lowest level in four years. At the same time, the pace of U.S. economic growth slowed, unemployment remained at historically high levels, and real estate markets exhibited ongoing weaknesses in many parts of the country. These factors have slowed the improvement in asset quality and contributed to keeping the number of problem institutions and failures well above historic norms. Notwithstanding these challenges, the losses to the DIF from failures that occurred in 2011 fell short of the amount reserved at the end of 2010, as the aggregate number and size of institution failures in 2011 were less than anticipated. The removal from the reserve of banks that did fail in 2011, as well as projected favorable trends in bank supervisory downgrade and failure rates and the smaller size of institutions that remain troubled, all contributed to a decline by \$11.2 billion to \$6.5 billion in the contingent liability for anticipated failures of insured institutions at the end of 2011.

In addition to these recorded contingent liabilities, the FDIC has identified risk in the financial services industry that could result in additional losses to the DIF should potentially vulnerable insured institutions ultimately

fail. As a result of these risks, the FDIC believes that it is reasonably possible that the DIF could incur additional estimated losses of up to \$10.2 billion for year-end 2011 as compared to \$24.5 billion for year-end 2010. The actual losses, if any, will largely depend on future economic and market conditions and could differ materially from this estimate.

During 2011, 92 banks failed with combined assets at the date of failure of \$36.6 billion. Supervisory and market data suggest that while the financial performance of the banking industry should continue to improve over the coming year, ongoing asset quality problems and limited opportunities for earnings growth will continue to result in an elevated level of stress for the industry. The FDIC continues to evaluate the ongoing risks to affected institutions in light of the existing economic and financial conditions, and the extent to which such risks will continue to put stress on the resources of the insurance fund.

### LITIGATION LOSSES

The DIF records an estimated loss for unresolved legal cases to the extent that those losses are considered probable and reasonably estimable. During 2011, the contingent liability declined by \$299 million to \$1 million due primarily to a payment of \$276 million for a judgment of one legal case for which an allowance was previously recorded. As of December 31, 2011 and 2010, the FDIC has determined that there are no reasonably possible losses from unresolved cases.

### OTHER CONTINGENCIES

#### *IndyMac Federal Bank Representation and Indemnification Contingent Liability*

On March 19, 2009, the FDIC as receiver of IndyMac Federal Bank (IMFB) and certain subsidiaries (collectively, sellers) sold substantially all of the assets of IMFB and the respective subsidiaries, including mortgage loans and mortgage loan servicing rights, to OneWest Bank and its affiliates. To maximize sale returns, the sellers

made certain representations customarily made by commercial parties regarding the assets and agreed to indemnify the acquirers for losses incurred as a result of breaches of such representations, losses incurred as a result of the failure to obtain contractual counterparty consents to the sale, and third party claims arising from pre-sale acts and omissions of the sellers or the failed bank. Although the representations and indemnifications were made by or are obligations of the sellers, the FDIC, in its corporate capacity, guaranteed the receivership's indemnification obligations under the sale agreements. The representations relate generally to ownership of and right to sell the assets; compliance with applicable law in the origination of the loans; accuracy of the servicing records; validity of loan documents; and servicing of the loans serviced for others. Until the periods for asserting claims under these arrangements have expired and all indemnification claims quantified and paid, losses could continue to be incurred by the receivership and, in turn, the DIF, either directly, as a result of the FDIC corporate guaranty of the receivership's indemnification obligations, or indirectly, as a result of a reduction in the receivership's assets available to pay the DIF's claims as subrogee for insured accountholders. The acquirers' rights to assert claims to recover losses incurred as a result of breaches of loan seller representations extend out to March 19, 2019 for the Fannie Mae and Ginnie Mae reverse mortgage servicing portfolios (unpaid principal balance of \$16.7 billion at December 31, 2011 compared to \$21.7 billion at December 31, 2010), and March 19, 2014 for the Fannie Mae, Freddie Mac and Ginnie Mae mortgage servicing portfolios (unpaid principal balance of \$38.5 billion at December 31, 2011 compared to \$45.3 billion at December 31, 2010). The acquirers' rights to assert claims to recover losses incurred as a result of other third party claims (including due to pre-March 19, 2009 acts or omissions) and breaches of servicer representations, including liability with respect to the Fannie Mae, Ginnie Mae and Freddie Mac portfolios as well as the private mortgage servicing portfolio and whole loans (unpaid

principal balance of \$62.0 billion at December 31, 2011 compared to \$74.2 billion at December 31, 2010) expired on March 19, 2011. As of the expiration date of this claim period, notices relating to potential defects were received, but they require review to determine whether a valid defect exists and, if so, the identification and costing of possible cure actions. It is highly unlikely that all of these potential defects will result in losses.

As of December 31, 2011, the IndyMac receivership has paid \$5 million in approved claims and has accrued an additional \$2 million liability for claims asserted but unpaid. Alleged breaches of origination and servicing representations exist, and review and evaluation is in process for approximately \$275 to \$345 million in reasonably possible liabilities. In addition, potential losses relating to origination and servicing representations, which currently cannot be determined, may be incurred under other agreements with investors.

The FDIC believes it is likely that additional losses will be incurred, however quantifying the contingent liability associated with the representations and the indemnification obligations is subject to a number of uncertainties, including (1) borrower prepayment speeds; (2) the occurrence of borrower defaults and resulting foreclosures and losses; (3) the assertion by third party investors of claims with respect to loans serviced for them; (4) the existence and timing of discovery of breaches and the assertion of claims for indemnification for losses by the acquirer; (5) the compliance by the acquirer with certain loss mitigation and other conditions to indemnification; (6) third party sources of loss recovery (such as title companies and insurers); (7) the ability of the acquirer to refute claims from investors without incurring reimbursable losses; and (8) the cost to cure breaches and respond to third party claims. Because of these and other uncertainties that surround the liability associated with indemnifications and the quantification of possible losses, the FDIC has determined that, while additional losses are probable, the amount is not estimable.

### *Purchase and Assumption Indemnification*

In connection with purchase and assumption agreements for resolutions, the FDIC in its receivership capacity generally indemnifies the purchaser of a failed institution's assets and liabilities in the event a third party asserts a claim against the purchaser unrelated to the explicit assets purchased or liabilities assumed at the time of failure. The FDIC in its corporate capacity is a secondary guarantor if a receivership is unable to pay. These indemnifications generally extend for a term of six years after the date of institution failure. The FDIC is unable to estimate the maximum potential liability for these types of guarantees as the agreements do not specify a maximum amount and any payments are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. During 2011 and 2010, the FDIC in its corporate capacity made no indemnification payments under such agreements, and no amount has been accrued in the accompanying financial statements with respect to these indemnification guarantees.

### *FDIC Guaranteed Debt of Structured Transactions*

The FDIC as receiver uses three types of structured transactions to dispose of certain performing and non-performing residential mortgage loans, commercial loans, construction loans, and mortgage-backed securities held by the receiverships. The three types of structured transactions are 1) limited liability companies (LLCs), 2) securitizations, and 3) structured sale of guaranteed notes (SSGNs).

#### LLCs

Under the LLC structure, the FDIC in its receivership capacity contributes a pool of assets to a newly-formed LLC and offers for sale, through a competitive bid process, some of the equity in the LLC. The day-to-day management of the LLC is transferred to the highest bidder along with the purchased equity interest. In many instances, the FDIC in its corporate capacity guarantees notes issued by the LLCs. In exchange for a guarantee,

the DIF receives a guarantee fee in either 1) a lump-sum, up-front payment based on the estimated duration of the note or 2) a monthly payment based on a fixed percentage multiplied by the outstanding note balance. The terms of these guarantee agreements generally stipulate that all cash flows received from the entity's collateral be used to pay, in the following order, 1) operational expenses of the entity, 2) the FDIC's contractual guarantee fee, 3) the guaranteed notes (or, if applicable, fund the related defeasance account for payoff of the notes at maturity), and 4) the equity investors. If the FDIC is required to perform under these guarantees, it acquires an interest in the cash flows of the LLC equal to the amount of guarantee payments made plus accrued interest thereon. Once all expenses have been paid, the guaranteed notes have been satisfied, and the FDIC has been reimbursed for any guarantee payments, the equity holders receive any remaining cash flows.

Since 2009, private investors purchased a 40- to 50-percent ownership interest in the LLC structures for \$1.6 billion in cash and the LLCs issued notes of \$4.4 billion to the receiverships to partially fund the purchase of the assets. The receiverships hold the remaining 50- to 60-percent equity interest in the LLCs and, in most cases, the guaranteed notes. The FDIC in its corporate capacity guarantees the timely payment of principal and interest due on the notes. The terms of the note guarantees extend until the earlier of 1) payment in full of the notes or 2) two years following the maturity date of the notes. The note with the longest term matures in 2020. In the event of note payment default, the FDIC as guarantor is entitled to exercise or cause the exercise of certain rights and remedies including: 1) accelerating the payment of the unpaid principal amount of the notes; 2) selling the assets held as collateral; or 3) foreclosing on the equity interests of the debtor.



### Securizations and SSGNs

Securizations and SSGNs (collectively, “trusts”) are transactions in which certain assets or securities from failed institutions are pooled and transferred into a trust structure. The trusts issue 1) senior and/or subordinated debt instruments and 2) owner trust or residual certificates collateralized by the underlying mortgage-backed securities or loans.

Since 2010, private investors purchased the senior notes issued by the trusts for \$5.3 billion in cash. The receiverships hold 100 percent of the subordinated debt instruments and owner trust or residual certificates. The FDIC in its corporate capacity guarantees the timely payment of principal and interest due on the senior notes, the latest maturity of which is 2050. In exchange for the guarantee, the DIF receives a monthly payment based on a fixed percentage multiplied by the outstanding note balance. These guarantee agreements generally stipulate that all cash flows received from the entity’s collateral be used to pay, in the following order, 1) operational expenses of the entity, 2) the FDIC’s contractual guarantee fee, 3) interest on the guaranteed notes, 4) principal of the guaranteed notes, and 5) the holders of the subordinated notes and owner trust or residual certificates. If the FDIC is required to perform under its guarantees, it acquires an interest in the cash flows of the trust equal to the amount of guarantee payments made plus accrued interest thereon. Once all expenses have been paid, the guaranteed notes have been satisfied, and the FDIC has been reimbursed for any guarantee payments, the subordinated note holders and owner trust or residual certificates holders receive the remaining cash flows.

### All Structured Transactions with FDIC Guaranteed Debt

Through December 31, 2011, the receiverships have transferred a portfolio of loans with an unpaid principal balance of \$16.4 billion and mortgage-backed securities with a book value of \$7.7 billion to 14 LLCs and 8 trusts. The LLCs and trusts subsequently issued notes guaranteed by the FDIC in an original principal amount

of \$9.7 billion. To date, the DIF has collected guarantee fees totaling \$203 million and recorded a receivable for additional guarantee fees of \$106 million, included in the “Interest receivable on investments and other assets, net” line item on the Balance Sheet. All guarantee fees are recorded as deferred revenue, included in the “Accounts payable and other liabilities” line item, and recognized as revenue primarily on a straight-line basis over the term of the notes. At December 31, 2011, the amount of deferred revenue recorded was \$134 million. The DIF records no other structured-transaction-related assets or liabilities on its balance sheet.

The estimated loss to the DIF from the guarantees is derived from an analysis of the discounted present value of the expected guarantee payments by the FDIC, reimbursements to the FDIC for guarantee payments, and guarantee fee collections. Under both a base case and a more stressful modeling scenario, the cash flows from the LLC or trust assets provide sufficient coverage to fully pay the debts. Therefore, the estimated loss to the DIF from these guarantees is zero. To date, the FDIC in its corporate capacity has not provided, and does not intend to provide, any form of financial or other type of support to a trust or LLC that it was not previously contractually required to provide.

As of December 31, 2011, the maximum loss exposure is \$3.7 billion for LLCs and \$3.9 billion for trusts, representing the sum of all outstanding debt guaranteed by the FDIC in its corporate capacity. Some transactions have established defeasance accounts to pay off the notes at maturity. A total of \$2.2 billion has been deposited into these accounts.

## 9. Assessments

The Dodd-Frank Act, enacted on July 21, 2010, provides for significant assessment and capitalization reforms for the DIF. In response, the FDIC implemented several changes to the assessment system and developed a comprehensive, long-term fund management plan. The

plan is designed to restore and maintain a positive fund balance for the DIF even during a banking crisis and achieve moderate, steady assessment rates throughout any economic cycle. Summarized below are actions taken to implement assessment system changes and provisions of the comprehensive plan.

## NEW RESTORATION PLAN

In October 2010, the FDIC adopted a new Restoration Plan to ensure that the ratio of the DIF fund balance to estimated insured deposits (reserve ratio) reaches 1.35 percent by September 30, 2020. The new Plan provides for the following: 1) the period of the Restoration Plan is extended from the end of 2016 to September 30, 2020; 2) institutions may continue to use assessment credits without additional restriction during the term of the Restoration Plan; 3) the FDIC will pursue rulemaking regarding the method that will be used to offset the effect on small institutions (less than \$10 billion in assets) of requiring that the reserve ratio reach 1.35 percent by September 30, 2020, rather than 1.15 percent by the end of 2016; and 4) at least semiannually, the FDIC will update its loss and income projections for the fund and, if needed, increase or decrease assessment rates, following notice-and-comment rulemaking, if required.

## DESIGNATED RESERVE RATIO

In December 2011, the FDIC adopted a final rule maintaining the designated reserve ratio (DRR) at 2 percent, effective January 1, 2012. The FDIC views the 2 percent DRR as maintaining the DIF at a level that can withstand substantial losses, consistent with the FDIC's comprehensive, long-term fund management plan.

## CALCULATION OF ASSESSMENT

In February 2011, the FDIC adopted a final rule, effective on April 1, 2011, amending part 327 of title 12 of the Code of Federal Regulations to 1) redefine the assessment base used for calculating deposit insurance assessments from adjusted domestic deposits to average

consolidated total assets minus average tangible equity (measured as Tier 1 capital); 2) change the assessment rate adjustments; 3) lower the initial base rate schedule and the total base rate schedule for all IDIs to collect approximately the same revenue for the DIF as would have been collected under the old assessment base; 4) suspend dividends indefinitely, and, in lieu of dividends, adopt lower assessment rate schedules when the reserve ratio reaches 1.15 percent, 2 percent, and 2.5 percent; and 5) change the risk-based assessment system for large IDIs (generally, those institutions with at least \$10 billion in total assets). Specifically, the final rule eliminates risk categories and the use of long-term debt issuer ratings for large institutions and combines CAMELS ratings and certain forward-looking financial measures into two scorecards: one for most large institutions and another for large institutions that are structurally and operationally complex or that pose unique challenges and risks in case of failure (highly complex institutions).

## ASSESSMENT REVENUE

Annual assessment rates averaged approximately 17.6 cents per \$100 and 17.7 cents per \$100 of the assessment base for the first quarter of 2011 and all of 2010, respectively. Beginning in the second quarter of 2011, the assessment base changed to average total consolidated assets less average tangible equity (with certain adjustments for banker's banks and custodial banks), as required by the Dodd-Frank Act. The FDIC implemented a new assessment rate schedule at the same time to conform to the larger assessment base. The annual assessment rate averaged approximately 11.1 cents per \$100 of the assessment base for the last three quarters of 2011.

In December 2009, a majority of IDIs prepaid \$45.7 billion of estimated quarterly risk-based assessments to address the DIF's liquidity need to pay for projected near-term failures and to ensure that the deposit insurance system remained industry-funded. The prepaid assessments cover the insurance period from October 2009 through

December 2012. An institution's quarterly risk-based deposit insurance assessment thereafter is offset by the amount prepaid until the amount is exhausted or until June 30, 2013, when any amount remaining is to be returned to the institution. At December 31, 2011, the remaining prepaid amount of \$17.4 billion is included in the "Unearned revenue - prepaid assessments" line item on the Balance Sheet.

Prepaid assessments were mandatory for all institutions, but the FDIC exercised its discretion as supervisor and insurer to exempt an institution from the prepayment requirement if the FDIC determined that the prepayment would adversely affect the safety and soundness of the institution.

## RESERVE RATIO

As of December 31, 2011, the DIF reserve ratio was 0.17 percent of estimated insured deposits.

## ASSESSMENTS RELATED TO FICO

Assessments continue to be levied on institutions for payments of the interest on obligations issued by the Financing Corporation (FICO). The FICO was established as a mixed-ownership government corporation to function solely as a financing vehicle for the former FSLIC. The annual FICO interest obligation of approximately \$790 million is paid on a pro rata basis using the same rate for banks and thrifts. The FICO assessment has no financial impact on the DIF and is separate from deposit insurance assessments. The FDIC, as administrator of the DIF, acts solely as a collection agent for the FICO. During 2011 and 2010, approximately \$795 million and \$796 million, respectively, was collected and remitted to the FICO.

## 10. Other Revenue

### Other Revenue for the Years Ended December 31 DOLLARS IN THOUSANDS

	2011	2010
Temporary Liquidity Guarantee Program revenue (Note 16)	\$2,569,579	\$0
Dividends and interest on Citigroup trust preferred securities	178,000	177,675
Guarantee fees for structured transactions	92,229	44,557
Other	7,121	15,193
<b>Total</b>	<b>\$2,846,929</b>	<b>\$237,425</b>

## TEMPORARY LIQUIDITY GUARANTEE PROGRAM REVENUE

Pursuant to a systemic risk determination in October 2008, the FDIC established the TLGP (see Note 16). In exchange for guarantees issued under the TLGP, the FDIC received fees that were set aside, as deferred revenue, for potential TLGP losses. As losses occur, the FDIC recognizes the loss as a systemic risk expense and offsets the loss by recognizing an equivalent portion of the deferred revenue as systemic risk revenue. This accounting practice isolates systemic risk activities from the normal operating activities of the DIF.

From inception of the TLGP, it has been FDIC's policy to recognize revenue to the DIF for any deferred revenue not absorbed by losses upon expiration of the TLGP guarantee period (December 31, 2012) or earlier for any portion of guarantee fees determined in excess of amounts needed to cover potential losses. During 2011, the DIF recognized revenue of \$2.6 billion for fees held as deferred revenue (see Note 16). In the unforeseen event a debt default occurs greater than the remaining amount held as deferred revenue, to the extent needed, any amount

previously recognized as revenue to the DIF will be returned to the TLGP.

## 11. Operating Expenses

Operating expenses were \$1.6 billion for both 2011 and 2010. The chart below lists the major components of operating expenses.

<b>Operating Expenses for the Years Ended December 31</b>		
<b>DOLLARS IN THOUSANDS</b>		
	<b>2011</b>	<b>2010</b>
Salaries and benefits	\$1,320,991	\$1,184,523
Outside services	342,502	360,880
Travel	115,135	111,110
Buildings and leased space	93,630	85,137
Software/Hardware maintenance	58,981	50,575
Depreciation of property and equipment	77,720	68,790
Other	46,652	35,142
<b>Subtotal</b>	<b>2,055,611</b>	<b>1,896,157</b>
Services billed to resolution entities	(430,260)	(303,516)
<b>Total</b>	<b>\$1,625,351</b>	<b>\$1,592,641</b>

## 12. Provision for Insurance Losses

Provision for insurance losses was negative \$4.4 billion for 2011, compared to negative \$848 million for 2010. The negative provision for 2011 primarily resulted from a reduction in the contingent loss reserve due to the improvement in the financial condition of institutions that were previously identified to fail and a reduction in the estimated losses for institutions that have failed in prior years. The following chart lists the major components of the provision for insurance losses.

<b>Provision for Insurance Losses for the Years Ended December 31</b>		
<b>DOLLARS IN THOUSANDS</b>		
	<b>2011</b>	<b>2010</b>
<b>Valuation Adjustments</b>		
Closed banks and thrifts	\$6,786,643	\$25,483,252
Other assets	(1,024)	(4,406)
<b>Total Valuation Adjustments</b>	<b>6,785,619</b>	<b>25,478,846</b>
<b>Contingent Liabilities Adjustments</b>		
Anticipated failure of insured institutions	(11,176,248)	(26,326,689)
Litigation	(23,000)	0
<b>Total Contingent Liabilities Adjustments</b>	<b>(11,199,248)</b>	<b>(26,326,689)</b>
<b>Total</b>	<b>\$(4,413,629)</b>	<b>\$(847,843)</b>

## 13. Employee Benefits

### PENSION BENEFITS AND SAVINGS PLANS

Eligible FDIC employees (permanent and term employees with appointments exceeding one year) are covered by the federal government retirement plans, either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Although the DIF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The DIF also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported on and accounted for by the U.S. Office of Personnel Management (OPM).

Eligible FDIC employees also may participate in a FDIC-sponsored tax-deferred 401(k) savings plan with matching contributions up to 5 percent. Under the Federal Thrift Savings Plan (TSP), the FDIC provides FERS employees with an automatic contribution of 1 percent of pay and an additional matching contribution up to 4 percent of pay. CSRS employees also can contribute to the TSP, but they do not receive agency matching contributions.

#### Pension Benefits and Savings Plans Expenses for the Years Ended December 31

DOLLARS IN THOUSANDS

	2011	2010
Civil Service Retirement System	\$6,140	\$6,387
Federal Employees Retirement System (Basic Benefit)	95,846	78,666
FDIC Savings Plan	36,645	30,825
Federal Thrift Savings Plan	33,910	28,679
<b>Total</b>	<b>\$172,541</b>	<b>\$144,557</b>

### POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

The DIF has no postretirement health insurance liability since all eligible retirees are covered by the Federal Employees Health Benefits (FEHB) program. The FEHB is administered and accounted for by the OPM. In addition, OPM pays the employer share of the retiree's health insurance premiums.

The FDIC provides certain life and dental insurance coverage for its eligible retirees, the retirees' beneficiaries, and covered dependents. Retirees eligible for life and dental insurance coverage are those who have qualified due to 1) immediate enrollment upon appointment or five years of participation in the plan and 2) eligibility for an immediate annuity. The life insurance program provides basic coverage at no cost to retirees and allows converting optional coverage to direct-pay plans. For the dental coverage, retirees are responsible for a portion of the dental premium.

The FDIC has elected not to fund the postretirement life and dental benefit liabilities. As a result, the DIF recognized the underfunded status (the difference between the accumulated postretirement benefit obligation and the plan assets at fair value) as a liability. Since there are no plan assets, the plan's benefit liability is equal to the accumulated postretirement benefit obligation. At December 31, 2011 and 2010, the liability was \$188 million and \$166 million, respectively, which is recognized in the "Postretirement benefit liability" line item on the Balance Sheet. The cumulative actuarial losses (changes in assumptions and plan experience) and prior service costs (changes to plan provisions that increase benefits) were \$34 million and \$19 million at December 31, 2011 and 2010, respectively. These amounts are reported as accumulated other comprehensive income in the "Unrealized postretirement benefit loss" line item on the Balance Sheet.

The DIF’s expenses for postretirement benefits for 2011 and 2010 were \$12 million and \$9 million, respectively, which are included in the current and prior year’s operating expenses on the Statement of Income and Fund Balance. The changes in the actuarial losses and prior service costs for 2011 and 2010 of \$15 million and \$16 million, respectively, are reported as other comprehensive income in the “Unrealized postretirement benefit loss” line item. Key actuarial assumptions used in the accounting for the plan include the discount rate of 4.5 percent, the rate of compensation increase of 4.1 percent, and the dental coverage trend rate of 6.0 percent. The discount rate of 4.5 percent is based upon rates of return on high-quality fixed income investments whose cash flows match the timing and amount of expected benefit payments.

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

### COMMITMENTS:

#### *Leased Space*

The FDIC’s lease commitments total \$199 million for future years. The lease agreements contain escalation clauses resulting in adjustments, usually on an annual basis. The DIF recognized leased space expense of \$56 million and \$45 million for the years ended December 31, 2011 and 2010, respectively.

#### Leased Space Commitments DOLLARS IN THOUSANDS

2012	2013	2014	2015	2016	2017/ THEREAFTER
\$52,773	\$44,950	\$32,294	\$25,807	\$22,679	\$20,918

### OFF-BALANCE-SHEET EXPOSURE:

#### *Deposit Insurance*

As of December 31, 2011, estimated insured deposits for the DIF were \$7.0 trillion. This estimate is derived primarily from quarterly financial data submitted by IDIs to the FDIC. This estimate represents the accounting loss that would be realized if all IDIs were to fail and the acquired assets provided no recoveries. Included in this estimate was approximately \$1.4 trillion of noninterest-bearing transaction deposits that exceeded the basic coverage limit of \$250,000 per account, which received coverage under the Dodd-Frank Act beginning on December 31, 2010 to the end of 2012.

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

Financial assets recognized and measured at fair value on a recurring basis at each reporting date include cash

equivalents (Note 2), the investment in U.S. Treasury obligations (Note 3) and trust preferred securities (Note 5). The following tables present the DIP's financial assets measured at fair value as of December 31, 2011 and 2010.

### Assets Measured at Fair Value at December 31, 2011

DOLLARS IN THOUSANDS

Fair Value Measurements Using				
	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	TOTAL ASSETS AT FAIR VALUE
<b>Assets</b>				
Cash equivalents <sup>1</sup>	\$3,266,631			\$3,266,631
<b>Available-for-Sale Debt Securities</b>				
Investment in U.S. Treasury obligations <sup>2</sup>	33,863,245			33,863,245
Trust preferred securities		\$2,213,231		2,213,231
Trust preferred securities held for UST (Note 16)		795,769		795,769
<b>Total Assets</b>	<b>\$37,129,876</b>	<b>\$3,009,000</b>	<b>\$0</b>	<b>\$40,138,876</b>

(1) Cash equivalents are Special U.S. Treasury Certificates with overnight maturities valued at prevailing interest rates established by the U.S. Bureau of Public Debt.

(2) The investment in U.S. Treasury obligations is measured based on prevailing market yields for federal government entities.

In exchange for prior shared-loss guarantee coverage provided to Citigroup, the FDIC and the Treasury received TruPs (see Note 5). At December 31, 2011, the fair value of the securities in the amount of \$3.009 billion was classified as a Level 2 measurement based on an FDIC-developed model using observable market data for traded

Citigroup securities to determine the expected present value of future cash flows. Key inputs include market yields on U.S. dollar interest rate swaps and discount rates for default, call, and liquidity risks that are derived from traded Citigroup securities and modeled pricing relationships.

### Assets Measured at Fair Value at December 31, 2010

DOLLARS IN THOUSANDS

Fair Value Measurements Using				
	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	TOTAL ASSETS AT FAIR VALUE
<b>Assets</b>				
Cash equivalents <sup>1</sup>	\$27,083,918			\$27,083,918
<b>Available-for-Sale Debt Securities</b>				
Investment in U.S. Treasury obligations <sup>2</sup>	12,371,268			12,371,268
Trust preferred securities		\$2,297,818		2,297,818
Trust preferred securities held for UST (Note 16)		826,182		826,182
<b>Total Assets</b>	<b>\$39,455,186</b>	<b>\$3,124,000</b>	<b>\$0</b>	<b>\$42,579,186</b>

(1) Cash equivalents are Special U.S. Treasury Certificates with overnight maturities valued at prevailing interest rates established by the U.S. Bureau of Public Debt.

(2) The investment in U.S. Treasury obligations is measured based on prevailing market yields for federal government entities.



Some of the DIF's financial assets and liabilities are not recognized at fair value but are recorded at amounts that approximate fair value due to their short maturities and/or comparability with current interest rates. Such items include interest receivable on investments, assessments receivable, other short-term receivables, accounts payable, and other liabilities.

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

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

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

There is no readily available market for guarantees associated with systemic risk (see Note 16).

## 16. Systemic Risk Transactions

Pursuant to a systemic risk determination, the FDIC established the TLGP for IDIs, designated affiliates and certain holding companies on October 14, 2008, in an effort to counter the system-wide crisis in the nation's financial sector. The program is codified in part 370 of title 12 of the Code of Federal Regulations.

The FDIC received fees in exchange for guarantees issued under the TLGP and set aside, as deferred revenue, all fees for potential TLGP losses. At inception of the guarantees, the DIF recognized a liability for the non-contingent fair value of the obligation the FDIC assumed over the term of the guarantees. In accordance with FASB ASC 460, *Guarantees*, this non-contingent liability was measured at the amount of consideration received in exchange for issuing the guarantee. As systemic risk expenses are incurred, the DIF will reduce deferred revenue and recognize an offsetting amount as systemic risk revenue. Not later than the end of the guarantee period (December 31, 2012), any deferred revenue not absorbed by losses during the guarantee period will be recognized as revenue to the DIF.

At its inception, the TLGP consisted of two components: 1) the Transaction Account Guarantee Program (TAG) and 2) the Debt Guarantee Program (DGP). The TAG provided unlimited coverage for noninterest-bearing transaction accounts held by IDIs on all deposit amounts exceeding the fully insured limit of \$250,000 through December 31, 2010. During its existence, the FDIC collected TAG fees of \$1.2 billion. Total subrogated claims arising from obligations to depositors with noninterest-bearing transaction accounts were \$8.8 billion, with estimated losses of \$2.2 billion.

The DGP permitted participating entities to issue FDIC-guaranteed senior unsecured debt through October 31, 2009. The FDIC's guarantee for all such debt expires on the earliest of the conversion date for mandatory convertible debt, the stated date of maturity, or December 31, 2012. Through the end of the debt issuance period,

the DIF collected \$8.3 billion of guarantee fees and fees of \$1.2 billion from participating entities that elected to issue senior unsecured non-guaranteed debt. The fees are included in the “Cash and investments - restricted - systemic risk” line item and recognized as “Deferred revenue - systemic risk” on the Balance Sheet.

Additionally, the FDIC holds \$800 million (liquidation amount) of Citigroup TruPs on behalf of the Treasury (and any related interest) as security in the event payments are required to be made by the DIF for guaranteed debt instruments issued by Citigroup or any of its affiliates under the TLGP (see Note 5). At December 31, 2011, the fair value of these securities totaled \$796 million, and was determined using the valuation methodology described in Note 15 for other Citigroup TruPs held by the DIF. There is an offsetting liability in the “Deferred revenue -systemic risk” line item, representing amounts to be transferred to the Treasury or, if necessary, paid for guaranteed debt instruments issued by Citigroup or its affiliates under the TLGP. Consequently, there is no impact on the fund balance of the DIF.

The FDIC’s payment obligation under the DGP is triggered by a payment default. In the event of default, the FDIC will continue to make scheduled principal and interest payments under the terms of the debt instrument through its maturity, or in the case of mandatory convertible debt, through the mandatory conversion date. The debtholder or representative must assign to the FDIC the right to receive any and all distributions on the guaranteed debt from any insolvency proceeding, including the proceeds of any receivership or bankruptcy estate, to the extent of payments made under the guarantee.

Since inception of the program, \$618.0 billion in total guaranteed debt has been issued. Through December 31, 2011, the FDIC has paid \$35 million in claims for principal and/or interest arising from the default of guaranteed debt obligations of six debt issuers. Fifty-nine financial entities (33 IDIs and 26 affiliates and holding companies) had \$167.4 billion in guaranteed

debt outstanding at December 31, 2011. This compares to \$267.1 billion in guaranteed debt outstanding at December 31, 2010. Reported outstanding debt is derived from data submitted by debt issuers.

At December 31, 2011, the DIF recognized a liability of \$117 million for debt guarantee obligations that were paid in early 2012 as scheduled under the terms of the debt instruments. This liability is presented in the “Debt Guarantee Program liabilities – systemic risk” line item. The DIF has also recorded a contingent liability of \$2 million in the “Contingent liability for systemic risk” line item for probable additional guaranteed debt obligations. The FDIC believes that it is also reasonably possible that additional estimated losses of approximately \$93 million could be incurred under the DGP.

The DIF may recognize revenue before the end of the guarantee period for the portion of guarantee fees that was determined to exceed amounts needed to cover potential losses. During 2011, the DIF recognized revenue of \$2.6 billion for a portion of DGP guarantee fees previously held as systemic risk deferred revenue (see Note 10). The \$2.6 billion relates to fees on debt guarantees that have expired. In addition, the DIF transferred an equal amount of “Cash and investments - restricted - systemic risk” to the DIF’s cash and investments. In the unforeseen event a debt default occurs greater than the remaining amount held as deferred revenue, to the extent needed, any amount previously recognized as revenue to the DIF will be returned to the TLGP.

Because of uncertainties surrounding the outlook for the economy and financial markets, there remains a possibility that the TLGP could incur a loss that would absorb some or all of the remaining guarantee fees. Therefore, it is appropriate to continue the practice of deferring revenue recognition for the remaining \$5.7 billion of “Deferred revenue - systemic risk” (which excludes the liability of \$925 million to Treasury for the fair value and related interest of the Citigroup TruPs).

**Systemic Risk Activity at December 31, 2011**

DOLLARS IN THOUSANDS

	CASH AND INVESTMENTS - RESTRICTED - SYSTEMIC RISK <sup>1</sup>	RECEIVABLES AND OTHER ASSETS - SYSTEMIC RISK	DEFERRED REVENUE - SYSTEMIC RISK	DEBT GUARANTEE PROGRAM LIABILITIES - SYSTEMIC RISK	CONTINGENT LIABILITY - SYSTEMIC RISK	REVENUE/ EXPENSES - SYSTEMIC RISK
Balance at 01-01-11	\$6,646,968	\$2,269,422	\$(9,054,541)	\$(29,334)	\$(119,993)	
TAG fees collected	41,419	(50,235)	8,816			
DGP assessments collected	3		(3)			
Receivable for TAG fees						
Receivable for TAG accounts at failed institutions		(424,628)				
Dividends and overnight interest on TruPs held for UST		64,029	(64,029)			
Fair value adjustment on TruPs held for UST		(30,413)	30,413			
Estimated losses for TAG accounts at failed institutions		119,976	(119,976)			\$(119,976)
Realized losses not yet paid			117,027	(87,693)		87,693
Provision for DGP losses			(147,111)		117,777	(117,777)
Guaranteed debt obligations paid	(27,433)		27,433			27,433
Transfer of excess TLGP funds to the DIF	(2,569,579)		2,569,579			
U.S. investment interest collected	66,640		(66,640)			
Interest receivable on U.S. Treasury obligations	55,880		(55,880)			
Amortization of U.S. Treasury obligations	(71,262)		71,262			
Accrued interest purchased	(43,983)		43,983			
Unrealized gain on U.S. Treasury obligations	439		(439)			
TLGP operating expenses			152			(8,514)
Receipts of receivership's dividends	728,227					
<b>Totals</b>	<b>\$4,827,319</b>	<b>\$1,948,151</b>	<b>\$(6,639,954)</b>	<b>\$(117,027)</b>	<b>\$(2,216)</b>	<b>\$(131,141)</b>

(1) As of December 31, 2011, the fair value of investments in U.S. Treasury obligations held by TLGP was \$3.1 billion. An unrealized gain of \$439 thousand is reported in the "Deferred revenue - systemic risk" line item.

## 17. Subsequent Events

Subsequent events have been evaluated through April 11, 2012, the date the financial statements are available to be issued.

### **2012 FAILURES THROUGH APRIL 11, 2012**

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Through April 11, 2012, 16 insured institutions failed in 2012 with total losses to the DIF estimated to be \$1.3 billion.

## FSLIC RESOLUTION FUND (FRF)

Federal Deposit Insurance Corporation		
FSLIC Resolution Fund Balance Sheet at December 31		
DOLLARS IN THOUSANDS		
	2011	2010
<b>Assets</b>		
Cash and cash equivalents	\$3,533,410	\$3,547,907
Receivables from thrift resolutions and other assets, net (Note 3)	65,163	23,408
Receivables from U.S. Treasury for goodwill litigation (Note 4)	356,455	323,495
<b>Total Assets</b>	<b>\$3,955,028</b>	<b>\$3,894,810</b>
<b>Liabilities</b>		
Accounts payable and other liabilities	\$3,544	\$2,990
Contingent liabilities for goodwill litigation (Note 4)	356,455	323,495
<b>Total Liabilities</b>	<b>359,999</b>	<b>326,485</b>
<b>Resolution Equity (Note 5)</b>		
Contributed capital	127,875,656	127,792,696
Accumulated deficit	(124,280,627)	(124,224,371)
<b>Total Resolution Equity</b>	<b>3,595,029</b>	<b>3,568,325</b>
<b>Total Liabilities and Resolution Equity</b>	<b>\$3,955,028</b>	<b>\$3,894,810</b>

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

## FSLIC RESOLUTION FUND (FRF)

## Federal Deposit Insurance Corporation

## FSLIC Resolution Fund Statement of Income and Accumulated Deficit for the Years Ended December 31

DOLLARS IN THOUSANDS

	2011	2010
<b>Revenue</b>		
Interest on U.S. Treasury obligations	\$1,361	\$3,876
Other revenue	3,257	9,393
<b>Total Revenue</b>	<b>4,618</b>	<b>13,269</b>
<b>Expenses and Losses</b>		
Operating expenses	4,660	3,832
Provision for losses	(8,578)	(945)
Goodwill litigation expenses (Note 4)	82,960	(53,266)
Recovery of tax benefits	(18,373)	(63,256)
Other expenses	205	3,070
<b>Total Expenses and Losses</b>	<b>60,874</b>	<b>(110,565)</b>
<b>Net (Loss) Income</b>	<b>(56,256)</b>	<b>123,834</b>
<b>Accumulated Deficit - Beginning</b>	<b>(124,224,371)</b>	<b>(124,348,205)</b>
<b>Accumulated Deficit - Ending</b>	<b>\$(124,280,627)</b>	<b>\$(124,224,371)</b>

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

## FSLIC RESOLUTION FUND (FRF)

<b>Federal Deposit Insurance Corporation</b>		
<b>FSLIC Resolution Fund Statement of Cash Flows for the Years Ended December 31</b>		
<b>DOLLARS IN THOUSANDS</b>		
	2011	2010
<b>Operating Activities</b>		
<b>Net (Loss) Income</b>	<b>\$(56,256)</b>	<b>\$123,834</b>
<b>Adjustments to reconcile net income (loss) to net cash (used) provided by operating activities:</b>		
Provision for losses	(8,578)	(945)
<b>Change in Operating Assets and Liabilities:</b>		
(Increase) Decrease in receivables from thrift resolutions and other assets	(33,177)	9,875
Increase in accounts payable and other liabilities	554	18
Increase (Decrease) in contingent liabilities for goodwill litigation	32,960	(81,917)
<b>Net Cash (Used) Provided by Operating Activities</b>	<b>(64,497)</b>	<b>50,865</b>
<b>Financing Activities</b>		
<b>Provided by:</b>		
U.S. Treasury payments for goodwill litigation (Note 4)	50,000	26,917
<b>Net Cash Provided by Financing Activities</b>	<b>50,000</b>	<b>26,917</b>
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	<b>(14,497)</b>	<b>77,782</b>
<b>Cash and Cash Equivalents - Beginning</b>	<b>3,547,907</b>	<b>3,470,125</b>
<b>Cash and Cash Equivalents - Ending</b>	<b>\$3,533,410</b>	<b>\$3,547,907</b>

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

# NOTES TO THE FINANCIAL STATEMENTS

## FSLIC RESOLUTION FUND

December 31, 2011 and 2010

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

#### LEGISLATIVE HISTORY

The Federal Deposit Insurance Corporation (FDIC) is the independent deposit insurance agency created by Congress in 1933 to maintain stability and public confidence in the nation's banking system. Provisions that govern the operations of the FDIC are generally found in the Federal Deposit Insurance (FDI) Act, as amended (12 U.S.C. 1811, *et seq.*). In carrying out the purposes of the FDI Act, the FDIC, as administrator of the Deposit Insurance Fund (DIF), insures the deposits of banks and savings associations (insured depository institutions). In cooperation with other federal and state agencies, the FDIC promotes the safety and soundness of insured depository institutions by identifying, monitoring and addressing risks to the DIF. Commercial banks, savings banks and savings associations (known as "thrifts") are supervised by either the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve Board. In addition, the FDIC, through administration of the FSLIC Resolution Fund (FRF), is responsible for the sale of remaining assets and satisfaction of liabilities associated with the former Federal Savings and Loan Insurance Corporation (FSLIC) and the former Resolution Trust Corporation (RTC). The DIF and the FRF are maintained separately by the FDIC to support their respective mandates.

The U.S. Congress created the FSLIC through the enactment of the National Housing Act of 1934. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) abolished the insolvent FSLIC, created the FRF, and transferred the assets and liabilities

of the FSLIC to the FRF—except those assets and liabilities transferred to the RTC—effective on August 9, 1989.

Further, the FIRREA established the Resolution Funding Corporation (REFCORP) to provide part of the initial funds used by the RTC for thrift resolutions.

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

#### OPERATIONS/DISSOLUTION OF THE FRF

The FRF will continue operations until all of its assets are sold or otherwise liquidated and all of its liabilities are satisfied. Any funds remaining in the FRF-FSLIC will be paid to the U.S. Treasury. Any remaining funds of the FRF-RTC will be distributed to the REFCORP to pay the interest on the REFCORP bonds. In addition, the FRF-FSLIC has available until expended \$602 million in appropriations to facilitate, if required, efforts to wind up the resolution activity of the FRF-FSLIC.

The FDIC has conducted an extensive review and cataloging of FRF's remaining assets and liabilities. Some of the issues and items that remain open in FRF are 1) criminal restitution orders (generally have from 1 to 12 years remaining to enforce); 2) collections of settlements and judgments obtained against officers and directors and other professionals responsible for



causing or contributing to thrift losses (generally have from 2 months to 7 years remaining to enforce, unless the judgments are renewed, which will result in significantly longer periods for collection for some judgments); 3) a few assistance agreements entered into by the former FSLIC (FRF could continue to receive or refund overpayments of tax benefits sharing through 2014); 4) goodwill litigation (no final date for resolution has been established; see Note 4); and 5) affordable housing program monitoring (requirements can exceed 25 years). The FRF could potentially realize recoveries from tax benefits sharing of up to approximately \$36 million; however, any associated recoveries are not reflected in FRF's financial statements given the significant uncertainties surrounding the ultimate outcome.

## RECEIVERSHIP OPERATIONS

The FDIC is responsible for managing and disposing of the assets of failed institutions in an orderly and efficient manner. The assets held by receivership entities, and the claims against them, are accounted for separately from FRF assets and liabilities to ensure that receivership proceeds are distributed in accordance with applicable laws and regulations. Also, the income and expenses attributable to receiverships are accounted for as transactions of those receiverships. Receiverships are billed by the FDIC for services provided on their behalf.

## 2. Summary of Significant Accounting Policies

### GENERAL

These financial statements pertain to the financial position, results of operations, and cash flows of the FRF and are presented in accordance with U.S. generally accepted accounting principles (GAAP). As permitted by the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, the FDIC prepares financial

statements in conformity with standards promulgated by the Financial Accounting Standards Board (FASB). These statements do not include reporting for assets and liabilities of receivership entities because these entities are legally separate and distinct, and the FRF does not have any ownership interests in them. Periodic and final accountability reports of receivership entities are furnished to courts, supervisory authorities, and others upon request.

### USE OF ESTIMATES

Management makes estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Where it is reasonably possible that changes in estimates will cause a material change in the financial statements in the near term, the nature and extent of such changes in estimates have been disclosed. The more significant estimates include the allowance for losses on receivables from thrift resolutions and the estimated losses for litigation.

### CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid investments consisting primarily of U.S. Treasury Overnight Certificates.

### PROVISION FOR LOSSES

The provision for losses represents the change in the estimation of the allowance for losses related to the receivables from thrift resolutions and other assets.

### RELATED PARTIES

The nature of related parties and a description of related party transactions are discussed in Note 1 and disclosed throughout the financial statements and footnotes.

## DISCLOSURE ABOUT RECENT RELEVANT ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements have been deemed to be not applicable or material to the financial statements as presented.

### 3. Receivables From Thrift Resolutions and Other Assets, Net

#### RECEIVABLES FROM THRIFT RESOLUTIONS

The receivables from thrift resolutions include payments made by the FRF to cover obligations to insured depositors, advances to receiverships for working capital, and administrative expenses paid on behalf of receiverships. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. Assets held by the FDIC in its receivership capacity for the former RTC are a significant source of repayment of the FRF's receivables from thrift resolutions. As of December 31, 2011, five of the 850 FRF receiverships remain active until their goodwill litigation or liability-related impediments are resolved. During 2011, the receivables from closed thrifts and related allowance for losses decreased by \$4.0 billion due to three receiverships that were terminated during the year.

The FRF receiverships held assets with a book value of \$15 million and \$18 million as of December 31, 2011 and 2010, respectively (which primarily consist of cash, investments, and miscellaneous receivables). At December 31, 2011, \$12 million of the \$15 million in assets in the FRF receiverships was cash held for non-FRF, third party creditors.

#### OTHER ASSETS

Other assets include credit enhancement reserves valued at \$14 million and \$17 million as of December 31, 2011 and 2010, respectively. The credit enhancement reserves resulted from swap transactions where the former RTC

received mortgage-backed securities in exchange for single-family mortgage loans. The RTC supplied credit enhancement reserves for the mortgage loans in the form of cash collateral to cover future credit losses over the remaining life of the loans. These cash reserves, which may cover future credit losses through 2020, are valued by estimating credit losses on the underlying loan portfolio and then discounting cash flow projections using market-based rates.

Most of the remaining amount in other assets is a receivable of \$44 million for recoveries from tax benefit sharing as of December 31, 2011. Recoveries from tax benefit sharing represents receipts based on the realization of tax savings from entities that either entered into assistance agreements with the former FSLIC, or have subsequently purchased financial institutions that had prior agreements with the FSLIC. In 2011, the FRF refunded \$26 million in tax benefit sharing recoveries that were received in a prior year.

#### Receivables From Thrift Resolutions and Other Assets, Net at December 31 DOLLARS IN THOUSANDS

	2011	2010
Receivables from closed thrifts	\$1,800,417	\$5,763,949
Allowance for losses	(1,797,154)	(5,762,186)
<b>Receivables from Thrift Resolutions, Net</b>	<b>3,263</b>	<b>1,763</b>
Other assets	61,900	21,645
<b>Total</b>	<b>\$65,163</b>	<b>\$23,408</b>

## 4. Contingent Liabilities for:

### GOODWILL LITIGATION

In *United States v. Winstar Corp.*, 518 U.S. 839 (1996), the Supreme Court held that when it became impossible following the enactment of FIRREA in 1989 for the federal government to perform certain agreements to count goodwill toward regulatory capital, the plaintiffs were entitled to recover damages from the United States.

On July 22, 1998, the Department of Justice's (DOJ's) Office of Legal Counsel (OLC) concluded that the FRF is legally available to satisfy all judgments and settlements in the goodwill litigation involving supervisory action or assistance agreements. OLC determined that nonperformance of these agreements was a contingent liability that was transferred to the FRF on August 9, 1989, upon the dissolution of the FSLIC. On July 23, 1998, the U.S. Treasury determined, based on OLC's opinion, that the FRF is the appropriate source of funds for payments of any such judgments and settlements. The FDIC General Counsel concluded that, as liabilities transferred on August 9, 1989, these contingent liabilities for future nonperformance of prior agreements with respect to supervisory goodwill were transferred to the FRF-FSLIC, which is that portion of the FRF encompassing the obligations of the former FSLIC. The FRF-RTC, which encompasses the obligations of the former RTC and was created upon the termination of the RTC on December 31, 1995, is not available to pay any settlements or judgments arising out of the goodwill litigation.

The FRF can draw from an appropriation provided by Section 110 of the Department of Justice Appropriations Act, 2000 (Public Law 106-113, Appendix A, Title I, 113 Stat. 1501A-3, 1501A-20) such sums as may be necessary for the payment of judgments and compromise settlements in the goodwill litigation. This appropriation is to remain available until expended. Because an appropriation is available to pay such judgments and settlements, any estimated liability for goodwill litigation

should have a corresponding receivable from the U.S. Treasury and therefore have no net impact on the financial condition of the FRF-FSLIC.

For the year ended December 31, 2011, the FRF paid \$50 million as a result of a settlement in one goodwill case compared to \$27 million for four goodwill cases in 2010. The FRF received appropriations from the U.S. Treasury to fund these payments.

As of December 31, 2011, five remaining cases are pending against the United States based on alleged breaches of the agreements stated above. Of the five remaining cases, a contingent liability and an offsetting receivable of \$356 million and \$323 million was recorded for one case as of December 31, 2011 and 2010, respectively. This case is currently before the lower court pending remand following appeal and is still considered active.

The FDIC believes that it is reasonably possible that the FRF could incur additional estimated losses for two of the five remaining cases of up to \$268 million. The plaintiff in one case was awarded \$205 million by the Court of Federal Claims, and this case is currently on appeal. The remaining \$63 million is additional damages contended by the plaintiff to the \$356 million contingent liability for the one case mentioned in the previous paragraph. For the three remaining active cases, the FDIC is unable to estimate a range of loss to the FRF-FSLIC. No awards were given to the plaintiffs in these three cases by the appellate courts. Two cases are currently on appeal, and the other case is fully adjudicated but the Court of Federal Claims is considering awarding litigation costs to the United States.

In addition, the FRF-FSLIC pays the goodwill litigation expenses incurred by the DOJ, the entity that defends these lawsuits against the United States, based on a Memorandum of Understanding (MOU) dated October 2, 1998, between the FDIC and the DOJ. FRF-FSLIC pays in advance the estimated goodwill litigation expenses. Any unused funds are carried over and applied toward the next fiscal year (FY) charges. In 2011, FRF-FSLIC did

not provide any additional funding to the DOJ because the unused funds from FY 2011 were sufficient to cover estimated FY 2012 expenses of \$2.6 million.

### GUARINI LITIGATION

Paralleling the goodwill cases were similar cases alleging that the government breached agreements regarding tax benefits associated with certain FSLIC-assisted acquisitions. These agreements allegedly contained the promise of tax deductions for losses incurred on the sale of certain thrift assets purchased by plaintiffs from the FSLIC, even though the FSLIC provided the plaintiffs with tax-exempt reimbursement. A provision in the Omnibus Budget Reconciliation Act of 1993 (popularly referred to as the “Guarini legislation”) eliminated the tax deductions for these losses.

All eight of the original Guarini cases have been settled. However, a case settled in 2006 further obligates the FRF-FSLIC as a guarantor for all tax liabilities in the event the settlement amount is determined by tax authorities to be taxable. The maximum potential exposure under this guarantee is approximately \$81 million. However, the FDIC believes that it is very unlikely the settlement will be subject to taxation. More definitive information may be available during 2012, after the Internal Revenue Service (IRS) completes its Large Case Program audit on the affected entity’s 2006 returns; this audit remains ongoing. As of December 31, 2011, no liability has been recorded. The FRF does not expect to fund any payment under this guarantee.

### REPRESENTATIONS AND WARRANTIES

As part of the RTC’s efforts to maximize the return from the sale of assets from thrift resolutions, representations and warranties, and guarantees were offered on certain loan sales. The majority of loans subject to these agreements have been paid off, refinanced, or the period for filing claims has expired. The FDIC’s estimate of maximum potential exposure to the FRF is zero. No claims in connection with representations and warranties

have been asserted since 1998 on the remaining open agreements. Because of the age of the remaining portfolio and lack of claim activity, the FDIC does not expect new claims to be asserted in the future. Consequently, the financial statements at December 31, 2011 and 2010, do not include a liability for these agreements.

## 5. Resolution Equity

As stated in the Legislative History section of Note 1, the FRF is comprised of two distinct pools: the FRF-FSLIC and the FRF-RTC. The FRF-FSLIC consists of the assets and liabilities of the former FSLIC. The FRF-RTC consists of the assets and liabilities of the former RTC. Pursuant to legal restrictions, the two pools are maintained separately and the assets of one pool are not available to satisfy obligations of the other.

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

<b>Resolution Equity at December 31, 2011</b>			
<b>DOLLARS IN THOUSANDS</b>			
	<b>FRF-FSLIC</b>	<b>FRF-RTC</b>	<b>FRF CONSOLIDATED</b>
Contributed capital - beginning	\$46,043,359	\$81,749,337	\$127,792,696
Add: U.S. Treasury payments/receivable for goodwill litigation	82,960	0	82,960
<b>Contributed capital - ending</b>	<b>46,126,319</b>	<b>81,749,337</b>	<b>127,875,656</b>
Accumulated deficit	(42,702,916)	(81,577,711)	(124,280,627)
<b>Total</b>	<b>\$3,423,403</b>	<b>\$171,626</b>	<b>\$3,595,029</b>

## CONTRIBUTED CAPITAL

The FRF-FSLIC and the former RTC received \$43.5 billion and \$60.1 billion from the U.S. Treasury, respectively, to fund losses from thrift resolutions prior to July 1, 1995. Additionally, the FRF-FSLIC issued \$670 million in capital certificates to the Financing Corporation (a mixed-ownership government corporation established to function solely as a financing vehicle for the FSLIC) and the RTC issued \$31.3 billion of these instruments to the REFCORP. FIRREA prohibited the payment of dividends on any of these capital certificates.

Through December 31, 2011, the FRF-RTC has returned \$4.6 billion to the U.S. Treasury and made payments of \$5.0 billion to the REFCORP. These actions serve to reduce contributed capital. The most recent payment to the REFCORP was in January of 2008 for \$225 million.

FRF-FSLIC received \$50 million in U.S. Treasury payments for goodwill litigation in 2011. Furthermore, \$356 million and \$323 million were accrued for as receivables at year-end 2011 and 2010, respectively. The effect of this activity was an increase in contributed capital of \$83 million in 2011.

## ACCUMULATED DEFICIT

The accumulated deficit represents the cumulative excess of expenses and losses over revenue for activity related to the FRF-FSLIC and the FRF-RTC. Approximately \$29.8 billion and \$87.9 billion were brought forward from the former FSLIC and the former RTC on August 9, 1989, and January 1, 1996, respectively. The FRF-FSLIC accumulated deficit has increased by \$12.9 billion, whereas the FRF-RTC accumulated deficit has decreased by \$6.3 billion, since their dissolution dates.

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

The financial assets recognized and measured at fair value on a recurring basis at each reporting date are cash equivalents and credit enhancement reserves.

The following table presents the FRF's financial assets measured at fair value as of December 31, 2011 and 2010.

### Assets Measured at Fair Value at December 31, 2011

DOLLARS IN THOUSANDS

Fair Value Measurements Using				
	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	TOTAL ASSETS AT FAIR VALUE
<b>Assets</b>				
Cash equivalents <sup>1</sup>	\$3,377,203			\$3,377,203
Credit enhancement reserves <sup>2</sup>		\$14,431		14,431
<b>Total Assets</b>	<b>\$3,377,203</b>	<b>\$14,431</b>	<b>\$0</b>	<b>\$3,391,634</b>

(1) Cash equivalents are Special U.S. Treasury Certificates with overnight maturities valued at prevailing interest rates established by the U.S. Bureau of Public Debt. Cash equivalents are included in the "Cash and cash equivalents" line item.

(2) Credit enhancement reserves are valued by performing projected cash flow analyses using market-based assumptions (see Note 3).

**Assets Measured at Fair Value at December 31, 2010**

DOLLARS IN THOUSANDS

Fair Value Measurements Using				
	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	TOTAL ASSETS AT FAIR VALUE
<b>Assets</b>				
Cash equivalents <sup>1</sup>	\$3,397,440			\$3,397,440
Credit enhancement reserves <sup>2</sup>		\$17,378		17,378
<b>Total Assets</b>	<b>\$3,397,440</b>	<b>\$17,378</b>	<b>\$0</b>	<b>\$3,414,818</b>

(1) Cash equivalents are Special U.S. Treasury Certificates with overnight maturities valued at prevailing interest rates established by the U.S. Bureau of Public Debt. Cash equivalents are included in the "Cash and cash equivalents" line item.

(2) Credit enhancement reserves are valued by performing projected cash flow analyses using market-based assumptions (see Note 3).

Some of the FRF's financial assets and liabilities are not recognized at fair value but are recorded at amounts that approximate fair value due to their short maturities and/or comparability with current interest rates. Such items include other short-term receivables and accounts payable and other liabilities.

The net receivable from thrift resolutions is influenced by the underlying valuation of receivership assets. This

corporate receivable is unique and the estimate presented is not necessarily indicative of the amount that could be realized in a sale to the private sector. Such a sale would require indeterminate, but substantial, discounts for an interested party to profit from these assets because of credit and other risks. Consequently, it is not practicable to estimate its fair value.

## GOVERNMENT ACCOUNTABILITY OFFICE'S AUDIT OPINION



United States Government Accountability Office  
Washington, D.C. 20548

To the Board of Directors  
The Federal Deposit Insurance Corporation

In accordance with section 17 of the Federal Deposit Insurance Act, as amended, and the Government Corporation Control Act, we are responsible for conducting audits of the financial statements of the funds administered by the Federal Deposit Insurance Corporation (FDIC). In our audits of the Deposit Insurance Fund's (DIF) and the FSLIC Resolution Fund's (FRF) financial statements<sup>1</sup> for 2011 and 2010, we found

- the financial statements as of and for the years ended December 31, 2011, and 2010, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- although certain internal controls should be improved, FDIC maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011; and
- no reportable noncompliance with provisions of laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions; (2) our audit objectives, scope, and methodology; and (3) agency comments.

## Opinion on the DIF's Financial Statements

The financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the DIF's assets, liabilities, and fund balance as of December 31, 2011, and 2010, and its income and fund balance and its cash flows for the years then ended.

As discussed in note 8 to the DIF's financial statements, the banking industry continued to recover in 2011 from the effects of the financial crisis and the recession of 2007-09. During 2011, 92 insured banks with combined assets of \$36.6 billion failed. However, the losses to the DIF from failures that occurred in 2011 fell short of the amount reserved at the

<sup>1</sup> A third fund managed by FDIC, the Orderly Liquidation Fund, established by section 210 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1506 (July 21, 2010), is unfunded and did not have any transactions during 2010 and 2011.

## GOVERNMENT ACCOUNTABILITY OFFICE'S AUDIT OPINION (continued)

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end of 2010, as the aggregate number and size of institution failures in 2011—and their estimated cost to the DIF—were less than anticipated. The DIF's contingent liability for anticipated failures declined from \$17.7 billion at December 31, 2010, to \$6.5 billion at December 31, 2011. As discussed in note 17 to the DIF's financial statements, through April 11, 2012, 16 institutions have failed during 2012.

As of December 31, 2011, the DIF had a fund balance of \$11.8 billion, and its ratio of reserves to estimated insured deposits was 0.17 percent. In contrast, at December 31, 2010, the DIF had a negative fund balance of \$7.4 billion, and its ratio of reserves to estimated insured deposits was a negative 0.12 percent. The improvement was primarily attributable to assessment revenue earned in 2011, lower losses from bank failures in 2011 than projected at December 31, 2010, and a reduction in estimated losses from anticipated failures at December 31, 2011.

During 2011, FDIC continued its implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act,<sup>2</sup> which included significant provisions related to the capitalization of the DIF. The act set a statutory minimum designated reserve ratio for the DIF of not less than 1.35 percent of estimated insured deposits and requires that FDIC take such steps as may be necessary to achieve this reserve ratio by September 30, 2020. FDIC adopted a new DIF restoration plan in October 2010 in response to the act's requirements. As discussed in note 9 to the DIF's financial statements, in December 2011, the FDIC adopted a final rule to maintain the DIF's designated reserve ratio at 2 percent, based on its view that this level would enable it to withstand substantial losses consistent with FDIC's comprehensive long-term management plan. In addition, the act provides for a permanent increase in the standard deposit insurance coverage amount from \$100,000 to \$250,000 (retroactive to January 1, 2008), and unlimited deposit insurance coverage for non-interest-bearing transaction accounts through the end of 2012. The act also authorizes FDIC to undertake enforcement actions against depository institution holding companies if their conduct, or threatened conduct, poses a risk of loss to the DIF.

The DIF also continues to face some exposure as a result of actions taken pursuant to the systemic risk determination made in 2008. As discussed in note 16 to DIF's financial statements, pursuant to this systemic risk

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<sup>2</sup> Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).



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determination, FDIC established the Temporary Liquidity Guarantee Program (TLGP) in 2008. The only component of the TLGP remaining is the Debt Guarantee Program, under which FDIC guaranteed newly issued senior unsecured debt up to prescribed limits issued by insured institutions and certain holding companies. FDIC charged fees to participants that are to be used to cover any losses under the Debt Guarantee Program. The guarantees covered each participating debt to the earliest of the related date of maturity, or December 31, 2012. As of December 31, 2011, the amount of debt guaranteed by FDIC under the Debt Guarantee Program was \$167.4 billion.

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### Opinion on the FRF's Financial Statements

The financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the FRF's assets, liabilities, and resolution equity as of December 31, 2011, and 2010, and its income and accumulated deficit and its cash flows for the years then ended.

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### Opinion on Internal Control

Although certain internal controls associated with the DIF's financial reporting should be improved, FDIC maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011. FDIC's internal control provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the DIF financial statements and the FRF financial statements would be prevented or detected and corrected on a timely basis. Our opinion is based on criteria established under 31 U.S.C. §3512 (c), (d), commonly known as the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

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### Significant Deficiency

During our 2011 audit, we identified deficiencies in controls over FDIC's process for deriving and reporting estimates of losses to the DIF from resolution transactions involving shared loss agreements. These deficiencies resulted in errors in the draft 2011 DIF financial statements that FDIC did not detect and that necessitated FDIC adjustments in finalizing the financial statements. While these deficiencies, individually and collectively, do not constitute a material weakness in internal control

GOVERNMENT ACCOUNTABILITY OFFICE'S AUDIT OPINION (continued)

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over financial reporting,<sup>3</sup> they nevertheless increase the risk of additional undetected errors or irregularities in the DIF's financial statements. Consequently, we believe they collectively represent a significant deficiency in FDIC's internal control over financial reporting for the DIF.<sup>4</sup>

Since 2009, FDIC has used purchase and assumption agreements with accompanying shared loss agreements as the primary means of resolving failed financial institutions. Under such agreements, FDIC sells a failed institution to an acquirer with an agreement that FDIC, through the DIF, will share in any losses the acquirer experiences in servicing and disposing of assets purchased and covered under the shared loss agreement. Typically, these shared loss agreements are structured such that FDIC assumes 80 percent of any such losses.

For financial reporting purposes, FDIC developed a process to calculate an estimate of losses under these shared loss agreements. The estimate was \$42.8 billion (46 percent) of the total DIF allowance for losses related to the Receivables from resolutions, net line item on the DIF's balance sheet at December 31, 2011. As an integral part of this shared loss estimation process, FDIC developed a series of computerized programs that are commonly referred to as the shared loss model.

As part of our audit, we reviewed the process by which FDIC derived its estimates of losses to the DIF from shared loss agreements. We identified deficiencies in internal control over this process that allowed significant errors in the shared loss estimate to occur and not be detected or corrected. During prior financial audits, we identified and reported on control deficiencies in FDIC's process for estimating losses from shared

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<sup>3</sup> A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis.

<sup>4</sup> A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

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loss agreements.<sup>5</sup> Although FDIC has taken steps intended to address the deficiencies that we previously identified, the controls put in place were not sufficient to prevent, detect, and correct errors in the shared loss model. During our 2011 audit, the following three control deficiencies were identified that adversely affected FDIC's shared loss estimation process:

1. FDIC lacked effective controls over testing and verifying the shared loss model. FDIC's tests were not designed to consistently verify that the model's logic and test results were consistent with the objectives of the model. Further, the tests did not evaluate all portions of the model's loss calculation. As a result, FDIC's tests did not detect three separate programming errors in the model, such as double counting of some losses that led to errors in the shared loss estimate in the draft DIF financial statements. The lack of effective controls resulted in undetected gross errors in the draft DIF financial statements' overall allowance for losses of \$578 million and a \$184 million net reduction in the loss estimate. FDIC subsequently corrected this error in finalizing the DIF's 2011 financial statements.
2. FDIC lacked effective controls over the integrity of source data used by the shared loss model in deriving the shared loss estimates. FDIC's controls did not fully provide reasonable assurance that the source data used by the model were accurate. FDIC recognized that the model depended on accurate source data. However, in testing the model, FDIC did not develop steps to verify either the model's input or results with original source documents. As a result, we identified errors, not only in the source data but also in the model itself that FDIC's testing had not previously identified. This control deficiency resulted in undetected gross errors in the draft DIF financial statements' overall allowance for losses of \$191 million and a \$90 million net reduction in the loss estimate. FDIC subsequently corrected this error in finalizing the DIF's 2011 financial statements.
3. FDIC lacked effective documentation for key aspects of its shared loss estimation process that hindered an adequate review of both the

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<sup>5</sup> GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2009 and 2008 Financial Statements*, GAO-10-705 (Washington, D.C.: June 25, 2010); *Management Report: Opportunities for Improvements in FDIC's Internal Controls and Accounting Procedures*, GAO-11-23R (Washington, D.C.: Nov. 30, 2010); and *Management Report: Opportunities for Improvements in FDIC's Internal Controls and Accounting Procedures*, GAO-11-687R (Washington, D.C.: Aug. 5, 2011).

**GOVERNMENT ACCOUNTABILITY OFFICE'S AUDIT OPINION** (continued)

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process and the shared loss model and, ultimately, the loss estimates derived from the model. As a result, FDIC's multiple reviews and approvals did not identify programming errors that existed within the model. We reported in 2009 and again in 2010 that FDIC did not have clear and comprehensive documentation over this process to allow for such a review.<sup>6</sup> FDIC attempted to address this continuing issue by strengthening its internal controls over the entire shared loss estimation process in 2011 through documenting flow charts, data dictionaries, and high-level descriptions of the process. However, FDIC did not adequately document how the model should perform calculations or how the calculations link to its estimation methodology. As a result, FDIC's review of the model was not fully effective at identifying errors.

As a direct result of these deficiencies in internal control over the shared loss model, FDIC did not detect errors in the calculation of the shared loss estimate in preparing the draft 2011 DIF financial statements. Given the significance of this process and its impact on the DIF's financial statements, it is critical that FDIC design and implement effective controls and ensure that all steps in the shared loss model are fully documented to allow for appropriate review of key steps in the process. We will be making recommendations to FDIC to address the issues that make up this significant deficiency in a separate report.

We identified other less significant matters concerning FDIC's internal control that we will report separately, along with recommended corrective actions for these matters.

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**Compliance with Laws and Regulations**

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

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<sup>6</sup> GAO-10-705, GAO-11-23R, and GAO-11-687R.

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## Objectives, Scope, and Methodology

FDIC management is responsible for (1) preparing the annual financial statements in conformity with U.S. generally accepted accounting principles, (2) establishing and maintaining effective internal control over financial reporting and evaluating its effectiveness, and (3) complying with applicable laws and regulations. Management evaluated the effectiveness of FDIC's internal control over financial reporting as of December 31, 2011, based on criteria established under FMFIA. FDIC management provided an assertion concerning the effectiveness of its internal control over financial reporting (see app. I).

We are responsible for planning and performing the audit to obtain reasonable assurance and provide our opinion about whether (1) the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, and (2) FDIC management maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011. We are also responsible for testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by FDIC management;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of FDIC and its operations, including its internal control over financial reporting;
- considered FDIC's process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA;
- assessed the risk that a material misstatement exists in the financial statements and the risk that a material weakness exists in internal control over financial reporting;

## GOVERNMENT ACCOUNTABILITY OFFICE'S AUDIT OPINION (continued)

- 
- tested relevant internal control over financial reporting;
  - evaluated the design and operating effectiveness of internal control over financial reporting based on the assessed risk;
  - tested compliance with certain laws and regulations, including selected provisions of the Federal Deposit Insurance Act, as amended; and
  - performed such other procedures as we considered necessary in the circumstances.

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition and (2) transactions are executed in accordance with laws and regulations that could have a direct and material effect on the financial statements.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting. Because of inherent limitations in internal control, internal control may not prevent or detect and correct misstatements caused by error or fraud, losses, or noncompliance. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

We did not test compliance with all laws and regulations applicable to FDIC. We limited our tests of compliance to those laws and regulations that have a direct and material effect on the financial statements for the year ended December 31, 2011. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our audits in accordance with U.S. generally accepted government auditing standards. We believe our audits provide a reasonable basis for our opinions and other conclusions.

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## FDIC Comments

In commenting on a draft of this report, the FDIC's Chief Financial Officer (CFO) noted that the agency was pleased to receive unqualified opinions on the DIF and FRF financial statements and that we reported that it had effective internal control over financial reporting and compliance with laws and regulations for each fund.

FDIC's CFO also stated that during the audit year, FDIC management and staff continued to take steps to strengthen and improve controls over the shared loss estimation process and will continue to focus on this area in the coming audit year. The CFO added that FDIC recognizes the important role a strong internal control program plays in an agency achieving its mission, and that FDIC's dedication to sound financial management has been and will remain a top priority.



Steven J. Sebastian  
Managing Director  
Financial Management and Assurance

April 11, 2012

## APPENDIX I

## MANAGEMENT'S RESPONSE



Federal Deposit Insurance Corporation  
550 17th Street NW, Washington, D.C. 20429-9990

Deputy to the Chairman and CFO

April 11, 2012

Mr. Steven J. Sebastian  
Director, Financial Management and Assurance  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

**Re: FDIC Management Response on the GAO 2011 Financial Statements Audit Report**

Dear Mr. Sebastian:

Thank you for the opportunity to review and comment on the U.S. Government Accountability Office's (GAO's) draft report titled, **Financial Audit: Federal Deposit Insurance Corporation Funds' 2011 and 2010 Financial Statements, GAO-12-416**. We are pleased that the Federal Deposit Insurance Corporation (FDIC) received an unqualified opinion for the twentieth consecutive year on the financial statements of its funds: the Deposit Insurance Fund (DIF) and the FSLIC Resolution Fund (FRF). Also, GAO reported that the FDIC had effective internal control over financial reporting and compliance with laws and regulations for each fund, and there was no reportable noncompliance with the laws and regulations that were tested. GAO did report a significant control deficiency in FDIC's process for deriving and reporting estimates of losses to the DIF from resolution transactions involving shared loss agreements.

During the audit year, the FDIC management and staff continued to take steps to strengthen and improve controls over the shared loss estimation process and will continue to focus on this area in the coming audit year. FDIC recognizes the important role a strong internal control program plays in an agency achieving its mission. Our dedication to sound financial management has been and will remain a top priority.

In complying with audit standards that require management to provide a written assertion about the effectiveness of its internal control over financial reporting, the FDIC has prepared **Management's Report on Internal Control over Financial Reporting** (see attachment). The report acknowledges management's responsibility for establishing and maintaining internal control over financial reporting and provides the FDIC's conclusion regarding the effectiveness of its internal control.

We want to thank the GAO staff for their professionalism and dedication during the audit and look forward to a productive and successful relationship during the 2012 audit. If you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script that reads "Steven O. App".

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



**MANAGEMENT'S RESPONSE** (continued)**Management's Report on Internal Control over Financial Reporting**

The Federal Deposit Insurance Corporation's (FDIC's) internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in conformity with U.S. generally accepted accounting principles (GAAP), and compliance with applicable laws and regulations. The objective of the FDIC's internal control over financial reporting is to reasonably assure that (1) transactions are properly recorded, processed and summarized to permit the preparation of financial statements in accordance with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with the laws and regulations that could have a direct and material effect on the financial statements.

Management is responsible for establishing and maintaining effective internal control over financial reporting. Management assessed the effectiveness of the FDIC's internal control over financial reporting as of December 31, 2011 through its corporate risk management program that seeks to comply with the spirit of the following standards, among others: Federal Managers' Financial Integrity Act of 1982 (FMFIA); Chief Financial Officers Act (CFO Act); Government Performance and Results Act (GPRA); Federal Information Security Management Act (FISMA); and OMB Circular A-123. In addition, other standards that the FDIC considers are the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control – Integrated Framework* and the U.S. Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government*.

Based on the above assessment, management concluded that, as of December 31, 2011, FDIC's internal control over financial reporting is effective based upon the criteria established in FMFIA.

Federal Deposit Insurance Corporation  
April 11, 2012

## OVERVIEW OF THE INDUSTRY

The 7,357 FDIC-insured commercial banks and savings institutions that filed financial results at year-end 2011 reported net income of \$119.5 billion for the year, an increase of \$34.0 billion compared with full year 2010. This is the highest annual earnings total since 2006, when insured institutions reported \$145.2 billion in net income. The year-over-year improvement was made possible by large reductions in provisions for loan and lease losses, reflecting an improving trend in credit quality. The improvement in earnings was fairly widespread; more than two out of every three insured institutions – 66.9 percent – reported higher net income than in 2010. Fewer than one in seven institutions – 15.5 percent – reported a net loss for the year, the lowest proportion since 2007. Reduced loss provisioning expenses made up for a year-over-year decline in the industry’s revenues. Net operating revenue (the sum of net interest income and total noninterest income) was \$12.8 billion lower than in 2010.

The average return on assets (ROA) rose to 0.88 percent from 0.65 percent a year earlier. This is the highest full year ROA for the industry since 2006. More than 59 percent of insured institutions had higher ROAs in 2011 than in 2010. Insured institutions set aside \$76.9 billion in provisions for loan and lease losses during 2011, a reduction of \$81.1 billion (51.3 percent) compared to 2010. The industry’s total noninterest income declined by \$5.3 billion (2.3 percent), as income from asset servicing fell by \$8.0 billion (48.6 percent), gains on loan sales dropped by \$4.8 billion (43.0 percent), and income from service charges on deposit accounts declined by \$2.2 billion (5.9 percent). These declines were partially offset by a \$2.2 billion (9.5 percent) increase in trading income. Net interest income was \$7.5 billion (1.7 percent) lower than in 2010. Total noninterest expenses were \$19.8 billion (5.1 percent) higher.

A problematic interest-rate environment characterized by historically low short-term interest rates contributed to a decline in the industry’s net interest margin. The average margin fell from 3.76 percent in 2010 to 3.60 percent in 2011. Narrower spreads between the yields on interest-earning assets and the costs of funding those assets combined with weak growth in earning assets to produce the year-over-year decline in net interest income. The greatest margin declines occurred at the largest banks, where much of the growth in interest-earning assets consisted of low-yield investments, such as balances with Federal Reserve banks.

An improving trend in asset quality indicators that began in the second half of 2010 continued through the end of 2011. For the twelve months ended December 31, total noncurrent loans and leases – those that were 90 days or more past due or in nonaccrual status – fell by \$53.5 billion (14.9 percent). All major loan categories registered improvements, with loans secured by real estate properties accounting for more than two-thirds (68 percent) of the total decline in noncurrent loan balances. Noncurrent real estate construction and development loans declined by \$19.3 billion, while balances of loans to commercial and industrial (C&I) borrowers that were noncurrent fell by \$11.7 billion. Noncurrent real estate loans secured by nonfarm nonresidential properties declined by \$6.1 billion, and noncurrent residential mortgage balances dropped by \$5.6 billion. Net charge-offs of loans and leases (NCOs) totaled \$113.0 billion in 2011, a \$74.7 billion decline from 2010. This is the fourth consecutive year that industry charge-offs exceeded \$100 billion. Credit card loan NCOs had the largest year-over-year decline, falling by \$27.9 billion. NCOs of real estate construction loans were \$11.8 billion lower, C&I NCOs were down by \$9.8 billion, and residential mortgage NCOs fell by \$8.3 billion. At the end of 2011, there were 813 institutions on the FDIC’s “Problem List,” down from 884 “problem” institutions at the beginning of the year.

Asset growth picked up in 2011, funded by strong deposit inflows. During the 12 months ended December 31, total assets of insured institutions increased by \$564.4 billion (4.2 percent). Cash and balances due from depository institutions (including balances with Federal Reserve banks) accounted for \$298.4 billion (52.9 percent) of the growth in assets. Securities portfolios rose by \$182.6 billion (6.8 percent). Net loans and leases increased by \$130.8 billion, as C&I loan balances rose by \$160.9 billion (13.6 percent). Balances fell in most other major loan categories in 2011. The largest declines occurred in real estate construction and development loans, where balances fell by \$81.4 billion (25.3 percent), and in home equity lines of credit, which declined by \$33.5 billion (5.3 percent). Banks reduced their reserves for loan losses by \$40.5 billion (17.5 percent) during 2011, while increasing their equity capital by \$68.0 billion (4.6 percent).

Growth in deposits outpaced the increase in total assets in 2011. Deposits in domestic offices of insured institutions increased by \$881.9 billion (11.2 percent), while deposits in foreign offices fell by \$121.4 billion (7.8 percent). A large portion of the increase in domestic deposits occurred in noninterest-bearing transaction accounts with balances greater than \$250,000 that are fully insured until the end of 2012. Balances in these accounts increased by \$569.1 billion (56 percent) during the year. Nondeposit liabilities fell by \$255.6 billion (10.7 percent), as banks reduced their Federal Home Loan Bank advances by \$59.1 billion (15.3 percent), Fed funds purchased declined by \$72.5 billion (60.9 percent), securities sold under repurchase agreements dropped by \$30.3 billion (6.6 percent), and other secured borrowings fell by \$76.4 billion (19.6 percent).