IV. Financial Statements and Notes

Deposit Insurance Fund

Deposit Insurance Fund *(combined BIF and SAIF for 2005 – Note 2)*

Federal Deposit Insurance Corporation

Deposit Insurance Fund Balance Sheet at December 31

Dollars in Thousands

	2006	2005
Assets		
Cash and cash equivalents	$ 2,953,995	$ 3,209,444
Cash and other assets: *Restricted for SAIF-member exit fees (Note 8)*		
(Includes cash and cash equivalents of $20.9 million at December 31, 2005)	0	341,656
Investment in U.S. Treasury obligations, net: (Note 3)		
Held-to-maturity securities	37,184,214	34,253,237
Available-for-sale securities	8,958,566	9,987,223
Interest receivable on investments and other assets, net	747,715	737,566
Receivables from resolutions, net (Note 4)	538,991	533,474
Property and equipment, net (Note 5)	376,790	378,064
Total Assets	**$ 50,760,271**	**$ 49,440,664**
Liabilities		
Accounts payable and other liabilities	$ 154,283	$ 296,540
Postretirement benefit liability (Note 11)	129,906	0
Contingent liabilities for: (Note 6)		
Anticipated failure of insured institutions	110,775	5,366
Litigation losses	200,000	200,500
SAIF-member exit fees and investment proceeds held in escrow (Note 8)	0	341,656
Total Liabilities	**594,964**	**844,062**
Commitments and off-balance-sheet exposure (Note 12)		
Fund Balance		
Accumulated net income	49,929,226	48,190,062
Unrealized gain on available-for-sale securities, net (Note 3)	233,822	406,540
Unrealized postretirement benefit gain (Note 11)	2,259	0
Total Fund Balance	**50,165,307**	**48,596,602**
Total Liabilities and Fund Balance	**$ 50,760,271**	**$ 49,440,664**

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

Deposit Insurance Fund (combined BIF and SAIF for 2005 – Note 2)

Federal Deposit Insurance Corporation

Deposit Insurance Fund Statement of Income and Fund Balance for the Years Ended December 31

Dollars in Thousands

	2006	2005
Revenue		
Interest on U.S. Treasury obligations	$ 2,240,723	$ 2,341,505
Exit fees earned (Note 8)	345,295	0
Assessments (Note 7)	31,945	60,884
Other revenue	25,565	18,073
Total Revenue	**2,643,528**	**2,420,462**
Expenses and Losses		
Operating expenses (Note 9)	950,618	965,652
Provision for insurance losses (Note 10)	(52,097)	(160,170)
Insurance and other expenses	5,843	3,821
Total Expenses and Losses	**904,364**	**809,303**
Net Income	**1,739,164**	**1,611,159**
Unrealized loss on available-for-sale securities, net	(172,718)	(521,350)
Unrealized postretirement benefit gain	2,259	0
Comprehensive Income	**1,568,705**	**1,089,809**
Fund Balance - Beginning	**48,596,602**	**47,506,793**
Fund Balance - Ending	**$ 50,165,307**	**$ 48,596,602**

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

Federal Deposit Insurance Corporation

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

Dollars in Thousands

	2006	2005
Operating Activities		
Net Income:	$ 1,739,164	$ 1,611,159
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of U.S. Treasury obligations	599,274	834,118
Treasury inflation-protected securities (TIPS) inflation adjustment	(109,394)	(345,023)
Depreciation on property and equipment	52,919	56,006
Provision for insurance losses	(52,097)	(160,170)
Terminations/adjustments of work-in-process accounts	433	178
Exit fees earned	(345,295)	0
Change in Operating Assets and Liabilities:		
Decrease/(Increase) in unamortized premium and discount of U.S. Treasury obligations (restricted)	1,359	(6,565)
(Increase)/Decrease in interest receivable and other assets	(14,635)	5,590
Decrease in receivables from resolutions	147,258	348,173
(Decrease)/Increase in accounts payable and other liabilities	(166,822)	27,145
Increase in postretirement benefit liability	129,906	0
(Decrease) in contingent liabilities for litigation losses	0	(182)
Increase in exit fees and investment proceeds held in escrow	3,639	28,556
Net Cash Provided by Operating Activities	**1,985,709**	**2,398,985**
Investing Activities		
Provided by:		
Maturity of U.S. Treasury obligations, held-to-maturity	5,955,000	8,220,000
Maturity of U.S. Treasury obligations, available-for-sale	845,000	1,830,000
Used by:		
Purchase of property and equipment	(11,721)	(47,197)
Purchase of U.S. Treasury obligations, held-to-maturity	(9,050,372)	(11,693,984)
Net Cash Used by Investing Activities	**(2,262,093)**	**(1,691,181)**
Net (Decrease)/Increase in Cash and Cash Equivalents	**(276,384)**	**707,804**
Cash and Cash Equivalents - Beginning	**3,230,379**	**2,522,575**
Unrestricted Cash and Cash Equivalents - Ending	**2,953,995**	**3,209,444**
Restricted Cash and Cash Equivalents - Ending	**0**	**20,935**
Cash and Cash Equivalents - Ending	**$ 2,953,995**	**$ 3,230,379**

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

Deposit Insurance Fund

Notes to the Financial Statements
December 31, 2006 and 2005

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, as amended, the FDIC insures the deposits of banks and savings associations (insured depository institutions), and in cooperation with other federal and state agencies promotes the safety and soundness of insured depository institutions by identifying, monitoring and addressing risks to the deposit insurance fund. An active institution's primary federal supervisor is generally determined by the institution's charter type. Commercial and savings banks are supervised by the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve Board, while thrifts are supervised by the Office of Thrift Supervision.

The Deposit Insurance Fund (DIF) was established on March 31, 2006 as a result of the merger of the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) pursuant to the recently enacted deposit insurance reform legislation. The FDIC is the administrator of the DIF and the FSLIC Resolution Fund (FRF). These funds are maintained separately to carry out their respective mandates.

The DIF is an insurance fund responsible for protecting insured bank and thrift depositors from loss due to institution failures. 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 and the Resolution Trust Corporation.

Recent Legislation

The Federal Deposit Insurance Reform Act of 2005 (Reform Act [Title II, Subtitle B of Public Law 109-171, 120 Stat. 9]) was enacted on February 8, 2006. Companion legislation, the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (Public Law 109-173, 119 Stat. 3601), was enacted on February 15, 2006. In addition to merging the BIF and the SAIF, the legislation: 1) requires the deposit of funds into the DIF for SAIF-member exit fees that had been restricted and held in escrow; 2) provides FDIC with greater discretion to charge insurance assessments and to impose more sensitive risk-based pricing; 3) annually permits the designated reserve ratio to vary between 1.15 and 1.50 percent of estimated insured deposits, thereby eliminating the statutorily fixed designated reserve ratio of 1.25 percent; 4) generally requires the declaration and payment of dividends from the DIF if the reserve ratio of the DIF equals or exceeds 1.35 percent of estimated insured deposits at the end of a calendar year; 5) grants a one-time assessment credit for each eligible insured depository institution or its successor based on an institution's proportionate share of the aggregate assessment base of all eligible institutions at December 31, 1996; and 6) immediately increases coverage for certain retirement accounts to $250,000 and allows the FDIC to increase all deposit insurance coverage, under certain circumstances, to reflect inflation every five years beginning January 1, 2011. See Note 7 for a more detailed discussion of these reforms.

Operations of the DIF

The primary purpose of the DIF is to: 1) insure the deposits and protect the depositors of DIF-insured institutions and 2) resolve DIF-insured failed institutions upon appointment of FDIC as receiver in a manner that will result in the least possible cost to the DIF.

The DIF is primarily funded from: 1) interest earned on investments in U.S. Treasury obligations and 2) deposit insurance assessments. Additional funding sources, if necessary, are borrowings from the U.S. Treasury, Federal Financing Bank, Federal Home Loan Banks, and insured depository institutions. The FDIC has borrowing authority from the U.S. Treasury up to $30 billion for insurance purposes on behalf of the DIF. On December 15, 2006, the FDIC entered into a Note Purchase Agreement with the Federal Financing Bank in an amount not exceeding $40 billion. The Note Purchase Agreement, if needed, will enhance DIF's ability to fund large deposit insurance obligations and deal with large institution resolutions.

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 U.S. Treasury. The MOL for the DIF was $79.7 billion and $78.2 billion as of December 31, 2006 and 2005, respectively.

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 DIF assets and liabilities to ensure that receivership proceeds are distributed in accordance with applicable laws and regulations. Accordingly, 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 DIF and are presented in conformity with U.S. generally accepted accounting principles (GAAP). These statements do not include reporting for assets and liabilities of closed banks and thrifts for which the FDIC acts as receiver. Periodic and final accountability reports of the FDIC's activities as receiver are furnished to courts, supervisory authorities, and others as required.

Merger of the Funds

The merger of the BIF and SAIF into the newly established DIF was accounted for by combining the carrying value of each Fund's assets and liabilities. Since this merger results in a new reporting entity, financial results of the newly formed DIF were retrospectively applied as though they had been combined at the beginning of the reporting year as well as for full prior year periods reported for comparative purposes.

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 allowance for loss on receivables from resolutions, the estimated losses for anticipated failures and litigation, and the postretirement benefit obligation.

Cash Equivalents

Cash equivalents are short-term, highly liquid investments with original maturities of three months or less. Cash equivalents consist primarily of Special U.S. Treasury 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 U.S. Treasury must approve all such investments in excess of $100,000. The Secretary has granted 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 (GAS) program.

DIF's investments in U.S. Treasury obligations are either classified as held-to-maturity or available-for-sale. Securities designated as held-to-maturity are shown at amortized cost. Amortized cost is the face value of securities plus the unamortized premium or less the unamortized discount. Amortizations are computed on a daily basis from the date of acquisition to the date of maturity, except for callable U.S. Treasury securities, which are amortized to the first call date. Securities designated as available-for-sale are shown at market value, which approximates fair value. Unrealized gains and losses are included in Comprehensive Income. Realized gains and losses are included in the Statement of Income and Fund Balance as components of Net Income. Income on both types of securities is calculated and recorded on a daily basis using the effective interest method.

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 life include mainframe equipment; furniture, fixtures, and general equipment; and internal-use software. Personal computer equipment is depreciated on a straight-line basis over a three-year estimated life.

Disclosure about Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. For FDIC's postretirement benefits other than pensions, this pronouncement amends the recognition and disclosure requirements of SFAS No. 106 and SFAS No. 132(R).

The pronouncement requires recognition of: 1) the funded status of the plan as an asset or liability, 2) the cumulative actuarial gains/losses and prior service costs/credits as accumulated comprehensive income, and 3) the changes in the actuarial gains/losses and prior service costs/credits for the period as other comprehensive income. The FDIC adopted SFAS No. 158 for the 2006 calendar year financial statements. As a result, the FDIC recognized the underfunded status (difference between the accumulated postretirement benefit obligation and the plan assets at fair value) as a liability and the cumulative actuarial gains/losses and prior service costs/credits are shown as accumulated other comprehensive income on the Balance Sheet. In addition, the changes in the actuarial gains/losses and prior service costs/credits for the period are recognized as other comprehensive income on the Statement of Income and Fund Balance. Prior to this change, the net postretirement benefit obligation (comprised of both the underfunded status and unrecognized actuarial gains/losses and prior service costs/credits) was recognized as a liability on the Balance Sheet.

Retrospective application is not permitted or required by the Statement. See Note 11 for specifics regarding postretirement benefits other than pensions.

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.

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

As of December 31, 2006 and 2005, the book value of investments in U.S. Treasury obligations, net, was $46.1 billion and $44.2 billion, respectively. As of December 31, 2006, the DIF held $9.2 billion of Treasury inflation-protected securities (TIPS). These securities are indexed to increases or decreases in the Consumer Price Index for All Urban Consumers (CPI-U). Additionally, the DIF held $6.1 billion of callable U.S. Treasury bonds at December 31, 2006. Callable U.S. Treasury bonds may be called five years prior to the respective bonds' stated maturity on their semi-annual coupon payment dates upon 120 days notice.

U.S. Treasury Obligations at December 31, 2006

Dollars in Thousands

Maturity●	Yield at Purchase▼	Face Value	Net Carrying Amount	Unrealized Holding Gains	Unrealized Holding Losses■	Market Value
Held-to-Maturity						
U . S. Treasury notes and bonds						
Within 1 year	4.58%	$ 6,401,000	$ 6,448,905	$ 3,389	$ (20,704)	$ 6,431,590
After 1 year thru 5 years	4.47%	15,500,000	16,276,424	91,703	(196,635)	16,171,492
After 5 years thru 10 years	4.68%	9,025,000	9,690,085	36,025	(42,270)	9,683,840
After 10 years	5.01%	2,445,000	3,247,814	57,589	(3,227)	3,302,176
U. S. Treasury inflation-protected securities						
After 1 year thru 5 years	3.83%	926,751	926,844	21,185	0	948,029
After 5 years thru 10 years	2.41%	568,345	594,142	0	(778)	593,364
Total		**$ 34,866,096**	**$ 37,184,214**	**$ 209,891**	**$ (263,614)**	**$ 37,130,491**
Available-for-Sale						
U . S. Treasury notes and bonds						
Within 1 year	3.85%	$ 1,225,000	$ 1 ,269,835	$ 0	$ (9,208)	$ 1,260,627
U. S. Treasury inflation-protected securities						
After 1 year thru 5 years	3.80%	7,443,478	7,454,909	243,030	0	7,697,939
Total		**$ 8,668,478**	**$ 8,724,744**	**$ 243,030**	**$ (9,208)**	**$ 8,958,566**
Total Investment in U.S. Treasury Obligations, Net						
Total		**$ 43,534,574**	**$ 45,908,958**	**$ 452,921**	**$ (272,822)**	**$ 46,089,057**

● For purposes of this table, all callable securities are assumed to mature on their first call dates. Their yields at purchase are reported as their yield to first call date.

▼ 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 2.2 percent, based on figures issued by the Congressional Budget Office and *Blue Chip Economic Indicators* in early 2006.

■ All unrealized losses occurred as a result of changes in market interest rates. FDIC has the ability and intent to hold the related securities until maturity. As a result, all unrealized losses are considered temporary. However, of the $273 million reported as total unrealized losses, $237 million is recognized as unrealized losses occurring over a period of 12 months or longer with a market value of $13.3 billion applied to the affected securities.

U.S. Treasury Obligations at December 31, 2005

Dollars in Thousands

Maturity[•]	Yield at Purchase[▼]	Face Value	Net Carrying Amount	Unrealized Holding Gains	Unrealized Holding Losses[■]	Market Value
Held-to-Maturity						
U . S. Treasury notes and bonds						
Within 1 year	5.19%	$ 5,920,000	$ 5,942,398	$ 29,554	$ (18,187)	$ 5,953,765
After 1 year thru 5 years	4.47%	18,680,000	19,872,850	219,864	(187,672)	19,905,042
After 5 years thru 10 years	4.53%	5,350,000	5,674,953	62,578	(13,184)	5,724,347
After 10 years	4.72%	1,420,000	1,848,524	31,668	0	1,880,192
U. S. Treasury inflation-protected securities						
After 1 year thru 5 years	3.83%	914,596	914,512	40,784	0	955,296
Total		**$ 32,284,596**	**$ 34,253,237**	**$ 384,448**	**$ (219,043)**	**$ 34,418,642**
Available-for-Sale						
U . S. Treasury notes and bonds						
Within 1 year	3.71%	$ 845,000	$ 898,720	$ 696	$ (6,870)	$ 892,546
After 1 year thru 5 years	3.86%	1,225,000	1,324,055	4,967	(16,448)	1,312,574
U. S. Treasury inflation-protected securities						
After 1 year thru 5 years	3.97%	5,119,864	5,122,414	280,679	0	5,403,093
After 5 years thru 10 years	3.39%	2,225,975	2,235,494	143,516	0	2,379,010
Total		**$ 9,415,839**	**$ 9,580,683**	**$ 429,858**	**$ (23,318)**	**$ 9,987,223**
Total Investment in U.S. Treasury Obligations, Net						
Total		**$ 41,700,435**	**$ 43,833,920**	**$ 814,306**	**$ (242,361)**	**$ 44,405,865**

• For purposes of this table, all callable securities are assumed to mature on their first call dates. Their yields at purchase are reported as their yield to first call date.

▼ 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 2.2 percent, based on figures issued by the Congressional Budget Office and *Blue Chip Economic Indicators* in early 2005.

■ All unrealized losses occurred as a result of changes in market interest rates. FDIC has the ability and intent to hold the related securities until maturity. As a result, all unrealized losses are considered temporary. However, of the $242 million reported as total unrealized losses, $116 million is recognized as unrealized losses occurring

As of December 31, 2006 and 2005, the unamortized premium, net of the unamortized discount, was $2.4 billion and $2.1 billion, respectively.

4. Receivables From Resolutions, Net

The receivables from resolutions include payments made by the DIF 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 DIF receiverships are the main source of repayment of the DIF's receivables from closed banks and thrifts. As of December 31, 2006, there were 25 active receiverships, with no failures in the current year.

As of December 31, 2006 and 2005, DIF receiverships held assets with a book value of $655 million and $745 million, respectively (including cash, investments, and miscellaneous receivables of $348 million and $370 million at December 31, 2006 and 2005, respectively). The estimated cash recoveries from the management and disposition of these assets that are used to derive the allowance for losses are based on a sampling of receivership assets in liquidation. Assets in the judgmental sample, which represents 97 percent of the asset book value for all active DIF receiverships, are generally valued by estimating future cash recoveries, net of applicable liquidation cost estimates, and then discounting these net cash recoveries using current market-based risk factors based on a given asset's type and quality. Resultant recovery estimates are extrapolated to the non-sampled assets in order to derive the allowance for loss on the receivable. These estimated recoveries are regularly evaluated, but remain subject to uncertainties because of potential changes in economic and market conditions. Such uncertainties could cause the DIF's actual recoveries to vary from the level currently estimated.

As of December 31, 2006, the DIF allowance for loss was $4.1 billion. The allowance for loss is equivalent to 88 percent of the gross receivable. Of the remaining 12 percent of the gross receivable, the amount of credit risk is limited since 89.1 percent of the receivable will be repaid from receivership cash, investments, and a promissory note fully secured by a letter of credit.

5. Property and Equipment, Net

Property and Equipment, Net at December 31

Dollars in Thousands

	2006	2005
Land	$ 37,352	$ 37,352
Buildings (includes construction-in-process)	284,871	272,861
Application software (includes work-in-process)	259,744	241,424
Furniture, fixtures, and equipment	161,127	140,728
Accumulated depreciation	(323,274)	(273,789)
Retirements	(43,030)	(40,512)
Total	**$ 376,790**	**$ 378,064**

The depreciation expense was $53 million and $56 million for December 31, 2006 and 2005, respectively.

6. 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 within one year of the reporting date, absent some favorable event such as obtaining additional capital or merging, when the liability becomes 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. In addition, institution-specific analysis is performed on those institutions where failure is imminent absent institution management resolution of existing problems, or where additional information is available that may affect the estimate of losses. As of December 31, 2006 and 2005, the contingent liabilities for anticipated failure of insured institutions were $110.8 million and $5.4 million, respectively.

In addition to these recorded contingent liabilities, the FDIC has identified additional risk in the financial services industry that could result in an additional loss to the DIF should potentially vulnerable insured institutions ultimately fail. This risk results from the presence of various high-risk banking business activities that are particularly vulnerable to adverse economic and market conditions. Due to the uncertainty surrounding such conditions in the future, there are institutions other than those with losses included in the contingent liability for which the risk of failure is less certain, but still considered reasonably possible. As a result of these risks, the FDIC believes that it is reasonably possible that the DIF could incur additional estimated losses up to approximately $0.6 billion.

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

Litigation Losses

The DIF records an estimated loss for unresolved legal cases to the extent that those losses are considered probable and reasonably estimable. In addition to the amount recorded as probable, the FDIC has determined that losses from unresolved legal cases totaling $0.6 million are reasonably possible.

Other Contingencies

Representations and Warranties

As part of the FDIC's efforts to maximize the return from the sale of assets from bank and thrift resolutions, representations and warranties, and guarantees were offered on certain loan sales. In general, the guarantees, representations, and warranties on loans sold relate to the completeness and accuracy of loan documentation, the quality of the underwriting standards used, the accuracy of the delinquency status when sold, and the conformity of the loans with characteristics of the pool in which they were sold. The total amount of loans sold subject to unexpired representations and warranties, and guarantees was $8.1 billion as of December 31, 2006. There were no contingent liabilities from any of the outstanding claims asserted in connection with representations and warranties at December 31, 2006 and 2005, respectively.

In addition, future losses could be incurred until the contracts offering the representations and warranties, and guarantees have expired, some as late as 2032. Consequently, the FDIC believes it is possible that additional losses may be incurred by the DIF from the universe of outstanding contracts with unasserted representation and warranty claims. However, because of the uncertainties surrounding the timing of when claims may be asserted, the FDIC is unable to reasonably estimate a range of loss to the DIF from outstanding contracts with unasserted representation and warranty claims.

7. Assessments

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) required the FDIC to establish a risk-based assessment system, charging higher rates to those insured depository institutions that posed greater risks to the DIF. To arrive at a risk-based assessment for a particular institution, the FDIC placed each institution in one of nine risk categories based on capital ratios and supervisory examination data. Based on FDIC's evaluation of the institutions under the risk-based premium system and due to limitations imposed by the

Deposit Insurance Funds Act of 1996 (DIFA) and the continued health of the banking and thrift industries, most institutions were not charged an assessment for a number of years. In addition, the FDIC was required by statute to maintain the insurance funds at a designated reserve ratio (DRR) of not less than 1.25 percent of estimated insured deposits (or a higher percentage as circumstances warranted). Of the institutions assessed, the assessment rate averaged approximately 5 cents and 10 cents per $100 of assessable deposits for 2006 and 2005, respectively. During 2006 and 2005, $32 million and $61 million were recognized as assessment income from institutions, respectively.

The assessment process will significantly change as of January 1, 2007. The Reform Act (enacted in February 2006) and the implementing regulations (published in November 2006):

- provide the FDIC with greater discretion to charge insurance assessments, eliminate the cap on assessments for the best-rated institutions, and provide that no insured institution may be barred from the lowest risk category solely because of its size. By regulation, the FDIC has placed each institution into one of four risk categories for risk-based assessment purposes, so that all insured depository institutions will be required to pay assessments;
- establish a range for the DRR from 1.15 to 1.50 percent of estimated insured deposits and eliminate the fixed DRR of 1.25 percent. The FDIC is required to annually publish the DRR and has, by regulation, set the DRR at 1.25 percent for 2007;
- grant a one-time assessment credit of approximately $4.7 billion to certain eligible insured depository institutions (or their successors) based on the assessment base of the institution as of December 31, 1996, as compared to the combined aggregate assessment base of all eligible institutions; and
- require the FDIC to annually determine if a dividend should be paid, based on the statutory requirements generally to declare dividends if: 1) the reserve ratio of the DIF exceeds 1.50 percent of estimated insured deposits, for the full amount in excess of the amount required to maintain the reserve ratio at 1.50 percent, or 2) if the reserve ratio equals or exceeds 1.35 percent of estimated insured deposits but is no greater than 1.50 percent, for one-half of the amount in excess of the amount required to maintain the reserve ratio at 1.35 percent.

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 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 2006 and 2005, $788 million and $780 million, respectively, were collected and remitted to the FICO.

8. Exit Fees Earned

From the early to mid-1990s, the SAIF collected entrance and exit fees for conversion transactions when an insured depository institution converted from the BIF to the SAIF (resulting in an entrance fee) or from the SAIF to the BIF (resulting in an exit fee). Regulations approved by the FDIC's Board of Directors (Board) and published in the *Federal Register* on March 21, 1990, directed that: 1) exit fees paid to the SAIF be held in escrow, and 2) the Board and the Secretary of the Treasury will determine when it is no longer necessary to escrow such funds for the payment of interest on obligations previously issued by the FICO. These escrowed exit fees were invested in U.S. Treasury securities pending determination of ownership. The interest earned was also held in escrow and as a result of the above, the SAIF did not recognize exit fees or any interest earned as revenue.

The recent deposit insurance legislation removed the restriction on SAIF-member exit fees held in escrow and the funds were deposited into the general (unrestricted) fund of the DIF. The exit fees plus earned interest, a total of $345 million, are recognized as revenue at their carrying value on the Income Statement for 2006 and are classified on the Balance Sheet as a combination of Cash and cash equivalents, Investments in U.S. Treasury obligations, net, and Interest receivable on investments. At December 31, 2005, the exit fees and earned interest are shown on the Balance Sheet line items of Cash and other assets: Restricted for SAIF-member exit fees (an asset) and SAIF-member exit fees and investment proceeds held in escrow (a liability).

9. Operating Expenses

Operating expenses were $951 million for 2006, compared to $966 million for 2005. The chart below lists the major components of operating expenses.

Operating Expenses for the Years Ended December 31

Dollars in Thousands

	2006	2005
Salaries and benefits	$ 619,452	$ 645,418
Outside services	124,045	113,416
Travel	49,408	45,732
Buildings and leased space	65,929	71,480
Software/Hardware maintenance	27,139	33,366
Depreciation of property and equipment	52,919	55,989
Other	22,124	21,959
Services billed to receiverships	(10,398)	(21,708)
Total	**$ 950,618**	**$ 965,652**

10. Provision for Insurance Losses

Provision for insurance losses was a negative $52 million for 2006 and a negative $160 million for 2005. The following chart lists the major components of the provision for insurance losses.

Provision for Insurance Losses for the Years Ended December 31

Dollars in Thousands

	2006	2005
Valuation Adjustments:		
Closed banks and thrifts	$ (152,776)	$ (159,421)
Other assets	(4,230)	3,762
Total Valuation Adjustments	**(157,006)**	**(155,659)**
Contingent Liabilities Adjustments:		
Anticipated failure of insured institutions	105,409	(4,852)
Litigation losses	(500)	200
Other contingencies	0	141
Total Contingent Liabilities Adjustments	**104,909**	**(4,511)**
Total	**$ (52,097)**	**$ (160,170)**

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11. Employee Benefits

Pension Benefits, Savings Plans and Postemployment Benefits

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.

Eligible FDIC employees also may participate in a FDIC-sponsored tax-deferred 401(k) savings plan with matching contributions up to five percent. Under the Federal Thrift Savings Plan (TSP), 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. However, CSRS employees do not receive agency matching contributions.

Prior to 2006, the FDIC reduced its workforce with a voluntary buyout program, and to a lesser extent, reduction-in-force actions resulting in separation or severance payments. The 2006 and 2005 related costs for these reductions are included in the "Operating expenses" line item in the Income Statement.

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

Dollars in Thousands

	2006	2005
Civil Service Retirement System	$ 6,808	$ 7,632
Federal Employees Retirement System (Basic Benefit)	38,915	38,458
FDIC Savings Plan	20,681	20,886
Federal Thrift Savings Plan	15,328	15,228
Separation Incentive Payment	0	22,371
Severance Pay	39	2,733
Total	**$ 81,771**	**$ 107,308**

Postretirement Benefits Other Than Pensions

The FDIC provides certain life and dental insurance coverage for its eligible retirees, the retirees' beneficiaries, and covered dependents. Retirees eligible for life 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 coverages to direct-pay plans. Dental coverage is provided to all retirees eligible for an immediate annuity.

At December 31, 2006, the DIF's accumulated postretirement benefit obligation, representing the underfunded status of the plan, was $129.9 million, which is recognized in the "Postretirement benefit liability" line item on the Balance Sheet. The cumulative actuarial gains/losses (changes in assumptions and plan experience) and prior service costs/credits (changes to plan provisions that increase or decrease benefits) was $2.3 million at December 31, 2006, which is reported as accumulated other comprehensive income in the "Unrealized post-retirement benefit gain" line item on the Balance Sheet. At December 31, 2005, the net postretirement benefit liability (the underfunded status adjusted for any unrecognized actuarial gains/losses and prior service costs/credits) of $126.7 million is recognized in the "Accounts payable and other liabilities" line item.

The DIF's expense for postretirement benefits in 2006 and 2005 was $9.0 million and $10.3 million, respectively, which is included in the current and prior year's operating expenses on the Statement of Income and Fund Balance. The changes in the actuarial gains/losses and prior service costs/credits for 2006 of $2.3 million are reported as other comprehensive income in the "Unrealized postretirement benefit gain" line item. Key actuarial assumptions used in the accounting for the plan include the discount rate of 4.75 percent, the rate of compensation increase of 4.00 percent, and the dental coverage trend rate of 6.70 percent. See Note 2 regarding the recent issuance of a relevant FASB accounting pronouncement.

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12. Commitments and Off-Balance-Sheet Exposure

Commitments:

Leased Space
The FDIC's lease commitments total $62.9 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 $30 million and $39 million for the periods ended December 31, 2006 and 2005, respectively.

Leased Space Commitments

Dollars in Thousands

2007	2008	2009	2010	2011	2012/Thereafter
$ 21,491	$ 15,723	$ 13,552	$ 6,334	$ 3,727	$ 2,026

Off-Balance-Sheet Exposure:

Deposit Insurance
As of September 30, 2006, the estimated insured deposits for DIF were $4.1 trillion. This estimate is derived primarily from quarterly financial data submitted by insured depository institutions to the FDIC. This estimate represents the accounting loss that would be realized if all insured depository institutions were to fail and the acquired assets provided no recoveries.

13. Disclosures About the Fair Value of Financial Instruments

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

The net receivables from resolutions primarily include the DIF's subrogated claim arising from payments to insured depositors. The receivership assets that will ultimately be used to pay the corporate subrogated claim are valued using discount rates that include consideration of market risk. These discounts ultimately affect the DIF's allowance for loss against the net 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 receivership assets (see Note 4), such receivership valuation is not equivalent to the valuation of the corporate claim. Since the corporate claim is unique, not intended for sale to the private sector, and has no established market, it is not practicable to estimate its fair market value.

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

FSLIC Resolution Fund

Federal Deposit Insurance Corporation

FSLIC Resolution Fund Balance Sheet at December 31

Dollars in Thousands

	2006	2005
Assets		
Cash and cash equivalents	$ 3,616,466	$ 3,602,703
Receivables from thrift resolutions and other assets, net (Note 3)	36,730	38,746
Receivables from U.S. Treasury for goodwill judgments (Note 4)	251,827	0
Total Assets	**$ 3,905,023**	**$ 3,641,449**
Liabilities		
Accounts payable and other liabilities	$ 5,497	$ 7,799
Contingent liabilities for litigation losses and other (Note 4)	279,327	257,503
Total Liabilities	**284,824**	**265,302**
Resolution Equity (Note 5)		
Contributed capital	127,453,996	127,007,441
Accumulated deficit	(123,833,797)	(123,631,294)
Total Resolution Equity	**3,620,199**	**3,376,147**
Total Liabilities and Resolution Equity	**$ 3,905,023**	**$ 3,641,449**

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

Federal Deposit Insurance Corporation

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

Dollars in Thousands

	2006	2005
Revenue		
Interest on U.S. Treasury obligations	$ 151,648	$ 98,260
Other revenue	17,650	24,176
Total Revenue	**169,298**	**122,436**
Expenses and Losses		
Operating expenses	12,002	24,626
Provision for losses	(19,257)	(16,112)
Goodwill/Guarini litigation expenses (Note 4)	411,056	975,598
Recovery of tax benefits	(34,783)	(45,946)
Other expenses	2,783	10,333
Total Expenses and Losses	**371,801**	**948,499**
Net (Loss)	**(202,503)**	**(826,063)**
Accumulated Deficit - Beginning	**(123,631,294)**	**(122,805,231)**
Accumulated Deficit - Ending	**$ (123,833,797)**	**$ (123,631,294)**

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

Federal Deposit Insurance Corporation

FSLIC Resolution Fund Statement of Cash Flows for the Years Ended December 31

Dollars in Thousands

	2006	2005
Operating Activities		
Net (Loss)	$ (202,503)	$ (826,063)
Adjustments to reconcile net (loss) to net cash (used by) operating activities:		
Provision for losses	(19,257)	(16,112)
Change in Assets and Liabilities:		
Decrease in receivables from thrift resolutions and other assets	21,273	59,630
(Decrease)/Increase in accounts payable and other liabilities	(2,302)	2,196
Increase in contingent liabilities for litigation losses and other	21,824	257,104
Net Cash (Used by) Operating Activities	**(180,965)**	**(523,245)**
Financing Activities		
Provided by:		
U.S.Treasury payments for goodwill litigation	194,728	624,564
Net Cash Provided by Financing Activities	**194,728**	**624,564**
Net Increase in Cash and Cash Equivalents	**13,763**	**101,319**
Cash and Cash Equivalents - Beginning	**3,602,703**	**3,501,384**
Cash and Cash Equivalents - Ending	**$ 3,616,466**	**$ 3,602,703**

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

FSLIC Resolution Fund

Notes to the Financial Statements
December 31, 2006 and 2005

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, as amended, the FDIC insures the deposits of banks and savings associations, and in cooperation with other federal and state agencies promotes the safety and soundness of insured depository institutions by identifying, monitoring and addressing risks to the deposit insurance funds established in the FDI Act, as amended. In addition, FDIC is charged with responsibility for the sale of remaining assets and satisfaction of liabilities associated with the former Federal Savings and Loan Insurance Corporation (FSLIC) and the Resolution Trust Corporation (RTC).

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 FSLIC Resolution Fund (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.

Pursuant to the Federal Deposit Insurance Reform Act of 2005, the Bank Insurance Fund and the Savings Association Insurance Fund were merged into a new fund, the Deposit Insurance Fund (DIF). The FDIC is the administrator of the FRF and the DIF. These funds are maintained separately to carry out their respective mandates.

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 $602.2 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 and is continuing to explore approaches for concluding FRF's activities. An executive-level Steering Committee was established in 2003 to facilitate the FRF dissolution. Some of the issues and items that remain open in FRF are: 1) criminal restitution orders (generally have from 5 to 10 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 6 months to 12 years remaining to enforce); 3) numerous assistance agreements entered into by the former FSLIC (FRF could continue to receive tax-sharing benefits through year 2008); 4) goodwill and Guarini litigation (no final date for resolution has been established; see Note 4); and 5) environmentally impaired owned real estate assets. The FDIC is considering whether enabling legislation or other measures may be needed to accelerate liquidation of the remaining FRF assets and liabilities. The FRF could realize substantial recoveries from the tax-sharing benefits, criminal restitution orders and professional liability claims ranging from $165 million to $271.4 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 conformity with U.S. generally accepted accounting principles (GAAP). These statements do not include reporting for assets and liabilities of closed thrift institutions for which the FDIC acts as receiver. Periodic and final accountability reports of the FDIC's activities as receiver are furnished to courts, supervisory authorities, and others as required.

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 allowance for losses on receivables from thrift resolutions and the estimated losses for litigation.

Provision for Losses

The provision for losses represents the change in the valuation of the recievables from thrift resolutions and other assets.

Fair Value of Financial Instruments

Cash equivalents, which consist of Special U.S. Treasury Certificates, are short-term, highly liquid investments with original maturities of three months or less and are shown at fair value. The carrying amount of short-term receivables and accounts payable and other liabilities approximates their fair market value, due to their short maturities.

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 market value.

Other assets primarily consist of credit enhancement reserves, which are valued by performing projected cash flow analyses using market-based assumptions (see Note 3).

Disclosure About Recent Accounting Pronouncements

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

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.

Reclassifications

Reclassifications have been made in the 2005 financial statements to conform to the presentation used in 2006.

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 FSLIC and SAIF-insured institutions are a significant source of repayment of the FRF's receivables from thrift resolutions. As of December 31, 2006, 20 of the 850 FRF receiverships remain active primarily due to unresolved litigation, including goodwill matters.

As of December 31, 2006 and 2005, FRF receiverships held assets with a book value of $33 million and $139 million, respectively (including cash, investments, and miscellaneous receivables of $26 million and $113 million at December 31, 2006 and 2005, respectively). The estimated cash recoveries from the management and disposition of these assets that are used to derive the allowance for losses are based on a sampling of receivership assets in liquidation. Assets in the judgmental sample, which represents 96 percent of the asset book value for all active FRF receiverships, are generally valued by estimating future cash recoveries, net of applicable liquidation cost estimates, and then discounting these net cash recoveries using current market-based risk factors based on a given asset's type and quality. Resultant recovery estimates are extrapolated to the non-sampled assets in order to derive the allowance for loss on the receivable. These estimated recoveries are regularly evaluated, but remain subject to uncertainties because of potential changes in economic and market conditions. Such uncertainties could cause the FRF's actual recoveries to vary from the level currently estimated.

Other Assets

Other assets primarily include credit enhancement reserves valued at $20.2 million and $16.7 million as of December 31, 2006 and 2005, 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 reserves may cover future credit losses through 2020.

Receivables From Thrift Resolutions and Other Assets, Net at December 31

Dollars in Thousands

	2006	2005
Receivables from closed thrifts	$ 11,308,460	$ 16,080,789
Allowance for losses	(11,299,448)	(16,065,703)
Receivables from Thrift Resolutions, Net	**9,012**	**15,086**
Other assets	27,718	23,660
Total	**$ 36,730**	**$ 38,746**

Gross receivables from thrift resolutions subject the FRF to credit risk. An allowance for loss of $11.3 billion, or 99.9 percent of the gross receivable, was recorded as of December 31, 2006. Of the remaining 0.1 percent of the gross receivable, 65 percent is expected to be repaid from receivership cash and investments.

4. Contingent Liabilities for:

Litigation Losses

The FRF records an estimated loss for unresolved legal cases to the extent those losses are considered probable and reasonably estimable. In addition to the amount recorded as probable, the FDIC has determined that losses from unresolved legal cases totaling $3 million are reasonably possible.

Additional Contingency

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. Approximately 26 remaining cases are pending against the United States based on alleged breaches of these agreements.

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 goodwill lawsuits are against the United States and as such are defended by the DOJ. On November 15, 2006, the DOJ again informed the FDIC that it is "unable at this time to provide a reasonable estimate of the likely aggregate contingent liability resulting from the *Winstar*-related cases." This uncertainty arises, in part, from the existence of significant unresolved issues pending at the appellate or trial court level, as well as the unique circumstances of each case.

The FDIC believes that it is probable that additional amounts, possibly substantial, may be paid from the FRF-FSLIC as a result of judgments and settlements in the goodwill litigation. Based on the representations from the DOJ, the FDIC is unable to estimate a range of loss to the FRF-FSLIC from the goodwill litigation. However, 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 liability for the 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.

The FRF paid $194.7 million as a result of judgments and settlements in four goodwill cases for the year ended December 31, 2006, compared to $624.6 million for seven goodwill cases for the year ended December 31, 2005. As described above, the FRF received appropriations from the U.S. Treasury to fund these payments. At December 31, 2006, the FRF accrued a $251.8 million contingent liability and offsetting receivable from the U.S. Treasury for judgments in two additional cases that were fully adjudicated as of year end. These funds were paid in January 2007.

In addition, the FRF-FSLIC pays the goodwill litigation expenses incurred by DOJ based on a Memorandum of Understanding (MOU) dated October 2, 1998, between the FDIC and DOJ. Under the terms of the MOU, the FRF-FSLIC paid $17.5 million and $18.3 million to DOJ for fiscal years (FY) 2007 and 2006, respectively. DOJ returns any unused fiscal year funding to the FRF unless special circumstances warrant these funds be carried over and applied against current fiscal year charges. At September 30, 2006, DOJ had an additional $3.4 million in unused fiscal year 2006 funds that were applied against FY 2007 charges of $20.9 million.

Guarini Litigation

Paralleling the goodwill cases are 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.

Eight Guarini cases were originally filed seeking damages relating to the government's elimination of certain tax deductions. Seven of those eight cases have now concluded. One case settled in 2002 for $20,000, and a second case concluded in 2004 with no damage award. Judgments were paid in four cases in 2005 and 2006 for a total of $152.6 million. In a seventh case settled in 2006 for $99 million, the settlement agreement 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 through 2009 is approximately $81 million. After reviewing relevant case law in relation to the nature of the settlement, the FDIC believes that it is very unlikely the settlement will be subject to taxation. Therefore, the FRF is not expected to fund any payment under this guarantee and no liability has been recorded. The eighth Guarini case is currently before the U.S. Court of Federal Claims for consideration of one remaining issue.

The FDIC has established a contingent liability of approximately $27.5 million for the remaining Guarini litigation loss exposure.

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 $30 million based on an assessment of remaining portfolio balances still covered by representations and warranties. 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, 2006 and 2005 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.

Resolution Equity at December 31, 2006

Dollars in Thousands

	FRF-FSLIC	FRF-RTC	FRF Consolidated
Contributed capital - beginning	$ 44,808,104	$ 82,199,337	$ 127,007,441
Add: U.S. Treasury payments for goodwill litigation	446,555	0	446,555
Contributed capital - ending	**45,254,659**	**82,199,337**	**127,453,996**
Accumulated deficit	(42,212,338)	(81,621,459)	(123,833,797)
Total	**$ 3,042,321**	**$ 577,878**	**$ 3,620,199**

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, 2006, the FRF-RTC has returned $4.556 billion to the U.S. Treasury and made payments of $4.572 billion to the REFCORP. These actions serve to reduce contributed capital.

During 2006, the FRF-FSLIC recieved $194.7 million for U.S. Treasury payments for goodwill litigation and established a receivable for $251.8 million (see Note 4).

Accumulated Deficit

The accumulated deficit represents the cumulative excess of expenses 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 $12.4 billion, whereas the FRF-RTC accumulated deficit has decreased by $6.3 billion, since their dissolution dates.

6. Employee Benefits

Pension Benefits

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 FRF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The FRF also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported on and accounted for by the U.S. Office of Personnel Management. The FRF's pension-related expenses were $850 thousand and $2.9 million for 2006 and 2005, respectively.

Postretirement Benefits Other Than Pensions

The FRF no longer records a liability for the postretirement benefits of life and dental insurance as a result of FDIC's change in funding policy for these benefits and elimination of the separate entity formerly used to account for such estimated future costs. In implementing this change, management decided not to allocate either the plan assets or the revised net accumulated postretirement benefit obligation (a long-term liability) to the FRF due to the expected dissolution of the FRF. However, the FRF does continue to pay its proportionate share of the yearly claim expenses associated with these benefits.

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Washington, D.C. 20548

To the Board of Directors
The Federal Deposit Insurance Corporation

We have audited the balance sheets as of December 31, 2006, and 2005, for the two funds administered by the Federal Deposit Insurance Corporation (FDIC), the related statements of income and fund balance (accumulated deficit), and the statements of cash flows for the years then ended. In our audits of the Deposit Insurance Fund (DIF) and the FSLIC Resolution Fund (FRF), we found

- the financial statements of each fund are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- FDIC had effective internal control over financial reporting and compliance with laws and regulations for each fund; and
- no reportable noncompliance with laws and regulations we tested.

The following sections discuss our conclusions in more detail. They also present information on the scope of our audits and our evaluation of FDIC management's comments on a draft of this report.

Opinion on 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, DIF's financial position as of December 31, 2006, and 2005, and the results of its operations and its cash flows for the years then ended.

As discussed in note 1 to DIF's financial statements, on February 8, 2006, the President signed into law the Federal Deposit Insurance Reform Act of 2005 (the Act). Among its provisions, the Act called for the merger of the Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) into a single deposit insurance fund. In accordance with the Act, on March 31, 2006, FDIC established the DIF with the merger of the BIF and SAIF. As further discussed in note 2 to DIF's financial statements, the merger resulted in a new reporting entity. The financial results of the newly formed DIF were retrospectively applied as though they had been combined at the beginning of the reporting year as well as for prior periods presented for comparative purposes.

Opinion on 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, FRF's financial position as of December 31, 2006, and 2005, and the results of its operations and its cash flows for the years then ended.

Opinion on Internal Control

FDIC management maintained, in all material respects, effective internal control over financial reporting (including safeguarding assets) and compliance as of December 31, 2006, that provided reasonable assurance that misstatements, losses, or noncompliance material in relation to FDIC's financial statements for each fund would be prevented or detected 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 (FMFIA)].

In our prior year audit,[1] we reported on weaknesses we identified in FDIC's information system controls, which we considered to be a reportable condition.[2] Specifically, FDIC had implemented a new financial system May 2005 and, in doing so, did not ensure that controls were adequate to accommodate its new systems environment.

1 GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2005 and 2004 Financial Statements*, GAO-06-146 (Washington, D.C.: Mar. 2, 2006).

2 Reportable conditions involve matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control and could adversely affect FDIC's ability to meet the control objectives described in this report. In May 2006, the American Institute of Certified Public Accountants (AICPA) issued Statement on Auditing Standard (SAS) 112, which became effective for audits of financial statements for periods ending on or after December 15, 2006. SAS 112 established standards and provides guidance on the auditor's responsibilities for identifying, evaluating, and communicating matters related to an entity's internal control over financial reporting identified in an audit of financial statements. Under the new SAS, the auditor is required to communicate control deficiencies that are significant deficiencies or material weaknesses in internal controls. A significant deficiency is a control deficiency, or combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. As a result of SAS 112, the term reportable condition is no longer used.

During 2006, FDIC corrected many of these weaknesses and implemented mitigating or compensating controls to provide protection for the corporation's financial and sensitive information in the new systems environment. These improvements enabled us to conclude that the remaining issues related to information systems controls do not constitute a significant deficiency. However, continued management commitment to an effective information security program will be essential to ensure that the corporation's financial and sensitive information will be adequately protected. In light of the evolving nature of information security, and with new exposures and threats continuing to develop, the corporation's information security program will need to dynamically adapt to address changing information security challenges. As FDIC continues to enhance its new financial system, which is based on an integrated financial management software package, the corporation's reliance on controls implemented in the single, integrated financial system will increase. The continued effectiveness of FDIC's controls will be dependent on sound implementation of the integrated financial management software and its operations.

We did identify control deficiencies during our 2006 audits that we do not consider to be significant deficiencies. We will be reporting separately to FDIC management on these matters.

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.

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, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of FMFIA are met; and (3) complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles; and (2) management maintained effective internal control, the objectives of which are the following:

- financial reporting—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

- compliance with laws and regulations—transactions are executed in accordance with laws and regulations that could have a direct and material effect on the financial statements.

We are also responsible for testing compliance with selected provisions of laws and regulations that could 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 management;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of internal control related to financial reporting (including safeguarding assets) and compliance with laws and regulations;
- tested relevant internal controls over financial reporting and compliance, and evaluated the design and operating effectiveness of internal control;
- considered FDIC's process for evaluating and reporting on internal control based on criteria established by FMFIA; and
- tested compliance with certain laws and regulations, including selected provisions of the Federal Deposit Insurance Act, as amended, the Federal Deposit Insurance Reform Act of 2005, and the Chief Financial Officers Act of 1990.

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

We did not test compliance with all laws and regulations applicable to FDIC. We limited our tests of compliance to those laws and regulations that could have a direct and material effect on the financial statements for the year ended December 31, 2006. 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 work in accordance with U.S. generally accepted government auditing standards.

FDIC Comments and Our Evaluation

In commenting on a draft of this report, FDIC's Chief Financial Officer (CFO) was pleased to receive unqualified opinions on the DIF and FRF financial statements and to note that there were no material weaknesses identified during the 2006 audits. FDIC's CFO appreciated that we recognized the improvements that FDIC made over the past year to its information systems environment. Also, the CFO stated that FDIC's sustained commitment to enhancing information systems controls adequately addressed the concerns that we highlighted in the prior year report and enabled us to conclude that the remaining issues related to such controls do not constitute a significant deficiency. Finally, the CFO stated that FDIC's goal is to maintain an effective information security program going forward, and has pledged to work diligently to resolve control issues that we identified during the 2006 audits, as well as any that may arise in the future.

The complete text of FDIC's comments is reprinted in appendix I.

David M. Walker
Comptroller General
of the United States

January 31, 2007

FDIC
Federal Deposit Insurance Corporation
550 17th Street, NW Washington, DC 20429 Deputy to the Chairman and Chief Financial Officer

February 8, 2007

Mr. David M. Walker
Comptroller General of the United States
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Re: FDIC Management Response on the GAO 2006 Financial Statements Audit Report

Dear Mr. Walker:

Thank you for the opportunity to comment on the U.S. Government Accountability Office's (GAO) draft audit report titled, **Financial Audit: Federal Deposit Insurance Corporation Funds' 2006 and 2005 Financial Statements, GAO-07-371**. The report presents GAO's opinions on the calendar year 2006 and 2005 financial statements of the Deposit Insurance Fund (DIF) and the Federal Savings and Loan Insurance Corporation Resolution Fund (FRF). The report also presents GAO's opinion on the effectiveness of FDIC's internal controls as of December 31, 2006, and GAO's evaluation of FDIC's compliance with selected laws and regulations.

We are pleased to accept GAO's unqualified opinions on the DIF and the FRF financial statements and to note that there were no material weaknesses identified during the 2006 audits. The GAO reported that the funds' financial statements were presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles; FDIC had effective internal control over financial reporting and compliance with laws and regulations for each fund; and there were no instances of noncompliance with laws and regulations that were tested.

In addition, we appreciate that GAO recognized the improvements that FDIC made over the past year to its information systems environment. We believe that our sustained commitment to enhancing information systems controls adequately addressed the concerns that GAO highlighted in the prior year report, thus enabling GAO to conclude that the remaining issues related to such controls do not constitute a significant deficiency. Our goal is to maintain an effective information security program going forward. Accordingly, we will work diligently to resolve any control issues that GAO identified during its 2006 audits, as well as any that may arise in the future.

We look forward to continuing our cooperative working relationship with the GAO in the coming year. Our collaborative efforts and open communication at all levels of our organizations should ensure continued success. If you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

Steven O. App

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

Overview of the Industry

The 8,743 FDIC-insured commercial banks and savings institutions that filed financial results for the first three quarters of 2006 reported year-to-date net income of $112.4 billion (excludes 12 U.S. branches of foreign banks). This was $10.6 billion (10.4 percent) more than the industry reported for the first three quarters of 2005, and represented the largest three-quarter earnings total ever reported by the industry. The improvement in earnings reflected strong growth in loans and other interest-bearing investments, very good asset quality, and higher noninterest income at larger institutions. More than half of all insured institutions– 56.8 percent – reported earnings increases for the first three quarters of 2006, but the percentage of institutions that were unprofitable increased to 6.9 percent, from 5.8 percent in the first three quarters of 2005.

Profitability, as measured by return on assets (ROA), remained very high by historic standards. For the first three quarters of 2006, the industry ROA was 1.33 percent, the same as in the first three quarters of 2005, and the third-highest ever registered for a nine-month period. Earnings growth was led by increased noninterest income. Total noninterest income grew by $17.6 billion (10.5 percent) compared to the same period in 2005. Income from trading was $3.9 billion (34.6 percent) higher than a year earlier, securitization income was $2.5 billion (14.1 percent) higher, and income from investment banking increased by $1.6 billion (20.8 percent). Net interest income was $16.0 billion higher than in the same period of 2005, but this represented only a 6.7 percent increase, while interest-earning assets grew by 9.7 percent. The relatively sluggish growth in net interest income reflected narrower net interest margins caused by rising short-term interest rates and a flattening yield curve. Improvements in asset quality also provided a boost to earnings in 2006. Provisions for loan and lease losses were $1.8 billion (8.1 percent) lower than in 2005, as net charge-offs declined by $3.6 billion (16.0 percent). Lower gains on sales of securities and other assets (down $2.5 billion, or 58.3 percent), and higher noninterest expenses (up $18.0 billion, or 7.6 percent) limited the improvement in earnings.

Asset growth at insured institutions remained very robust in 2006. For the 12 months ended September 30, 2006, total assets of FDIC-insured institutions grew by $1.1 trillion (9.9 percent). Loans and leases accounted for more than half of the growth in assets (56.2 percent), while growth in securities accounted for almost one-tenth of the increase in total assets (9.6 percent). Loans to commercial borrowers accounted for two-thirds of the growth in total loans, with loans to commercial and industrial (C&I) borrowers, real estate construction and development loans, and loans secured by nonfarm nonresidential properties registering the biggest increases. Residential mortgage loans had the largest increase of any single loan category, growing by $158 billion (7.8 percent).

Deposit growth was also strong in 2006, but it did not keep pace with the rapid growth in assets. Total deposits increased by $609.5 billion (8.7 percent) between September 30, 2005, and September 30, 2006, but this growth represented only 57.7 percent of insured institutions' funding needs. Nondeposit liabilities increased by $315 billion (12.0 percent) during this period, and equity capital grew by $132.5 billion (12.1 percent). Merger-related goodwill accounted for almost one-third ($43.1 billion, or 32.6 percent) of the total increase in equity capital. More than 99 percent of all insured institutions met or exceeded the highest regulatory capital requirements as of September 30.

Asset quality indicators remained very positive in 2006. At mid-year, the percentage of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) reached the lowest level in the 23 years that all insured institutions have reported noncurrent loan data. The industry's net charge-off rate was also at a historical low level in 2006. At the end of the third quarter, the number of institutions on the FDIC's "Problem List" stood at 47, the lowest level in the 36 years for which data are available.