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FINANCIAL AUDIT

Federal Deposit Insurance Corporation's 1995 and 1994 Financial Statements





**United States
General Accounting Office
Washington, D.C. 20548**

**Comptroller General
of the United States**

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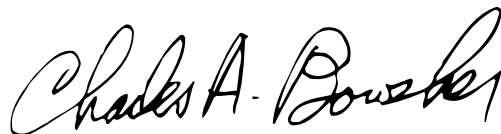
To the President of the Senate and the
Speaker of the House of Representatives

This report presents our opinions on the financial statements of the Bank Insurance Fund, the Savings Association Insurance Fund, and the Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund for the years ended December 31, 1995 and 1994. These financial statements are the responsibility of the Federal Deposit Insurance Corporation (FDIC), the administrator of the three funds. This report also presents (1) our opinion on FDIC management's assertions regarding the effectiveness of its system of internal controls as of December 31, 1995, and (2) our evaluation of FDIC's compliance with laws and regulations during 1995. In addition, it discusses FDIC's progress in correcting internal control weaknesses and presents our recommendations for further improvement. The report also highlights the recent development of a significant premium rate differential between the insured institutions of the Bank Insurance Fund and the Savings Association Insurance Fund as a result of the Bank Insurance Fund attaining its designated capitalization level. We discuss our observations concerning the impact this premium rate differential may have on the thrift industry's ability to finance certain obligations arising from the thrift crisis of the 1980s and on future deposit insurance premium rates.

We conducted our audits pursuant to the provisions of section 17(d) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1827(d)), and in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Chairman of the Board of Directors of the Federal Deposit Insurance Corporation; the Chairman of the Board of Governors of the Federal Reserve System; the Comptroller of the Currency; the Acting Director of the Office of Thrift Supervision; the Chairmen and Ranking Minority Members of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking and Financial Services; the Secretary of the Treasury; the Director of the Office of Management and Budget; and other interested parties.

This report was prepared under the direction of Robert W. Gramling, Director, Corporate Audits and Standards. Other major contributors to this report are listed in appendix II.

A handwritten signature in black ink, reading "Charles A. Bowsher". The signature is written in a cursive, flowing style with a large initial "C" and a long, sweeping underline.

Charles A. Bowsher
Comptroller General
of the United States

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Abbreviations

ADM	Asset Disposition Manual
BIF	Bank Insurance Fund
CAOG	Contractor Accounting Oversight Group
CFO	Chief Financial Officers Act
COMB	Contractor Oversight and Monitoring Branch
DAS	Division of Depositor and Asset Services
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FICO	Financing Corporation
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
FRF	FSLIC Resolution Fund
FSLIC	Federal Savings and Loan Insurance Corporation
RTC	Resolution Trust Corporation
SAIF	Savings Association Insurance Fund

Comptroller General
of the United States

B-262039

To the Board of Directors
Federal Deposit Insurance Corporation

We have audited the statements of financial position as of December 31, 1995 and 1994, of the three funds administered by the Federal Deposit Insurance Corporation (FDIC), the related statements of income and fund balance (accumulated deficit), and statements of cash flows for the years then ended. In our audits of the Bank Insurance Fund (BIF), the Savings Association Insurance Fund (SAIF), and the Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund (FRF), we found

- the financial statements of each fund, taken as a whole, were reliable in all material respects;
- although certain internal controls should be improved, FDIC management fairly stated that internal controls in place on December 31, 1995, were effective in safeguarding assets from material loss, assuring compliance with relevant laws and regulations, and assuring that there were no material misstatements in the financial statements of the three funds administered by FDIC; and
- no reportable noncompliance with laws and regulations we tested.

During our audits of the 1994 financial statements of the three funds,¹ we identified weaknesses in FDIC's internal controls which, while not material, affected its ability to ensure that internal control objectives were achieved. We made a number of recommendations to address each of the weaknesses identified in our 1994 audits.

In conducting our 1995 audits, we found that FDIC made progress in addressing several internal control weaknesses identified in our 1994 audits. FDIC's actions during 1995 fully resolved weaknesses we identified in controls over safeguarding of assets and proper reporting of asset management and disposition activity by contracted asset servicing entities. Also, FDIC made some progress in improving controls over its asset valuation process. However, additional improvements are needed, as FDIC has not fully addressed our concerns regarding weaknesses in documentation maintained to support asset recovery estimates. Our 1995 audits continued to find weaknesses, though not material, in controls over FDIC's process for estimating recoveries from failed institution assets. In our 1995 audits, we also continued to find weaknesses in FDIC's time and attendance reporting process. FDIC has initiatives underway to streamline

¹Financial Audit: Federal Deposit Insurance Corporation's 1994 and 1993 Financial Statements (GAO/AIMD-95-102, March 31, 1995).

its time and attendance process which it believes will address the internal control weaknesses we identified. In addition, during 1995, we found a weakness in FDIC's electronic data processing controls which, due to its sensitive nature, is being communicated separately to FDIC.

The condition of the nation's banks and savings associations continued to improve. The improved condition of the banking industry, and the higher premiums BIF-insured institutions have paid in the last several years, resulted in BIF reaching its designated capitalization level in 1995. Consequently, FDIC lowered premium rates charged to BIF-insured institutions. While the improved condition of the nation's thrifts and higher premiums have helped improve SAIF's condition, a significant premium rate differential developed between BIF and SAIF during 1995 and, absent legislative action, will likely remain for a number of years. This significant premium rate differential could adversely affect the thrift industry's ability to finance certain obligations arising from the thrift crisis of the 1980s and could eventually lead to higher deposit insurance premium rates.

The following sections discuss our conclusions in more detail and discuss (1) the scope of our audits, (2) significant matters related to the condition and outlook of the banking and thrift industries and the insurance funds, and what progress the Corporation has made in addressing internal control weaknesses identified in prior audits, (3) reportable conditions² identified in our 1995 audits, (4) recommendations from our 1995 audits, and (5) the Corporation's comments on a draft of this report and our evaluation.

²Reportable conditions involve matters coming to the auditor's attention relating to significant deficiencies in the design or operation of internal controls that, in the auditor's judgment, could adversely affect an entity's ability to (1) safeguard assets against loss from unauthorized acquisition, use, or disposition, (2) ensure the execution of transactions in accordance with management's authority and in accordance with laws and regulations, and (3) properly record, process, and summarize transactions to permit the preparation of financial statements and to maintain accountability for assets. A material weakness is a reportable condition in which the design or operation of the internal controls does not reduce to a relatively low level the risk that losses, noncompliance, or misstatements in amounts that would be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of their assigned duties.

Opinion on Financial Statements

Bank Insurance Fund

In our opinion, the financial statements and accompanying notes present fairly, in all material respects, in conformity with generally accepted accounting principles, the Bank Insurance Fund's financial position as of December 31, 1995 and 1994, and the results of its operations and its cash flows for the years then ended.

However, misstatements may nevertheless occur in other FDIC-reported financial information on BIF as a result of the internal control weaknesses summarized above and discussed in detail in a later section of this report.

Savings Association Insurance Fund

In our opinion, the financial statements and accompanying notes present fairly, in all material respects, in conformity with generally accepted accounting principles, the Savings Association Insurance Fund's financial position as of December 31, 1995 and 1994, and the results of its operations and its cash flows for the years then ended.

However, misstatements may nevertheless occur in other FDIC-reported financial information on SAIF as a result of the internal control weaknesses summarized above and discussed in detail in a later section of this report.

FSLIC Resolution Fund

In our opinion, the financial statements and accompanying notes present fairly, in all material respects, in conformity with generally accepted accounting principles, the FSLIC Resolution Fund's financial position as of December 31, 1995 and 1994, and the results of its operations and its cash flows for the years then ended.

However, misstatements may nevertheless occur in other FDIC-reported financial information on FRF as a result of the internal control weaknesses summarized above and discussed in detail in a later section of this report.

On January 1, 1996, FRF assumed responsibility for liquidating the assets and satisfying the obligations of the Resolution Trust Corporation (RTC).³ As discussed in note 1 of FRF's financial statements,⁴ proceeds from the management and disposition of RTC's assets will be used to satisfy the transferred obligations. Any additional proceeds after satisfaction of RTC's obligations will be transferred to the Resolution Funding Corporation.⁵

As discussed in note 8 of FRF's financial statements, there are approximately 120 pending lawsuits which stem from legislation that resulted in the elimination of supervisory goodwill and other forbearances from regulatory capital. These lawsuits assert various legal claims including breach of contract or an uncompensated taking of property resulting from the FIRREA provisions regarding minimum capital requirements for thrifts and limitations as to the use of supervisory goodwill to meet minimum capital requirements. One case has resulted in a final judgment of \$6 million against FDIC, which was paid by FRF.

On July 1, 1996, the United States Supreme Court concluded that the government is liable for damages in three other cases, consolidated for appeal to the Supreme Court, in which the changes in regulatory treatment required by FIRREA led the government to not honor its contractual obligations. However, because the lower courts had not determined the appropriate measure or amount of damages, the Supreme Court returned the cases to the Court of Federal Claims for further proceedings. Until the amount of damages are determined by the court, the amount of additional costs from these three cases is uncertain. Further, with respect to the other pending cases, the outcome of each case and the amount of any possible damages will depend on the facts and circumstances, including

³The Resolution Trust Corporation was created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to manage and resolve all troubled savings institutions that were previously insured by FSLIC and for which a conservator or receiver was appointed during the period January 1, 1989, through August 8, 1992. This period was extended to September 30, 1993, by the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 and was further extended on December 17, 1993, to a date not earlier than January 1, 1995, nor later than July 1, 1995, by the Resolution Trust Corporation Completion Act of 1993 (RTC Completion Act). The RTC Completion Act stated that the final date would be determined by the Chairperson of the Thrift Depositor Protection Oversight Board. On December 5, 1994, the Chairperson made the determination that RTC would continue to resolve failed thrift institutions through June 30, 1995. Finally, the RTC Completion Act required RTC to terminate its operations no later than December 31, 1995.

⁴The notes to FRF's financial statements do not present amounts associated with the assets and obligations transferred from RTC as FDIC management is currently considering the future form of the reporting entity (that is, FRF and RTC).

⁵The Resolution Funding Corporation was established by FIRREA to provide funding for RTC through issuance of long-term debt securities. Any proceeds transferred to the Resolution Funding Corporation will be used to make interest payments on the long-term debt securities.

the wording of agreements between thrift regulators and acquirers of troubled savings and loan institutions. Estimates of possible damages suggest that the additional costs associated with these claims may be in the billions. The Congressional Budget Office's December 1995 update of its baseline budget projections increased its projection of future outlays for fiscal years 1997 through 2002 by \$9 billion for possible payments of such claims.

As mentioned above, the final judgment of \$6 million in one case against FDIC was paid by FRF. However, as discussed in note 8 of FRF's financial statements, FDIC believes that judgments in such cases are properly paid from the Judgment Fund.⁶ The extent to which FRF will be the source of paying other judgments in such cases is uncertain.

Opinion on FDIC Management's Assertions About the Effectiveness of FDIC's Internal Controls

For the three funds administered by FDIC, we evaluated FDIC management's assertions about the effectiveness of its internal controls designed to

- safeguard assets against unauthorized acquisition, use, or disposition;
- assure the execution of transactions in accordance with management's authority and with provisions of selected laws and regulations that have a direct and material effect on the financial statements of the three funds; and
- properly record, process, and summarize transactions to permit the preparation of financial statements in accordance with generally accepted accounting principles.

FDIC management fairly stated that those controls in place on December 31, 1995, provided reasonable assurance that losses, noncompliance, or misstatements material in relation to the financial statements of each of the three funds would be prevented or detected on a timely basis. Management made this assertion based on criteria in GAO's Standards for Internal Controls in the Federal Government and consistent with the requirements of the Federal Managers' Financial Integrity Act of 1982. However, our work identified the need to improve certain internal controls, which were previously summarized and are described in detail in a later section of this report. These weaknesses in internal controls, although not considered to be material weaknesses, represent significant deficiencies in the design or operation of internal controls which could adversely affect FDIC's ability to meet the internal control objectives listed above.

⁶The Judgment Fund is a permanent, indefinite appropriation established by 31 U.S.C. Sec. 1304.

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 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

- preparing the annual financial statements of BIF, SAIF, and FRF in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing the Corporation's internal control structure to provide reasonable assurance that internal control objectives as described in GAO's Standards for Internal Controls in the Federal Government are met; and
- complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the financial statements of each of the three funds are free of material misstatement and are presented fairly, in all material respects, in conformity with generally accepted accounting principles and (2) FDIC management's assertion about the effectiveness of internal controls is fairly stated, in all material respects, based upon the control criteria used by FDIC management in making its assertion. We are also responsible for testing compliance with selected provisions of laws and regulations and for performing limited procedures with respect to certain other information in FDIC's annual financial report.

In order to fulfill our responsibilities as auditor of record for the Federal Deposit Insurance Corporation, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements of each of the three funds;
- assessed the accounting principles used and significant estimates made by FDIC management;
- evaluated the overall presentation of the financial statements for each of the three funds;
- obtained an understanding of the internal control structure related to safeguarding assets, compliance with laws and regulations, including the execution of transactions in accordance with management's authority, and financial reporting;

- tested relevant internal controls over safeguarding, compliance, and financial reporting and evaluated management's assertion about the effectiveness of internal controls; and
- tested compliance with selected provisions of the Federal Deposit Insurance Act, as amended; the Chief Financial Officers Act; and the Federal Home Loan Bank Act, as amended.

We did not evaluate all internal controls relevant to operating objectives, such as controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to those controls necessary to achieve the objectives outlined in our opinion on management's assertion about the effectiveness of internal controls. Because of inherent limitations in any internal control structure, losses, noncompliance, or misstatements 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 conducted our audits from July 5, 1995, through May 2, 1996. Our audits were conducted in accordance with generally accepted government auditing standards.

FDIC provided comments on a draft of this report. FDIC's comments are discussed and evaluated in a later section of this report and are included in appendix I.

Significant Matters

The following section is provided to highlight the condition and outlook of the banking and thrift industries and the insurance funds. In addition, we discuss FDIC's progress in addressing internal control weaknesses identified during our previous audits.

Condition of FDIC-Insured Institutions Showed Continued Improvement in 1995

During 1995, the banking and thrift industries continued their strong performances.⁷ Commercial banks reported record profits of \$48.8 billion in 1995, marking the fourth consecutive year of record earnings. The main source of earnings in 1995 was higher net interest income. The increase in net interest income was attributable to growth in interest-bearing assets,

⁷The information in this section of the report was obtained from The FDIC Quarterly Banking Profile, Fourth Quarter 1995, compiled by FDIC's Division of Research and Statistics from quarterly financial reports submitted by federally insured depository institutions. Thus, we did not audit this information; however, we believe it is consistent with other audited information.

even though net interest margins declined for a second consecutive year. During 1995, commercial banks' return on assets was 1.17 percent, the third consecutive year that the industry return on assets has exceeded 1 percent.

The strong performance of banks was also reflected in the continued reduction in the number of banks identified as problem institutions. As of December 31, 1995, 144 commercial banks with total assets of \$17 billion were identified by FDIC as problem institutions. This represented an improvement over 1994, when 247 commercial banks with total assets of \$33 billion were identified as problem institutions. Six commercial banks failed in 1995, the fewest number of failures in any year since 1977.

Savings institutions reported record earnings of \$7.6 billion in 1995, up from the \$6.4 billion earned in 1994. Thrifts experienced an increase in net interest margins in the fourth quarter 1995, the first such increase since 1993. In addition, the thrift industry's annual return on assets rose to 0.78 percent, the highest since 1962. The industry's improved performance was also reflected in the reduction in the number of troubled institutions. As of December 31, 1995, regulators identified 49 savings institutions with total assets of \$14 billion as problem institutions. This was a significant improvement over 1994, when 71 institutions with total assets of \$39 billion were identified as problem institutions. In 1995, only two savings institutions failed.

A Significant Premium Rate Differential Between Banks and Thrifts Developed in 1995

The strengthened condition of the banking industry, coupled with the relatively high insurance premiums that banks paid between 1991 and 1995, resulted in an accelerated rebuilding of BIF's reserves. BIF reached its designated reserve ratio of 1.25 percent of estimated insured deposits in May 1995. Consequently, FDIC's Board of Directors significantly reduced the risk-based premium rates charged to BIF-insured institutions, and, in September 1995, refunded assessment overpayments from the month following the month BIF recapitalized, or from June 1995 through September 1995, after FDIC confirmed that BIF had achieved its designated reserve ratio. At December 31, 1995, BIF's ratio of reserves to insured deposits equaled 1.30 percent.

Although the thrift industry also experienced significant improvements over the past few years, SAIF has not experienced a similar increase in its ratio of reserves to insured deposits. As of December 31, 1995, SAIF's ratio of reserves to insured deposits equaled 0.47 percent, which is still

substantially below its designated reserve ratio of 1.25 percent. SAIF's capitalization has been slowed because its members' premiums have and continue to be used to pay for certain obligations of the thrift crisis, including interest on 30-year bonds issued by the Financing Corporation (FICO).⁸ FDIC estimates that, absent the statutory requirement to use premiums for these other obligations, SAIF would have been fully capitalized in 1994. Under current law, FICO has authority to assess SAIF-member savings associations to cover its annual interest expense, which will continue until the 30-year bonds mature in the years 2017 through 2019. In 1995, FICO's assessment totaled \$718 million, or approximately 42 percent of SAIF's assessment revenue.⁹

As a result of the annual FICO interest payments, the need to capitalize SAIF to its designated reserve ratio, and a reduction in premium rates for BIF-insured institutions, a significant differential in premium rates charged by BIF and SAIF developed in 1995 and, absent legislative action, will likely remain for many years.¹⁰ For example, during 1996, institutions with deposits insured by BIF are paying an average of less than one cent per \$100 of assessable deposits for deposit insurance (0.3 cents). In contrast, institutions with deposits insured by SAIF are paying an average of 23.4 cents per \$100 of assessable deposits for similar deposit insurance. Thus, a premium differential of about 23 basis points¹¹ currently exists.

⁸FICO was established in 1987 to recapitalize the Federal Savings and Loan Insurance Fund, the former insurance fund for thrifts. FICO was funded mainly through the issuance of public debt offerings which were initially limited to \$10.8 billion but were later effectively capped at \$8.2 billion by the RTC Refinancing, Restructuring, and Improvement Act of 1991. Neither FICO's bond obligations or the interest on these obligations are obligations of the United States nor are they guaranteed by the United States.

⁹The annual FICO interest obligation, on average, equals approximately \$780 million. Because FICO had available cash reserves in 1995, its draw on SAIF's assessments was slightly less than the amount needed to fully fund the 1995 interest payments.

¹⁰Deposit Insurance Funds: Analysis of Insurance Premium Disparity Between Banks and Thrifts (GAO/AIMD-95-84, March 3, 1995) and Deposit Insurance Funds: Analysis of Insurance Premium Disparity Between Banks and Thrifts (GAO/T-AIMD-95-111, March 23, 1995).

¹¹One hundred basis points are equivalent to one percentage point. In this context, the 23 basis points would translate into a 23-cent premium differential for every \$100 in assessable deposits.

The Premium Rate Differential Could Affect Funding for FICO's Interest Obligation and Future Deposit Insurance Premium Rates

Only a portion of SAIF's assessment base is available to fund the annual FICO interest obligation.¹² This portion of SAIF's assessment base has declined on average 11 percent each year since SAIF's inception in 1989. At December 31, 1995, only \$459 billion of SAIF's total assessment base of \$734 billion, or about 62 percent, was available to fund the annual FICO interest obligation. At SAIF's current premium rates, the portion of SAIF's assessment base needed to fund FICO cannot decline below \$333 billion in order to avoid a default on the FICO interest payments.

Absent a legislative solution, the premium rate differential between BIF and SAIF provides incentive for SAIF-member institutions to reduce their SAIF-insured deposits to avoid paying higher premiums. Such reductions would further decrease SAIF's assessment base and increase the potential for a default on the FICO bond interest obligation.

When the same product exists in the market place—in this case, deposit insurance—but at two substantially different prices, market forces can provide a strong incentive to avoid the higher price in favor of the lower. Institutions seeking to avoid higher SAIF premiums could do so in a number of ways: (1) reduce the institution's total assets, which, in turn, would reduce its need for deposits, (2) obtain funding from sources such as Federal Home Loan Bank advances or repurchase agreements, which are not subject to insurance premiums, (3) accept BIF-insured deposits as agents for BIF-member affiliates, or (4) pay lower interest rates on deposits, which would encourage deposits to migrate from SAIF to BIF by letting BIF-member affiliates draw away business with deposit rates reflecting their lower deposit insurance costs.

Federal regulators have already observed that some institutions are beginning to use these strategies to decrease their SAIF-insured deposits and, thus, to avoid the higher SAIF premiums. Recently, one large thrift shifted \$2.6 billion in deposits to a BIF affiliate. Currently, about 150 SAIF members, with deposits totaling \$165 billion, have BIF-member affiliates or are actively pursuing affiliates. The banking regulators have stated that, under existing law, they have limited ability to stop such deposit migration.

¹²Thrift deposits acquired by BIF members, referred to as "Oakar" deposits, retain SAIF insurance coverage, and the acquiring institution pays insurance premiums to SAIF for these deposits at SAIF's premium rates. However, because the institution acquiring these deposits is not a savings association and remains a BIF member as opposed to a SAIF member, the insurance premiums it pays to SAIF, while available to capitalize SAIF, are not available to service the FICO interest obligation. Similarly, premiums paid by SAIF-member savings associations that have converted to bank charters, referred to as "Sasser" institutions, are unavailable to fund the FICO interest obligation since the institutions are banks as opposed to savings associations.

As noted above, a continual shrinkage of SAIF's assessment base could have implications not only for debt servicing of the FICO interest obligation, but also for SAIF and BIF premium rates. If SAIF's assessment base shrinks to the point that current SAIF premium rates can no longer provide for sufficient revenue to fund the annual FICO interest payments, a default on the FICO interest obligation could result absent an increase in SAIF's premium rates. Increasing premium rates to compensate for the shrinkage in SAIF's assessment base could lead to even further shrinkage as the higher premiums force more institutions to seek relief by reducing their dependence on SAIF-insured deposits. This, in turn, would increase the potential for a default on the FICO interest obligation. Also, if SAIF deposits continue to shrink, the fund will become smaller and less able to diversify risk, as it is likely that the stronger SAIF member institutions will shift their deposits to BIF, leaving the weaker institutions to SAIF. Finally, if deposits migrate from SAIF to BIF, BIF's reserve ratio could be adversely affected because the transferred deposits do not bring with them any reserves. This could ultimately result in higher future premium rates for BIF members in order for the fund to maintain its designated reserve ratio.

On March 19, 1996, the House Committee on Banking and Financial Services held hearings on the condition of SAIF. At these hearings, the FDIC Chairman, the Acting Director of the Office of Thrift Supervision, and the Under Secretary for Domestic Finance of the United States Treasury, urged the Congress to pass comprehensive legislation to provide a solution to the problems associated with capitalizing SAIF, funding FICO, and eliminating the premium rate differential. We have, and continue, to support the need to address the significant risks associated with the premium rate differential.¹³

1995 Actions Address Some Weaknesses Identified in Previous Audits

In our 1994 financial statement audit report on the three funds administered by FDIC, we identified reportable conditions which affected FDIC's ability to ensure that internal control objectives were achieved. These weaknesses related to FDIC's internal controls designed to ensure that (1) estimated recoveries for failed institution assets were determined using sound methodologies and were adequately documented, (2) third party entities properly safeguarded assets and reported asset activity to FDIC, and (3) time and attendance reporting procedures were effective. During 1995, FDIC and third party asset servicing entities' actions

¹³Deposit Insurance Funds: Analysis of Insurance Premium Disparity Between Banks and Thrifts (GAO/T-AIMD-95-223, August 2, 1995).

addressed, or partially addressed, some of the weaknesses identified in our 1994 audit report.

During our 1994 audits, we identified weaknesses in FDIC's documentation of, and methodology for, estimating recoveries from assets acquired from failed institutions. To address our concerns, FDIC developed historical data to support the formula recovery estimates used for most assets with book values under \$250,000. Also, FDIC revised its guidance for estimating recoveries from failed institution assets. The revised guidance provides more comprehensive recovery estimation criteria which take into account the asset's most probable disposition strategy and contains strict documentation standards to support recovery estimates. However, while the revised procedures provide a sound basis for estimating recoveries for failed institution assets, our 1995 audits found that the revised procedures were not effectively implemented.

Our 1994 audits also identified weaknesses in oversight of third party entities contracted to manage and dispose of failed institution assets. During 1995, FDIC and third party servicers acted to address internal control weaknesses over third party servicers' reporting of asset management and disposition activity and safeguarding of collections. Specifically, the Contractor Accounting Oversight Group (CAOG) and Contractor Oversight and Monitoring Branch (COMB) of FDIC's Division of Finance and Division of Depositor and Asset Services, respectively, fully implemented the requirements of the Letter of Understanding on Accounting Roles and Responsibilities of CAOG and COMB. This letter outlines specific verification procedures, the timing of those procedures, and the FDIC entity responsible for performing the procedures at the contracted asset servicers. The letter was issued in October 1994, but was not fully implemented until after December 31, 1994. However, we found that during 1995, FDIC verified the accuracy of reported asset activity to supporting documentation and to servicers' detailed accounting records.

Third party servicers also improved daily collection procedures designed to ensure that collections are properly safeguarded and completely and accurately reported. Specifically, one servicer effectively implemented procedures to verify collections received and reconcile collections processed and deposited to daily collections. Another servicer implemented dual controls over daily collections and instituted aggressive procedures for collecting delinquent payments. In addition, another servicer completed its servicing agreement with FDIC. As a result of the actions taken by FDIC regarding verification of servicer activity reports and

actions taken by the asset servicers regarding safeguarding of collections, we no longer consider these issues to be a reportable condition as of December 31, 1995.

While the above actions address some of the internal control deficiencies identified in our prior year's audits, some long-standing deficiencies remain. During 1995, we continued to find weaknesses in FDIC's adherence to its time and attendance reporting procedures. Also, we continued to find weaknesses in documentation used to support estimated recoveries from failed institution assets. Finally, while FDIC revised its procedures for estimating recoveries for failed institution assets, we found these procedures were not effectively implemented. Consequently, as discussed below, we still consider these weaknesses to be reportable conditions as of December 31, 1995.

Reportable Conditions

The following reportable conditions represent significant deficiencies in FDIC's internal controls and should be corrected by FDIC management.

1. Controls to ensure that recovery estimates for assets acquired from failed financial institutions comply with FDIC's revised asset recovery estimation methodology are not working effectively. Specifically, FDIC's controls do not ensure that recovery estimates comply with the methodologies specified in FDIC's Asset Disposition Manual (ADM), or are based on current and complete file documentation. Also, FDIC does not have controls in place to ensure that, in deriving reasonable estimates of recovery for assets in liquidation, the asset recovery estimation process considers the impact of events through the period covered by the three funds' financial statements. These estimates are used by FDIC to determine the allowance for losses on receivables from resolution activities and investment in corporate-owned assets for the funds. Consequently, these weaknesses resulted in misstatements to BIF's and FRF's 1995 financial statements and could result in future misstatements to each fund's financial statements if corrective action is not taken by FDIC management.

In response to recommendations in our 1994 audit report, in August 1995, FDIC completed the ADM and issued it to Division of Depositor and Asset Services field office staff. This manual contained detailed guidance in asset recovery estimation methodologies and strict requirements for documentation to support such estimates. FDIC's intent in issuing this manual was to ensure that reasonable estimates of recoveries were available to facilitate the calculation of the December 31, 1995, allowance

for losses for the funds administered by FDIC. However, we found that the ADM was not effectively implemented. Specifically, we found that asset recovery estimates were not always consistently supported by, and/or consistent with file documentation or the most probable disposition strategy. Also, we found that asset recovery estimates were not always prepared using the most current information available at the time the estimate was developed.

The Asset Disposition Manual requires supervisory review to verify the accuracy and adequacy of recovery estimates. However, we found that the supervisory reviews were generally cursory in nature and frequently did not identify recovery estimates that were not in compliance with the ADM. Consequently, these reviews did not always identify inaccurate or unsupported asset recovery estimates.

FDIC uses asset recovery estimates prepared no later than September 30 in calculating the year-end allowance for losses on the receivables from resolution activities and investments in corporate-owned assets reflected in the funds' financial statements. This creates the potential for significant changes in the estimates of recoveries on the underlying assets in liquidation in the last 3 months of the year to not be fully reflected in the year-end financial statements.

In this regard, we found that significant fluctuations in the aggregate estimated recovery value of BIF's and FRF's failed institution asset inventory that occurred during the fourth quarter of 1995 were not fully reflected in the year-end allowance for losses on BIF's and FRF's receivables from resolution activities and investment in corporate-owned assets. These fluctuations were caused by a number of factors, such as collections on assets, asset dispositions, write-offs, and changes in the circumstances affecting individual assets' recovery potential. The ADM requires individual asset recovery estimates to be updated within 30 days following any significant event or change in disposition strategy that affects the estimated recovery by 5 percent or more. However, we found that recovery estimates were not always updated to reflect these changes. Also, when such changes were made, they were not used to update the year-end allowance for loss calculation.

The lack of consistent adherence to the revised asset valuation methodology, particularly regarding the need for adequate documentation to support such estimates, combined with the lack of an effective process for fully considering the impact of events between the asset valuation date

and year-end, resulted in FDIC understating BIF's and FRF's allowance for losses on their receivables from resolution activity and investment in corporate-owned assets. This, in turn, contributed to FDIC misstating BIF's fund balance and FRF's accumulated deficit as of December 31, 1995.

We selected samples of BIF's and FRF's inventories of failed institution assets. Using the criteria contained in the ADM, we reviewed FDIC's compliance with the ADM at September 30, 1995, and we estimated recoveries for the assets in our samples through the December 31, 1995, financial statement date. Based on our work, we estimate that BIF's fund balance was overstated by about \$266 million and FRF's accumulated deficit was understated by about \$183 million. However, these amounts were not significant enough to materially misstate the 1995 financial statements.¹⁴

FDIC is currently making substantial changes to its asset valuation process. The new process is intended to provide for uniformity throughout the organization in estimating amounts to be recovered from failed financial institution assets and will rely heavily on statistical sampling procedures as well as economic and market assumptions. However, it will also rely heavily on available asset documentation in determining the appropriate assumptions to be used to develop recovery estimates. Consequently, in implementing this new asset valuation process, FDIC should ensure that the weaknesses we have identified with respect to the process used during 1995 are fully addressed.

2. FDIC has not strictly enforced adherence to its time and attendance reporting procedures. As in previous audits, our 1995 audits continued to identify deficiencies in adherence to required procedures in preparing time and attendance reports, separation of duties between timekeeping and data entry functions, and reconciliation of payroll reports to time cards. These weaknesses could adversely affect FDIC's ability to properly allocate expenses among the three funds.

¹⁴In making this determination, we considered the needs of the users of BIF's and FRF's financial statements. In BIF's case, we considered the Fund balance to be the most significant component to the financial statement users, as the Fund balance reflects BIF's financial health and is a primary consideration in setting premium rates for insured member institutions. In FRF's case, we considered the Accumulated Deficit to be the most significant component to the financial statement users, as it reflects amounts to be funded from appropriations to liquidate the assets and contractual obligations of the defunct FSLIC. In this context, the misstatements we identified through our audits represent one-percent of BIF's \$25.5 billion fund balance, and 0.4 percent of FRF's \$43.4 billion Accumulated Deficit, respectively, at December 31, 1995. We also noted in FRF's case that the Fund's Resolution Equity at December 31, 1995, is more than sufficient to cover additional losses even were such losses to exceed the level of misstatement we identified in FRF's 1995 financial statements.

In April 1996, FDIC began implementing a new process intended to streamline and improve time and attendance reporting. FDIC officials have indicated that the revised time and attendance process constitutes the initial steps in developing a fully automated system. However, while this revised process may result in some increased efficiencies, the new process, in and of itself, will not correct the deficiencies we identified during the past several years. Further improvements and ultimately a fully automated system may reduce the occurrence of weaknesses such as inadequate reconciliations and lack of separation of duties, but they offer no assurance that existing problems will be fully resolved. Given the longstanding nature of time and attendance reporting deficiencies and the failure of past efforts to fully satisfy our prior audits' recommendations to correct these deficiencies, it is critical that FDIC management strictly enforce adherence to current and future time and attendance reporting procedures.

3. We identified another weakness related to FDIC's electronic data processing controls during our 1995 audits which, due to its sensitive nature, is being communicated to FDIC management, along with our recommendations for corrective action, through separate correspondence.

In addition to the weaknesses discussed above, we noted other less significant matters involving FDIC's system of internal accounting controls and its operations, which we will be reporting separately to FDIC.

Recommendations

To address weaknesses identified in this year's audits in the area of estimating recoveries for failed institution assets, we recommend that the Chairman of the Federal Deposit Insurance Corporation direct heads of the Division of Depositor and Asset Services and Division of Finance to

- ensure that field office personnel maintain complete and current documentation in asset files to provide a basis for assumptions used to derive asset recovery estimates and that the assumptions used are appropriately documented,
- ensure that supervisory reviews of asset recovery estimates are performed thoroughly and include a review of asset file documentation to identify and correct inaccurate or unsupported estimates, and
- establish and enforce procedures to ensure that recovery estimates are updated for information made available between the valuation date and the year-end financial statement reporting date.

Corporation Comments and Our Evaluation

In commenting on a draft of this report, FDIC acknowledged that further improvements could be made to resolve weaknesses in its asset valuation process and is initiating a new process for estimating asset recoveries. FDIC expects this process to be in place for the 1996 annual financial statements. FDIC believes that this new process will address concerns regarding asset valuation methodology, documentation, management review, and timing differences. We will review FDIC's new asset valuation process as part of our 1996 financial audits.

FDIC also stated that it reviewed the assets sampled by us in our audits. FDIC noted that its own review found instances of noncompliance by FDIC personnel with the revised Asset Disposition Manual guidelines for estimating asset recoveries. FDIC stated that its review also found numerous instances in which GAO and FDIC were in complete or substantial agreement. FDIC concluded from its review that the revised asset recovery methodology was generally understood and that its staff, in general, properly prepared asset recovery estimates.

FDIC also stated that it believes its asset recovery estimates, in the aggregate, are reasonable. FDIC said that asset valuations often cannot be determined with precision, and that various reasonableness tests performed by FDIC staff support the position that both FDIC's asset recovery estimates as reflected in BIF's and FRF's 1995 financial statements and our estimates of the aggregate recovery value of the assets are reasonable. Thus, FDIC believes that there is no basis for asserting that either set of estimates is more accurate than the other.

We agree that estimating potential recoveries on failed institution assets is subject to some degree of uncertainty. It is this inherent uncertainty in the estimation process that makes strict adherence to a sound methodology critical to ensuring that reasonable estimates are derived for use in preparing the financial statements. Our estimates are based on a strict application of FDIC's revised methodology and include the impact on asset recovery potential of events through the financial statement reporting date. While certain analytical procedures, as applied by FDIC, may help to provide additional comfort as to the reasonableness of FDIC's official estimation process, they are not a substitute for a systematic, reasonable, and verifiable methodology.

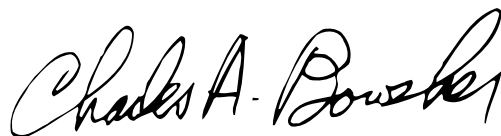
As we discuss in this report, FDIC took significant steps during 1995 to address the deficiencies in its asset valuation methodology that we identified in previous audits. However, the level of compliance with the

revised methodology was significantly deficient. We found that in over 41 percent of the assets we sampled, FDIC field office personnel did not comply with the revised methodology. This level of noncompliance coupled with the impact on asset recovery estimates of events subsequent to FDIC's valuation date but up to the financial statement reporting date resulted in differences in recovery estimates in about 89 percent of the assets we reviewed. FDIC's own review of the assets we sampled confirmed our audit findings. As we noted in this report, we believe the resulting level of misstatements were not significant enough to materially misstate BIF's and FRF's 1995 financial statements. However, they do illustrate the impact that weaknesses in controls over the asset valuation process can have on the financial statements.

FDIC also commented on initiatives it has underway to address the deficiencies we identified in its time and attendance reporting and audit processes. FDIC believes these initiatives will facilitate the timely identification and correction of time and attendance related issues. In addition, FDIC noted that it is studying its current expense allocation and recovery methodologies and, as part of this undertaking, is developing methods that will reduce reliance on time and attendance reporting in determining expense allocations to funds and receiverships. FDIC noted that it is currently addressing weaknesses we identified in its electronic data processing controls.

FDIC also discussed other management initiatives it has underway to improve its operational effectiveness, including enhancements to its contracting oversight and a more corporatewide monitoring of internal control issues. FDIC noted that it has also established an audit committee to review the adequacy of the Corporation's internal controls and compliance with laws and regulations, and to review internal and external audit recommendations.

The complete text of FDIC's response to our report is included in appendix I.

A handwritten signature in black ink, reading "Charles A. Bowsher". The signature is written in a cursive, flowing style with a large initial "C" and a stylized "B".

Charles A. Bowsher
Comptroller General
of the United States

May 2, 1996

Bank Insurance Fund's Financial Statements

Statements of Financial Position

Federal Deposit Insurance Corporation

Bank Insurance Fund Statements of Financial Position

Dollars in Thousands

	December 31	
	1995	1994
Assets		
Cash and cash equivalents (Note 3)	\$ 531,308	\$ 1,621,456
Investment in U.S. Treasury obligations, net (Note 4)	20,762,046	12,896,856
Interest receivable on investments and other assets, net	406,804	260,702
Receivables from bank resolutions, net (Note 5)	4,143,040	8,190,492
Investment in corporate owned assets, net (Note 6)	180,293	242,628
Property and buildings, net (Note 7)	151,740	155,079
Total Assets	\$ 26,175,231	\$ 23,367,213
Liabilities and the Fund Balance		
Accounts payable and other liabilities	\$ 192,744	\$ 256,197
Liabilities incurred from bank resolutions (Note 8)	31,882	81,945
<i>Estimated Liabilities for: (Note 9)</i>		
Anticipated failure of insured institutions	279,000	875,000
Assistance agreements	55,941	163,164
Asset securitization guarantee	126,151	128,417
Litigation losses	35,815	14,708
Total Liabilities	721,533	1,519,431
<i>Commitments and contingencies (Notes 14 and 15)</i>		
Fund Balance	25,453,698	21,847,782
Total Liabilities and the Fund Balance	\$ 26,175,231	\$ 23,367,213

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

Statements of Income and the Fund Balance

Federal Deposit Insurance Corporation**Bank Insurance Fund Statements of Income and the Fund Balance**

Dollars in Thousands

For the Year Ended
December 31

	1995	1994
Revenue		
Assessments (Note 11)	\$ 2,906,943	\$ 5,590,644
Interest on U.S. Treasury investments	1,068,395	521,473
Revenue from corporate owned assets	58,585	140,821
Other revenue	55,176	214,086
Total Revenue	4,089,099	6,467,024
Expenses and Losses		
Operating expenses	470,625	423,196
Provision for insurance losses (Note 10)	(33,167)	(2,873,419)
Corporate owned asset expenses	73,599	137,632
Interest and other insurance expenses	(27,874)	53,493
Total Expenses and Losses	483,183	(2,259,098)
Net Income	3,605,916	8,726,122
Fund Balance - Beginning	21,847,782	13,121,660
Fund Balance - Ending	\$ 25,453,698	\$ 21,847,782

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

Statements of Cash Flows

Federal Deposit Insurance Corporation

Bank Insurance Fund Statements of Cash Flows

Dollars in Thousands

For the Year Ended
December 31

	1995	1994
Cash Flows from Operating Activities		
Cash provided from:		
Assessments	\$ 2,796,114	\$ 5,709,912
Interest on U.S. Treasury investments	875,226	458,606
Recoveries from bank resolutions	5,059,751	5,336,125
Recoveries from corporate owned assets	211,691	694,401
Miscellaneous receipts	36,084	22,337
Cash used for:		
Operating expenses	(442,101)	(485,963)
Disbursements for bank resolutions	(1,596,391)	(2,791,417)
Disbursements for corporate owned assets	(159,299)	(173,601)
Miscellaneous disbursements	(23,929)	(658)
Net Cash Provided by Operating Activities (Note 17)	6,757,146	8,769,742
Cash Flows from Investing Activities		
Cash provided from:		
Maturity of U.S. Treasury obligations	3,830,000	800,000
Cash used for:		
Purchase of U.S. Treasury obligations	(11,675,925)	(8,431,525)
Net Cash Used by Investing Activities	(7,845,925)	(7,631,525)
Cash Flows from Financing Activities		
Cash used for:		
Repayments of indebtedness incurred from bank resolutions	(1,369)	0
Net Cash Used by Financing Activities	(1,369)	0
Net (Decrease) Increase in Cash and Cash Equivalents	(1,090,148)	1,138,217
Cash and Cash Equivalents - Beginning	1,621,456	483,239
Cash and Cash Equivalents - Ending	\$ 531,308	\$ 1,621,456

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

Notes to the Financial Statements

Notes to Financial Statements
Bank Insurance Fund
December 31, 1995 and 1994

1. Legislative History and Operations of the Bank Insurance Fund

Legislative History

The U.S. Congress created the Federal Deposit Insurance Corporation (FDIC) through enactment of the Banking Act of 1933. The FDIC was created to restore and maintain public confidence in the nation's banking system.

More recently, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted to reform, recapitalize and consolidate the federal deposit insurance system. The FIRREA created the Bank Insurance Fund (BIF), the Savings Association Insurance Fund (SAIF) and the FSLIC Resolution Fund (FRF). It also designated the FDIC as the administrator of these three funds. All three funds are maintained separately to carry out their respective mandates.

Pursuant to FIRREA, an active institution's insurance fund membership and primary federal supervisor are generally determined by the institution's charter type. Deposits of BIF-member institutions are mostly insured by the BIF; BIF members are predominantly commercial and savings banks supervised by the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve. Deposits of SAIF-member institutions are mostly insured by the SAIF; SAIF members are predominantly thrifts supervised by the Office of Thrift Supervision (OTS). The Oaker amendment to the Federal Deposit Insurance Act (FDI Act) allows BIF and SAIF members to acquire deposits insured by the other insurance fund without changing insurance fund coverage for the acquired deposits.

The FRF is responsible for winding up the affairs of the former Federal Savings and Loan Insurance Corporation (FSLIC).

Other significant legislation includes the Omnibus Budget Reconciliation Act of 1990 (1990 OBR Act) and the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). These acts made changes to the FDIC's assessment authority (see Note 11) and borrowing authority (see "Operations of the BIF" in a following section). The FDICIA also requires the FDIC to: 1) resolve troubled institutions in a manner that will result in the least possible cost to the deposit

insurance funds; 2) provide a schedule for bringing the reserves in the insurance funds to 1.25 percent of insured deposits; and 3) upon recapitalization, maintain the insurance funds at 1.25 percent of insured deposits or a higher percentage as circumstances warrant.

Recent Legislative Proposals

Recent proposed legislation would, if signed into law, affect the BIF in the following ways: 1) BIF-members would be required to share the interest costs of Financing Corporation (FICO) debt on a proportional basis with SAIF-members; 2) if the BIF's capitalization level exceeds the designated reserve ratio (currently 1.25 percent), FDIC would be required to refund such excess up to the amount of the BIF-members' most recent semi-annual assessment; and 3) if the thrift charter is eliminated by January 1, 1998, the BIF and the SAIF would be merged on that date. There would be a separate assessment to fund the BIF-members' share of the FICO interest costs, and therefore such interest costs would not affect regular assessments or the fund balance. Legislative proposals are subject to change as part of the normal legislative process; therefore, it is uncertain what provisions the proposed law, if enacted, will ultimately include.

The FICO, established under the Competitive Equality Banking Act of 1987, is a mixed-ownership government corporation whose sole purpose was to function as a financing vehicle for the FSLIC.

Operations of the BIF

The primary purpose of the BIF is to: 1) insure the deposits and protect the depositors of BIF-insured banks and 2) finance the resolution of failed banks, including managing and liquidating their assets. In addition, the FDIC, acting on behalf of the BIF, examines state-chartered banks that are not members of the Federal Reserve System and provides and monitors assistance to troubled banks.

The BIF is primarily funded from the following sources: 1) BIF assessment premiums; 2) interest earned on investments in U.S. Treasury obligations; 3) income earned on and funds received from the management and disposition of

assets acquired from failed banks; and 4) U.S. Treasury and Federal Financing Bank (FFB) borrowings, if necessary.

The 1990 OBR Act established the FDIC's authority to borrow working capital from the FFB on behalf of the BIF and the SAIF. The FDICIA increased the FDIC's authority to borrow for insurance losses from the U.S. Treasury, on behalf of the BIF and the SAIF, from \$5 billion to \$30 billion.

The FDICIA also established a limitation on obligations that can be incurred by the BIF known

as the maximum obligation limitation (MOL).

Under the MOL, the BIF cannot incur any additional obligation if its total obligations exceed the sum of: 1) the BIF's cash and cash equivalents; 2) 90 percent of the fair market value of the BIF's other assets; and 3) the total amount authorized to be borrowed from the U.S. Treasury, excluding FFB borrowings. For purposes of calculating the MOL, the FDIC's total U.S. Treasury borrowing authority was allocated between the BIF and the SAIF based on the ratio of each fund's insured deposits to total insured deposits. At December 31, 1995, the MOL for the BIF was \$47 billion.

2. Summary of Significant Accounting Policies

General

These financial statements pertain to the financial position, results of operations and cash flows of the BIF and are presented in accordance with generally accepted accounting principles (GAAP). These statements do not include reporting for assets and liabilities of closed banks for which the BIF acts as receiver or liquidating agent. Periodic and final accountability reports of the BIF's activities as receiver or liquidating agent are furnished to courts, supervisory authorities and others as required.

Use of Estimates

The preparation of the BIF's financial statements in conformity with generally accepted accounting principles requires FDIC management to make 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 in the financial statement.

U.S. Treasury Obligations

Securities are intended to be held to maturity and are shown at book value. Book value 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. Interest is calculated on a daily basis and recorded monthly using the effective interest method.

Allowance for Losses on Receivables from Bank Resolutions and Investment in Corporate Owned Assets

The BIF records as a receivable the amounts advanced and/or obligations incurred for assisting and closing banks. The BIF also records as an asset the amounts advanced for investment in corporate owned assets. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. The latter is based on the estimated cash recoveries from the assets of assisted or failed banks, net of all estimated liquidation costs. Estimated cash recoveries also include dividends and gains on sales from equity instruments acquired in resolution transactions.

Escrowed Funds from Resolution Transactions

In various resolution transactions, the BIF paid the acquirer the difference between failed bank liabilities assumed and assets purchased, plus or minus any premium or discount. The BIF considered the amount of the deduction for assets purchased to be funds held on behalf of the receivership (an obligation). The funds remained in escrow and accrued interest until such time as the receivership used the funds to: 1) repurchase assets under asset putback options; 2) pay preferred and secured claims; 3) pay receivership expenses; or 4) pay dividends.

The FDIC policy of holding escrowed funds was terminated during 1994. The BIF continues to pay the acquirer of the failed bank the difference between liabilities assumed and assets purchased, plus or minus any premium or discount. The BIF then pays the receivership for the assets purchased

by the assuming institution, plus or minus the premium or discount paid.

Litigation Losses

The BIF accrues, as a charge to current period operations, an estimate of probable losses from litigation against the BIF in both its corporate and receivership capacities. The FDIC's Legal Division recommends these estimates on a case-by-case basis. The litigation loss estimates related to receiverships are included in the allowance for losses for receivables from bank resolutions.

Receivership Administration

The FDIC is responsible for controlling and disposing of the assets of failed institutions in an orderly and efficient manner. The assets, and the claims against them, are accounted for separately to ensure that liquidation 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. Liquidation expenses incurred by the BIF on behalf of the receiverships are recovered from those receiverships.

Cost Allocations Among Funds

Certain operating expenses (including personnel, administrative and other indirect expenses) not directly charged to each fund under the FDIC's management are allocated on the basis of the relative degree to which the operating expenses were incurred by the funds. The cost of furniture, fixtures and equipment purchased by the FDIC on behalf of the three funds under its administration is allocated among these funds on a pro rata basis. The BIF expenses its share of these allocated costs at the time of acquisition because of their immaterial amounts.

Postretirement Benefits Other Than Pensions

The FDIC established an entity to provide the accounting and administration of postretirement benefits on behalf of the BIF, the SAIF, the FRF and the Resolution Trust Corporation (RTC). The BIF funds its liabilities for these benefits directly to the entity.

Disclosure about Recent Financial Accounting Standards Board Pronouncements

In May 1993, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 114,

"Accounting by Creditors for Impairment of a Loan," to be adopted for fiscal years beginning after December 15, 1994. While FDIC adopted SFAS No. 114, most of the BIF assets are specifically outside the scope of this pronouncement. These assets do not meet the definition of a loan within the meaning of the statement or are valued through alternative methods. Any assets subject to Statement No. 114 are immaterial either because of insignificant book value or because any potential adjustment to the carrying value as a result of applying Statement No. 114 would be immaterial.

The FASB issued SFAS No. 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures," in October 1994, to be adopted for fiscal years beginning after December 15, 1994. This statement is an amendment to SFAS No. 114 and was adopted by the FDIC this year.

Other recent pronouncements issued by the FASB have been adopted or are either not applicable or not material to the financial statements.

Depreciation

The FDIC has designated the BIF administrator of facilities owned and used in its operations. Consequently, the BIF includes the cost of these facilities in its financial statements and provides the necessary funding for them. The BIF charges other funds sharing the facilities a rental fee representing an allocated share of its annual depreciation expense.

The Washington, D.C., office buildings and the L. William Seidman Center in Arlington, Virginia, are depreciated on a straight-line basis over a 50-year estimated life. The San Francisco condominium offices are depreciated on a straight-line basis over a 35-year estimated life.

Related Parties

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

Reclassifications

Reclassifications have been made in the 1994 financial statements to conform to the presentation used in 1995.

3. Cash and Cash Equivalents

The BIF considers cash equivalents to be short-term, highly liquid investments with original maturities of three months or less. In 1995, cash restrictions included \$10 million for health insurance payable and \$274 thousand for funds

held in trust. In 1994, cash restrictions included \$7.4 million for health insurance payable and \$737 thousand for funds held in trust.

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

All cash received by the BIF is invested in U.S. Treasury obligations unless the cash is: 1) used to defray operating expenses; 2) used for outlays

related to assistance to banks and liquidation activities; or 3) invested in cash equivalents.

U.S. Treasury Obligations at December 31, 1995

Dollars in Thousands

Maturity	Description	Yield at Purchase	Book Value	Market Value	Face Value
Less than one year (a)	U.S. Treasury notes	5.53%	\$ 6,750,414	\$ 6,765,086	\$ 6,750,000
1-3 years	U.S. Treasury notes	5.88%	12,318,436	12,441,422	12,350,000
3-5 years	U.S. Treasury notes	5.59%	1,693,196	1,708,809	1,690,000
Total			\$ 20,762,046	\$ 20,915,317	\$ 20,790,000

(a) Includes a \$400 million Treasury note which matured on Sunday, December 31, 1995. Settlement occurred on the next business day, January 2, 1996.

U.S. Treasury Obligations at December 31, 1994

Dollars in Thousands

Maturity	Description	Yield at Purchase	Book Value	Market Value	Face Value
Less than one year	U.S. Treasury notes & bills	4.83%	\$ 3,821,758	\$ 3,775,131	\$ 3,830,000
1-3 years	U.S. Treasury notes	5.37%	8,034,591	7,763,422	8,000,000
3-5 years	U.S. Treasury notes	4.72%	1,040,507	945,562	1,000,000
Total			\$12,896,856	\$12,484,115	\$ 12,830,000

In 1995, the unamortized discount, net of unamortized premium, was \$28 million. In 1994, the unamortized premium, net of unamortized discount, was \$66.9 million.

5. Receivables from Bank Resolutions, Net

The FDIC resolution process results in different types of transactions depending on the unique facts and circumstances surrounding each failing or failed institution. Payments to prevent a failure are made to operating institutions when cost and other

criteria are met. Such payments may facilitate a merger or allow a troubled institution to continue operations. Payments for institutions that fail are made to cover insured depositors' claims and represent a claim against the receiverships' assets.

The FDIC, as receiver for failed banks, engages in a variety of strategies at the time of failure to maximize the return from the sale or disposition of assets and to minimize realized losses. A failed bank acquirer can purchase selected assets at the time of resolution and assume full ownership, benefit and risk related to such assets. In certain cases, the receiver offers a period of time when an acquirer can sell assets back to the receivership at a specified value (i.e., an asset "putback" option). The receiver can also enter into a loss-sharing arrangement with an acquirer whereby, for specified assets and in accordance with individual contract terms, the two parties share in credit losses and certain qualifying expenses. These arrangements typically direct that the receiver pay to the acquirer a specified percentage of the losses triggered by the charge-off of assets covered by the terms of the loss-sharing agreement. The receiver absorbs the majority of the losses incurred and shares in the acquirer's future recoveries of previously charged-off assets. Failed bank assets also can be retained by the receiver to either be managed and disposed of by FDIC liquidation staff

or by contracted private-sector servicers with oversight from the FDIC.

As stated in Note 2, the allowance for losses on receivables from bank resolutions represents the difference between amounts advanced and/or obligations incurred and the expected repayment. This is based upon the estimated cash recoveries from the management and disposition of the assets of the assisted or failed bank, net of all estimated liquidation costs.

As of December 31, 1995 and 1994, the BIF, in its receivership capacity, held assets with a book value of \$10 billion and \$18.3 billion, respectively. The estimated cash recoveries from the sale of these assets (excluding cash and miscellaneous receivables of \$2.1 billion in 1995 and \$4.2 billion in 1994) are regularly evaluated, but remain subject to uncertainties because of changing economic conditions. These factors could affect the claimants' (including the BIF's) actual recoveries from the level currently estimated.

Receivables from Bank Resolutions, Net		
Dollars in Thousands	December 31	
	1995	1994
Assets from Open Bank Assistance:		
Redeemable preferred stock/warrants	\$ 23,500	\$ 993,500
Subordinated debt instruments	100,000	119,500
Notes receivable	3,222	22,037
Other open bank assistance	29,761	29,773
Deferred settlement	0	229,525
Interest receivable	1,517	1,921
Allowance for losses (Note 10)	(57,405)	(1,155,680)
	100,595	240,576
Receivables from Closed Banks:		
Loans and related assets	1,525,295	1,528,443
Resolution transactions	23,512,531	28,736,839
Capital instruments	25,000	25,000
Depositors' claims unpaid	10,339	13,561
Allowance for losses (Note 10)	(21,030,720)	(22,353,927)
	4,042,445	7,949,916
Total	\$ 4,143,040	\$ 8,190,492

6. Investment in Corporate Owned Assets, Net

The BIF acquires assets in certain troubled and failed bank cases by either purchasing an institution's assets outright or purchasing the assets under the terms specified in each resolution agreement. In addition, the BIF can purchase assets remaining in a receivership to facilitate termination. The majority of corporate owned

assets are real estate and mortgage loans. The BIF recognizes income and expenses on these assets. Income consists primarily of the portion of collections on performing mortgages related to interest earned. Expenses are recognized for administering the management and liquidation of these assets.

Investment in Corporate Owned Assets, Net

Dollars in Thousands	December 31	
	1995	1994
Investment in corporate owned assets	\$ 939,756	\$ 902,304
Allowance for losses (Note 10)	(759,463)	(659,676)
Total	\$ 180,293	\$ 242,628

7. Property and Buildings, Net

Dollars in Thousands	December 31	
	1995	1994
Land	\$ 29,631	\$ 29,631
Office buildings	151,442	151,442
Accumulated depreciation	(29,333)	(25,994)
Total	\$ 151,740	\$ 155,079

8. Liabilities Incurred from Bank Resolutions

The FDIC can enter into different types of resolution transactions depending on the unique facts and circumstances surrounding each failing or

failed institution. The BIF can assume certain liabilities that require future payments over a specified period of time.

Liabilities Incurred from Bank Resolutions

Dollars in Thousands	December 31	
	1995	1994
Escrowed funds from resolution transactions (Note 2)	\$ 0	\$ 54,410
Funds held in trust	274	737
Depositors' claims unpaid	10,339	13,561
Note indebtedness	0	1,389
Interest payable/other liabilities	21,269	11,848
Total	\$ 31,882	\$ 81,945

The BIF's liabilities of \$32 million are considered current liabilities.

9. Estimated Liabilities for:

Anticipated Failure of Insured Institutions
The BIF records an estimated loss for banks that have not yet failed but have been identified by the

regulatory process as likely (probable) to fail within the foreseeable future as a result of regulatory insolvency (equity less than two percent

of assets). This includes banks that were solvent at year-end, but that have adverse financial trends and, absent some favorable event (such as obtaining additional capital or merging), are likely to fail in the future. The FDIC relies on this finding regarding regulatory insolvency as the determining factor in defining the existence of the "accountable event" that triggers loss recognition under GAAP.

The FDIC cannot predict the precise timing and cost of bank failures. An estimated liability and a corresponding reduction in the fund balance are recorded in the period when the liability is deemed probable and reasonably estimable. It should be noted, however, that future assessment revenues will be available to the BIF to recover some or all of these losses and that their amounts have not been reflected as a reduction in the losses.

The estimated liabilities for anticipated failure of insured institutions as of December 31, 1995 and 1994, were \$279 million and \$875 million, respectively. The estimated liability is derived in part from estimates of recoveries from the sale of the assets of these probable bank failures. As such, they are subject to the same uncertainties as those affecting the BIF's receivables from bank resolutions (see Note 5). This could affect the ultimate costs to the BIF from probable bank failures.

The FDIC estimates that banks with combined assets of approximately \$2 billion may fail in 1996 and 1997, and the BIF has recognized a loss of \$279 million for those failures considered probable. The level of bank failures during 1996 and 1997 may vary from this estimate with additional losses reasonably possible ranging up to \$70 million. The further into the future projections of bank failures are made, the greater the uncertainty of banks failing and the magnitude of the loss associated with those failures. The accuracy of these estimates will largely depend on future economic conditions.

Assistance Agreements

The estimated liabilities for assistance agreements resulted from several large transactions where problem assets were purchased by an acquiring institution under an agreement that calls for the FDIC to absorb credit losses and to pay related costs for funding and asset administration plus an incentive fee.

Asset Securitization Guarantee

As part of the FDIC's efforts to maximize the return from the failed bank assets and minimize losses from bank resolutions, the FDIC entered into its first securitization transaction in August 1994. The securitization transaction was accomplished through the creation of a real estate mortgage investment conduit (REMIC), a trust, that purchases the loans to be securitized from one or more institutions for which the FDIC acts as a receiver or purchases loans owned by the Corporation. The loans in the trust are pooled and stratified and the resulting cash flow is directed into a number of different classes of pass-through certificates. The regular pass-through certificates are sold to the public through licensed brokerage houses. The largest contributing receivership retains residual pass-through certificates, which are entitled to any remaining cash flows from the trust after obligations to regular pass-through holders have been met.

To increase the likelihood of full and timely distributions of interest and principal to the holders of the regular pass-through certificates, and thus the marketability of such certificates, the BIF agreed to provide a credit enhancement through a limited guarantee to cover future credit losses with respect to the loans underlying the certificates. The FDIC securitization involved the following structure: 1) approximately 1,800 performing commercial mortgages from nearly 200 failed banks were sold to a REMIC (FDIC REMIC Trust 1994 C-1); 2) the REMIC in turn sold approximately \$759 million in 11 classes of securities backed by the commercial mortgages; and 3) the investors received a limited guarantee backed by the BIF covering credit losses and other shortfalls due to credit defaults up to a maximum of \$248 million.

In exchange for backing the limited guarantee, the BIF received REMIC securities and a portion of the proceeds from the sale of the commercial mortgages. The net present value (NPV) of the assets received was priced to equal the NPV of the expected exposure under the guarantee so that the BIF neither profits nor suffers a loss as a result of the limited guarantee.

At December 31, 1995, the BIF has a liability of \$126 million under the guarantee and assets of \$126 million representing the REMIC securities and the portion of the mortgage sales proceeds

received. At December 31, 1994, the BIF liability for the guarantee was \$128 million and assets were \$128 million.

Cash receipts from the REMIC securities and mortgages sales proceeds received are \$12.9 million and \$5.3 million at December 31, 1995 and 1994, respectively, and are reflected in the Statement of Cash Flows as "Miscellaneous

receipts." Cash payments of guarantee claims are \$2.1 million at December 31, 1995 and are reflected in the Statement of Cash Flows as "Miscellaneous disbursements." Income related to the REMIC securities is \$183 thousand and \$28 thousand at December 31, 1995 and 1994, respectively, and is presented as "Other revenue." The following chart summarizes the BIF's remaining obligation under the guarantee.

Asset Securitization Guarantee

Dollars in Thousands

	Maximum Obligation	Guarantee Claims Paid through December 31	Maximum Remaining Obligation at December 31
1995	\$247,748	\$2,429	\$245,319
1994	\$247,748	\$0	\$247,748

Litigation Losses

The BIF records an estimated loss for unresolved legal cases to the extent those losses are considered to be probable in occurrence and reasonably estimable in amount. In addition, the FDIC's Legal Division has determined that losses from

unresolved legal cases totaling \$406 million are reasonably possible. This includes \$12 million in losses for the BIF in its corporate capacity and \$394 million in losses for the BIF in its receivership capacity (see Note 2).

10. Analysis of Changes in Allowance for Losses and Estimated Liabilities

Provision for insurance losses includes the estimated losses for bank resolutions that occurred during the year for which an estimated loss was not established and loss adjustments for bank resolutions that occurred in prior years. It also includes an estimated loss for banks that have not yet failed but have been identified by the regulatory process as likely to fail (see Note 9).

These are referred to as estimated liabilities for anticipated failure of insured institutions.

In the following charts, transfers include reclassifications from "Estimated Liabilities for: Anticipated failure of insured institutions" to "Closed banks." Terminations represent final adjustments to the estimated cost figures for those bank resolutions that were completed and the operations of the receivership ended.

Bank Insurance Fund's Financial Statements

Analysis of Changes in Allowance for Losses and Estimated Liabilities - 1995

Dollars in Millions	Beginning Balance 01/01/95	Provision for Insurance Losses Current Year	Prior Years	Total	Net Cash Payments	Adjustments/ Transfers/ Terminations	Ending Balance 12/31/95
Allowance for Losses:							
Open bank assistance	\$ 1,156	\$ 0	\$ (140)	\$ (140)	\$ 0	\$ (959)	\$ 57
Corporate owned assets	660	0	99	99	0	0	759
Closed banks	22,354	(52)	464	412	0	(1,735)	21,031
Total Allowance for Losses	24,170	(52)	423	371	0	(2,694)	21,847
Estimated Liabilities for:							
Anticipated failure of insured institutions	875	131	(570)	(439)	0	(157)	279
Assistance agreements	163	0	14	14	(101)	(20)	56
Asset securitization guarantee	128	0	0	0	(2)	0	126
Litigation losses	15	0	21	21	0	0	36
Total Estimated Liabilities	1,181	131	(535)	(404)	(103)	(177)	497
Provision for Insurance Losses		\$ 79	\$ (112)	\$ (33)			

Analysis of Changes in Allowance for Losses and Estimated Liabilities - 1994

Dollars in Millions	Beginning Balance 01/01/94	Provision for Insurance Losses Current Year	Prior Years	Total	Net Cash Payments	Adjustments/ Transfers/ Terminations	Ending Balance 12/31/94
Allowance for Losses:							
Open bank assistance	\$ 215	\$ 0	\$ (421)	\$ (421)	\$ 3	\$ 1,359	\$ 1,156
Corporate owned assets	742	0	(82)	(82)	0	0	660
Closed banks	23,191	(236)	(229)	(465)	0	(372)	22,354
Total Allowance for Losses	24,148	(236)	(732)	(968)	3	987	24,170
Estimated Liabilities for:							
Anticipated failure of insured institutions	2,972	406	(2,128)	(1,722)	0	(375)	875
Assistance agreements	326	0	(177)	(177)	(37)	51	163
Asset securitization guarantee	0	0	0	0	0	128	128
Litigation losses	21	0	(6)	(6)	0	0	15
Total Estimated Liabilities	3,319	406	(2,311)	(1,905)	(37)	(196)	1,181
Provision for Insurance Losses		\$ 170	\$ (3,043)	\$ (2,873)			

II. Assessments

The 1990 OBR Act removed caps on assessment rate increases and authorized the FDIC to set assessment rates for BIF members semiannually, to be applied against a member's average

assessment base. The FDICIA: 1) required the FDIC to implement a risk-based assessment system; 2) authorized the FDIC to increase assessment rates for BIF-member institutions as

needed to ensure that funds are available to satisfy the BIF's obligations; and 3) authorized the FDIC to increase assessment rates more frequently than semiannually and impose emergency special assessments as necessary to ensure that funds are available to repay U.S. Treasury borrowings.

The FDIC uses a risk-based assessment system that charges higher rates to those institutions that pose greater risks to the BIF. To arrive at a risk-based assessment for a particular institution, the FDIC places each institution in one of nine risk categories using a two-step process based first on capital ratios and then on other relevant information. The FDIC's Board of Directors (Board) reviews premium rates semiannually.

The BIF reached its capitalization level of 1.25 percent, as mandated by FDICIA, at the end of May 1995 (see Note 1). Based on the recapitalization, the Board approved a reduction in assessment rates for BIF members from a range of 23 cents to 31 cents per \$100 of domestic deposits to a range of 4 cents to 31 cents per \$100 of

domestic deposits. The Board's BIF rate decrease was approved retroactively to June 1, 1995, therefore the BIF refunded \$1.5 billion in assessment overpayments in September 1995.

In November 1995, the Board approved a new assessment rate structure for the BIF. Effective January 1996, the highest-rated institutions (approximately 92 percent of the nearly 11,000 BIF-insured banks) will pay the statutory annual minimum of \$2,000 for deposit insurance. Rates for all other institutions will be reduced to a range of 3 cents to 27 cents per \$100 of insured deposits.

The average assessment rate is expected to decline to approximately 0.43 cents per \$100 of domestic deposits, versus the current average assessment rate of 4.4 cents per \$100. The projected average assessment rate would be the lowest in the more than 60-year history of federal deposit insurance for banks. The lowest average assessment rates for banks previously was 3.13 cents per \$100 in both 1962 and 1963.

12. Pension Benefits, Savings Plans, Postemployment Benefits and Accrued Annual Leave

Eligible FDIC employees (i.e., all permanent and temporary employees with appointments exceeding one year) are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The CSRS is a defined benefit plan offset with the Social Security System in certain cases. Plan benefits are determined on the basis of years of creditable service and compensation levels. The CSRS-covered employees also can contribute to the tax-deferred Federal Thrift Savings Plan (TSP).

The FERS is a three-part plan consisting of a basic defined benefit plan that provides benefits based on years of creditable service and compensation levels, Social Security benefits and the TSP. Automatic and matching employer contributions to the TSP are provided up to specified amounts under the FERS.

Eligible FDIC employees also may participate in an FDIC-sponsored tax-deferred savings plan with matching contributions. The BIF pays its share of the employer's portion of all related costs.

Although the BIF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The BIF

also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported and accounted for by the U.S. Office of Personnel Management.

Due to a substantial decline in the FDIC's workload, the Corporation developed a staffing reduction program, a component of which is a voluntary separation incentive plan, or buyout. Employees eligible to participate in the buyout program were placed into two categories, depending on the immediacy of the need for staffing reduction. Participating Category I employees agreed to retirement or resignation by December 31, 1995. There are 328 Category I FDIC employees participating at an estimated cost to the BIF of \$8.3 million. The cost for Category I employees is presented as "Operating expenses" in 1995. Participating Category II employees must have applied by February 7, 1996, and resign or retire no later than September 30, 1997. Consideration of all Category II applications is not complete; however, the Corporation estimates the possible cost of the buyout program for Category II employees to be about \$15.8 million. The cost for Category II employees will be expensed in 1996. The buyout affects other liabilities

(postretirement and accrued annual leave); however, that effect is not estimable at this time. The liability to employees for accrued annual

leave is approximately \$43.4 million and \$40.3 million at December 31, 1995 and 1994, respectively.

Pension Benefits and Savings Plans Expenses		
Dollars in Thousands	For the Year Ended	
	December 31	
	1995	1994
Civil Service Retirement System	\$ 9,411	\$ 9,988
Federal Employee Retirement System (Basic Benefit)	36,741	32,410
FDIC Savings Plan	20,545	21,603
Federal Thrift Savings Plan	10,264	10,513
Total	\$ 76,961	\$ 74,514

13. Postretirement Benefits Other than Pensions

The FDIC provides certain health, dental and life insurance coverage for its eligible retirees, the retirees' beneficiaries and covered dependents. Retirees eligible for health and/or 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. Dental coverage is provided to all retirees eligible for an immediate annuity.

The FDIC is self-insured for hospital/medical, prescription drug, mental health and chemical dependency coverage. Additional risk protection was purchased from Aetna Life Insurance Company through stop-loss and fiduciary liability insurance. All claims are administered on an administrative services only basis with the hospital/medical claims administered by Aetna Life Insurance Company, the mental health and chemical dependency claims administered by OHS Foundation Health Psychcare Inc., and the prescription drug claims administered by Caremark.

The life insurance program, underwritten by Metropolitan Life Insurance Company, provides

basic coverage at no cost to retirees and allows converting optional coverages to direct-pay plans. Dental care is underwritten by Connecticut General Life Insurance Company and provides coverage at no cost to retirees.

The BIF expensed \$18.8 million and \$23 million for net periodic postretirement benefit costs for the years ended December 31, 1995 and 1994, respectively. For measurement purposes, the FDIC assumed the following: 1) a discount rate of 6 percent; 2) an average long-term rate of return on plan assets of 5 percent; 3) an increase in health costs in 1995 of 12 percent, decreasing down to an ultimate rate in 1999 of 8 percent; and 4) an increase in dental costs for 1995 and thereafter of 8 percent. Both the assumed discount rate and health care cost rate have a significant effect on the amount of the obligation and periodic cost reported.

If the health care cost rate were increased one percent, the accumulated postretirement benefit obligation as of December 31, 1995, would have increased by 22.9 percent. The effect of this change on the aggregate of service and interest cost for 1995 would be an increase of 25.6 percent.

Net Periodic Postretirement Benefit Cost

Dollars in Thousands	For the Year Ended December 31	
	1995	1994
Service cost (benefits attributed to employee service during the year)	\$ 22,574	\$ 25,206
Interest cost on accumulated postretirement benefit obligation	14,706	14,323
Net total of other components	(3,567)	(4,881)
Return on plan assets	(14,907)	(11,651)
Total	\$ 18,806	\$ 22,997

As stated in Note 2, the FDIC established an entity to provide accounting and administration on behalf of the BIF, the SAIF, the FRF and the RTC. The BIF funds its liability and these funds are being managed as "plan assets."

Accumulated Postretirement Benefit Obligation and Funded Status

Dollars in Thousands	December 31	
	1995	1994
Retirees	\$ 79,370	\$ 70,944
Fully eligible active plan participants	22,401	16,831
Other active participants	182,408	234,852
Total Obligation	284,179	322,627
Less: Plan assets at fair value (a)	317,037	302,130
(Over) Under Funded Status	(32,858)	20,497
Unrecognized prior service cost	57,242	0
Unrecognized net gain	11,954	0
Postretirement Benefit Liability Recognized in the Statements of Financial Position	\$ 36,338	\$ 20,497

(a) Consists of U.S. Treasury investments

14. Commitments**Leases**

The BIF's allocated share of FDIC's lease commitments totals \$132.9 million for future years. The lease agreements contain escalation

clauses resulting in adjustments, usually on an annual basis. The BIF recognized leased space expense of \$42.7 million and \$50.9 million for the years ended December 31, 1995 and 1994, respectively.

Leased Space Fees

Dollars in Thousands					
1996	1997	1998	1999	2000	2001
\$34,869	\$30,604	\$21,004	\$17,603	\$14,318	\$14,516

Asset Putbacks

Upon resolution of a failed bank, the assets are placed into receivership and may be sold to an acquirer under an agreement that certain assets

may be resold, or "putback," to the receivership. The values and time limits for these assets to be putback are defined within each agreement. It is possible that the BIF could be called upon to fund

the purchase of any or all of the "unexpired putbacks" at any time prior to expiration. As of

December 31, 1995 there are no assets that are eligible for putback.

15. Concentration of Credit Risk

The BIF is counterparty to a group of financial instruments with entities located throughout regions of the United States experiencing problems in both loans and real estate. The BIF's maximum

exposure to possible accounting loss, should each counterparty to these instruments fail to perform and any underlying assets prove to be of no value, is shown as follows:

Concentration of Credit Risk at December 31, 1995

Dollars in Millions

	South-east	South-west	North-east	Mid-west	Central	West	Total
Receivables from bank resolutions, net	\$97	\$267	\$2,958	\$150	\$13	\$652	\$4,137 (a)
Corporate owned assets, net	24	53	51	0	20	32	180
Total	\$121	\$320	\$3,009	\$150	\$33	\$684	\$4,317

(a) The net receivable excludes \$3.9 million and \$2.5 million, respectively, of the SAIF's allocated share of maximum credit loss exposure from the resolutions of Southeast Bank, N.A., Miami, FL, and Olympic National Bank, Los Angeles, CA. There is no risk that the SAIF will not meet these obligations.

Insured Deposits

As of December 31, 1995, the total deposits insured by the BIF is approximately \$2 trillion. This would be the accounting loss if all depository

institutions fail and if any assets acquired as a result of the resolution process provide no recovery.

16. Disclosures about the Fair Value of Financial Instruments

Cash equivalents are short-term, highly liquid investments and are shown at current value. The fair market value of the investment in U.S. Treasury obligations is disclosed in Note 4 and is based on current market prices. The carrying amount of interest receivable on investments, accounts payable and liabilities incurred from bank resolutions approximates their fair market value. This is due to their short maturities or comparisons with current interest rates.

It is not practicable to estimate the fair market value of net receivables from bank resolutions. These assets are unique, not intended for sale to the private sector, and have no established market. The FDIC believes that a sale to the private sector would require indeterminate, but substantial discounts for an interested party to profit from these assets because of credit and other risks. A discount of this proportion would significantly increase the cost of bank resolutions to the BIF. Comparisons with other financial instruments do

not provide a reliable measure of their fair market value. Due to these and other factors, the FDIC cannot determine an appropriate market discount rate and, thus, is unable to estimate fair market value on a discounted cash flow basis. As shown in Note 5, the carrying amount is the estimated cash recovery value which is the original amount advanced (and/or obligations incurred) net of the estimated allowance for loss.

The majority of the net investment in corporate owned assets (except real estate) is comprised of various types of financial instruments (investments, loans, accounts receivable, etc.) acquired from failed banks. As with net receivables from bank resolutions, it is not practicable to estimate fair market values. Cash recoveries are primarily from the sale of poor quality assets. They are dependent on market conditions that vary over time and can occur unpredictably over many years following resolution. Since the FDIC cannot reasonably predict the timing of these cash recoveries, it is

unable to estimate fair market value on a discounted cash flow basis. As shown in Note 6, the carrying amount is the estimated cash recovery value, which is the original amount advanced (and/or obligations incurred) net of the estimated allowance for loss.

As stated in Note 9, the carrying amount of the estimated liability for anticipated failure of insured

institutions is the total of estimated losses for banks that have not failed, but the regulatory process has identified as likely to fail within the foreseeable future. It does not consider discounted future cash flows. This is because the FDIC cannot predict the timing of events with reasonable accuracy. For this reason, the FDIC considers the total estimate of these losses to be the best measure of their fair market value.

17. Supplementary Information Relating to the Statements of Cash Flows

Reconciliation of Net Income to Net Cash Provided by Operating Activities

Dollars in Thousands	For the Year Ended December 31	
	1995	1994
Net Income	\$ 3,605,916	\$ 8,726,122
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities		
Income Statement Items:		
Provision for insurance losses	(33,167)	(2,873,419)
Amortization of U.S. Treasury securities	(19,266)	43,145
Depreciation on buildings	3,339	3,339
Change in Assets and Liabilities:		
(Increase) in interest receivable on investments and other assets	(146,102)	(179,994)
Decrease in receivables from bank resolutions	3,659,128	5,916,593
(Increase) decrease in corporate owned assets	(37,452)	566,472
(Decrease) increase in accounts payable and other liabilities	(63,454)	64,366
(Decrease) in liabilities incurred from bank resolutions	(48,694)	(3,263,790)
(Decrease) in estimated liability for anticipated failure of insured institutions	(157,000)	(375,000)
(Decrease) increase in estimated liabilities for assistance agreements	(4,048)	13,479
(Decrease) increase in estimated liability for asset securitization guarantee	(2,054)	128,429
Net Cash Provided by Operating Activities	\$ 6,757,146	\$ 8,769,742

Savings Association Insurance Fund's Financial Statements

Statements of Financial Position

Federal Deposit Insurance Corporation

Savings Association Insurance Fund Statements of Financial Position

Dollars in Thousands

	December 31	
	1995	1994
Assets		
Cash and cash equivalents, including restricted amounts of \$12,640 for 1995 and \$19,004 for 1994 (Note 3)	\$ 911,810	\$ 80,200
Investment in U.S. Treasury obligations, net (Note 4)	2,832,919	2,422,230
Entrance and exit fees receivable, net (Note 5)	8,821	35,692
Interest receivable on investments and other assets	48,634	38,863
Receivables from thrift resolutions, net	51	6,892
Total Assets	\$ 3,802,235	\$2,583,877
Liabilities and the Fund Balance		
Accounts payable and other liabilities	\$ 117,628	\$ 12,429
Estimated liability for anticipated failure of insured institutions (Note 6)	111,000	432,000
Total Liabilities	228,628	444,429
<i>Commitments and contingencies (Notes 10 and 11)</i>		
SAIF-Member Exit Fees and Investment Proceeds Held in Escrow (Note 5)	215,760	202,733
Fund Balance	3,357,847	1,936,715
Total Liabilities and the Fund Balance	\$ 3,802,235	\$ 2,583,877

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

Savings Association Insurance Fund's
Financial Statements

Statements of Income and the Fund Balance

Federal Deposit Insurance Corporation

Savings Association Insurance Fund Statements of Income and the Fund Balance

Dollars in Thousands

For the Year Ended
December 31

	1995	1994
Revenue		
Assessments (Note 7)	\$ 970,027	\$ 1,132,102
Interest on U.S. Treasury investments	169,101	82,942
Entrance fees (Note 5)	11	32
Other revenue	777	213
Total Revenue	1,139,916	1,215,289
Expenses and Losses		
Operating expenses	39,784	20,303
Provision for insurance losses	(321,000)	414,000
Total Expenses and Losses	(281,216)	434,303
Net Income	1,421,132	780,986
Fund Balance - Beginning	1,936,715	1,155,729
Fund Balance - Ending	\$ 3,357,847	\$ 1,936,715

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

Savings Association Insurance Fund's
Financial Statements

Statements of Cash Flows

Federal Deposit Insurance Corporation

Savings Association Insurance Fund Statements of Cash Flows

Dollars in Thousands

**For the Year Ended
December 31**

1995 1994

Cash Flows from Operating Activities

Cash provided from:

Assessments	\$ 1,060,829	\$ 1,132,914
Interest on U.S. Treasury investments	152,622	61,085
Interest on exit fees	8,449	6,984
Entrance and exit fee collections (Note 5)	29,757	31,144
Recoveries from "Oakar" bank resolutions	0	1,469
Recoveries from thrift resolutions	17,149	169,919
Miscellaneous receipts	437	602

Cash used for:

Operating expenses	(18,487)	(14,581)
Reimbursement to the FSLIC Resolution Fund for thrift resolutions	(15,881)	(166,958)
Disbursements for thrift resolutions	(1,142)	(1,864)
Miscellaneous disbursements	1	0

Net Cash Provided by Operating Activities (Note 13)	1,233,734	1,220,714
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Cash Flows from Investing Activities

Cash provided from:

Maturity and sale of U.S. Treasury obligations	1,385,000	220,420
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Cash used for:

Purchase of U.S. Treasury obligations	(1,787,124)	(1,376,669)
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Net Cash Used by Investing Activities	(402,124)	(1,156,249)
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Net Increase in Cash and Cash Equivalents	831,610	64,465
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Cash and Cash Equivalents - Beginning	80,200	15,735
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Cash and Cash Equivalents - Ending	\$ 911,810	\$ 80,200
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The accompanying notes are an integral part of these financial statements.

**Savings Association Insurance Fund's
Financial Statements**

Notes to the Financial Statements

***Notes to Financial Statements
Savings Association Insurance Fund
December 31, 1995 and 1994***

1. Legislative History and Operations of the Savings Association Insurance Fund

Legislative History

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted to reform, recapitalize and consolidate the federal deposit insurance system. The FIRREA created the Savings Association Insurance Fund (SAIF), the Bank Insurance Fund (BIF), and the FSLIC Resolution Fund (FRF). It also designated the Federal Deposit Insurance Corporation (FDIC) as the administrator of these three funds. All three funds are maintained separately to carry out their respective mandates.

Pursuant to FIRREA, an active institution's insurance fund membership and primary federal supervisor are generally determined by the institution's charter type. Deposits of SAIF-member institutions are mostly insured by the SAIF; SAIF members are predominantly thrifts supervised by the Office of Thrift Supervision (OTS). Deposits of BIF-member institutions are mostly insured by the BIF; BIF members are predominantly commercial and savings banks supervised by the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve. The FRF is responsible for winding up the affairs of the former Federal Savings and Loan Insurance Corporation (FSLIC).

The FIRREA also created the Resolution Trust Corporation (RTC), which managed and resolved all thrifts previously insured by the FSLIC for which a conservator or receiver was appointed during the period January 1, 1989, through August 8, 1992. The Resolution Trust Corporation Refinancing, Restructuring and Improvement Act of 1991 (1991 RTC Act) extended the RTC's general resolution responsibility through September 30, 1993, and beyond that date for those institutions previously placed under RTC control.

The Resolution Trust Corporation Completion Act of 1993 (1993 RTC Act) enacted December 17, 1993, extended the RTC's general resolution responsibility through a date between January 1, 1995, and July 1, 1995. Resolution responsibility transferred from the RTC to the SAIF on July 1, 1995.

The Financing Corporation (FICO), established under the Competitive Equality Banking Act of

1987, is a mixed-ownership government corporation whose sole purpose was to function as a financing vehicle for the FSLIC. Effective December 12, 1991, as provided by the 1991 RTC Act, the FICO's ability to serve as a financing vehicle for new debt was terminated. Assessments paid on SAIF-insured deposits (excluding BIF-member "Oakar" and "Sasser" banks) are subject to draws by FICO for payment of interest on their outstanding debt through maturity of this debt in 2019. "Sasser" banks are SAIF members that converted to a state bank charter in accordance with Section 5(d)(2)(G) of the Federal Deposit Insurance Act (FDI Act). "Oakar" banks are described in a following section, "Operations of the SAIF".

Other significant legislation includes the Omnibus Budget Reconciliation Act of 1990 (1990 OBR Act) and the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). These acts made changes to the FDIC's assessment authority (see Note 7) and borrowing authority (see "Operations of the SAIF"). The FDICIA also requires the FDIC to: 1) resolve troubled institutions in a manner that will result in the least possible cost to the deposit insurance funds; 2) to build the reserves in the insurance funds to 1.25 percent of insured deposits; and 3) upon recapitalization, maintain the insurance funds at 1.25 percent of insured deposits or a higher percentage as circumstances warrant.

Recent Legislative Proposals

Recent proposed legislation would, if signed into law, affect the SAIF in the following ways: 1) there would be a one-time special assessment on SAIF-assessable deposits to capitalize the SAIF at the designated reserve ratio of 1.25 percent; 2) BIF-members would be required to share the interest costs of Financing Corporation (FICO) debt on a proportional basis with SAIF-members; and 3) if the thrift charter is eliminated by January 1, 1998, the BIF and the SAIF would be merged on that date. There would be a separate assessment to fund the SAIF-members' share of the FICO interest costs, and therefore such interest costs would no longer affect regular assessments or the fund balance. Legislative proposals are subject to change as part of the normal legislative process; therefore, it is uncertain what provisions the proposed law, if enacted, will ultimately include.

Savings Association Insurance Fund's Financial Statements

Operations of the SAIF

The primary purpose of the SAIF is to insure the deposits and to protect the depositors of SAIF-insured institutions. In this capacity, the SAIF has financial responsibility for: 1) all SAIF-insured deposits held by SAIF-member institutions, and 2) all SAIF-insured deposits held by BIF-member "Oakar" banks.

The "Oakar" bank provisions are found in Section 5 (d) (3) of the FDI Act. The provisions allow, with approval of the appropriate federal regulatory authority, any insured depository institution to merge, consolidate or transfer the assets and liabilities of an acquired institution without changing insurance coverage for the acquired deposits. Such acquired deposits continue to be either SAIF-insured deposits and assessed at the SAIF assessment rate or BIF-insured deposits and assessed at the BIF assessment rate. In addition, any losses resulting from the failure of these institutions are to be allocated between the BIF and the SAIF based on the respective dollar amounts of the institution's BIF-insured and SAIF-insured deposits.

The SAIF is funded from the following sources: 1) SAIF assessments from BIF-member "Oakar" banks; 2) other SAIF assessments that are not required for the FICO, including assessments from "Sasser" banks; 3) interest earned on unrestricted investments in U.S. Treasury obligations; 4) U.S. Treasury payments not to exceed \$8 billion for losses for fiscal years 1994 through 1998 contingent upon appropriations from the U.S. Treasury; 5) U.S. Treasury payments from unused appropriations to the RTC for losses for two years after the date the RTC is terminated (December 31, 1995); and borrowings from 6)

Federal Home Loan Banks; and 7) U.S. Treasury and Federal Financing Bank (FFB).

The 1993 RTC Act places significant restrictions on funding from sources 4) and 5) above. Among other restrictions, before appropriated funds from either source are used, the FDIC must certify to Congress that: 1) SAIF-insured institutions are unable to pay premiums sufficient to cover insurance losses or to repay amounts borrowed from the U.S. Treasury without adversely affecting their ability to raise and maintain capital or to maintain the assessment base and 2) an increase in premiums could reasonably be expected to result in greater losses to the government.

The 1990 OBR Act established the FDIC's authority to borrow working capital from the FFB on behalf of the BIF and the SAIF. FDICIA increased the FDIC's authority to borrow for insurance losses from the U.S. Treasury, on behalf of the BIF and the SAIF, from \$5 billion to \$30 billion.

The FDICIA also established a limitation on obligations that can be incurred by the SAIF, known as the maximum obligation limitation (MOL). Under the MOL, the SAIF cannot incur any additional obligations if its total obligations exceed the sum of: 1) the SAIF's cash and cash equivalents; 2) 90 percent of the fair-market value of the SAIF's other assets; and 3) the total amount authorized to be borrowed from the U.S. Treasury, excluding FFB borrowings. For purposes of calculating the MOL, the FDIC's total U.S. Treasury borrowing authority was allocated between the BIF and the SAIF based on the ratio of each fund's insured deposits to total insured deposits. At December 31, 1995, the MOL for the SAIF was \$11.7 billion.

2. Summary of Significant Accounting Policies

General

These financial statements pertain to the financial position, results of operations and cash flows of the SAIF and are presented in accordance with generally accepted accounting principles (GAAP). These statements do not include reporting for assets and liabilities of closed thrifts for which the SAIF acts as receiver or liquidating agent. Periodic and final accountability reports of the SAIF's activities as receiver or liquidating agent are

furnished to courts, supervisory authorities and others as required.

Use of Estimates

The preparation of the SAIF's financial statements in conformity with generally accepted accounting principles requires FDIC management to make 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

**Savings Association Insurance Fund's
Financial Statements**

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 in the financial statements.

U.S. Treasury Obligations

Securities are intended to be held to maturity and are shown at book value. Book value 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. Interest is calculated on a daily basis and recorded monthly using the effective interest method.

Litigation Losses

The SAIF accrues, as a charge to current period operations, an estimate of probable losses from litigation against the SAIF in both its corporate and receivership capacities. The FDIC's Legal Division recommends these estimates on a case-by-case basis. The litigation loss estimates related to receiverships would be included in the allowance for losses for receivables from thrift resolutions.

Receivership Administration

The FDIC is responsible for controlling and disposing of the assets of failed thrift institutions placed in SAIF receivership in an orderly and efficient manner. The assets, and the claims against them, are accounted for separately to ensure that liquidation proceeds are distributed in accordance with applicable laws and regulations. Liquidation expenses incurred by the SAIF on behalf of its receivership are recovered from the receivership.

Cost Allocations Among Funds

Certain operating expenses (including personnel, administrative and other indirect expenses) not directly charged to each fund under the FDIC's management are allocated on the basis of the relative degree to which the operating expenses were incurred by the funds.

The FDIC includes the cost of facilities used in operations in the BIF's financial statements. The BIF charges the SAIF a rental fee representing an allocated share of its annual depreciation. The cost of furniture, fixtures and equipment purchased by the FDIC on behalf of the three funds under its

administration is allocated among these funds on a pro rata basis. The SAIF expenses its share of these allocated costs at the time of acquisition because of their immaterial amounts.

Postretirement Benefits Other Than Pensions

The FDIC established an entity to provide the accounting and administration of postretirement benefits on behalf of the SAIF, the BIF, the FRF and the RTC. The SAIF funds its liabilities for these benefits directly to the entity.

Disclosure about Recent Financial Accounting Standards Board Pronouncements

In May 1993, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 114, "Accounting by Creditors for Impairment of a Loan," to be adopted for fiscal years beginning after December 15, 1994. While FDIC adopted SFAS No. 114, most of the SAIF assets are specifically outside the scope of this pronouncement. These assets do not meet the definition of a loan within the meaning of the statement or are valued through alternative methods. Any assets subject to Statement No. 114 are immaterial either because of insignificant book value or because any potential adjustment to the carrying value as a result of applying Statement No. 114 would be immaterial.

The FASB issued SFAS No. 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures," in October 1994, to be adopted for fiscal years beginning after December 15, 1994". This statement is an amendment to SFAS No. 114 and was adopted by the FDIC this year.

Other recent pronouncements issued by the FASB have been adopted or are either not applicable or not material to the financial statements.

Related Parties

The nature of related parties and descriptions of related party transactions are disclosed throughout the financial statements and footnotes.

Reclassifications

Reclassifications have been made in the 1994 financial statements to conform to the presentation used in 1995.

**Savings Association Insurance Fund's
Financial Statements**

3. Cash and Cash Equivalents

The SAIF considers cash equivalents to be short-term, highly liquid investments with original maturities of three months or less. Substantially, all the restricted cash is comprised of the SAIF exit fees collected plus interest earned on exit fees. These funds have been restricted to meet any potential obligation of the SAIF to the FICO (see

Note 5). In 1995, cash restrictions included \$190 thousand for health insurance payable and \$12.5 million for exit fee and related interest collections. In 1994, cash restrictions included \$148 thousand for health insurance payable and \$18.9 million for exit fee and related interest collections.

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

All cash received by the SAIF is invested in U.S. Treasury obligations unless the cash is: 1) to defray operating expenses; 2) used for outlays related to liquidation activities; or 3) invested in cash or cash equivalents. In 1995, \$190 million was restricted for exit fee and related interest collections invested in U.S. Treasury notes. In 1994, \$145 million was restricted for exit fee and related interest collections invested in U.S. Treasury notes.

During 1994, the SAIF sold debt securities classified as held-to-maturity. The book value of the securities sold was \$170 million and realized loss was \$289 thousand. The sale was compelled by the need to transfer to the FRF funds that were retained by the SAIF in error and subsequently invested. This was an isolated, non-recurring and unusual event that could not have been reasonably anticipated.

U.S. Treasury Obligations at December 31, 1995

Dollars in Thousands

Maturity	Description	Yield at Purchase	Book Value	Market Value	Face Value
Less than one year	U.S. Treasury notes	5.8%	\$ 1,785,035	\$ 1,791,208	\$ 1,785,000
1-3 years	U.S. Treasury notes	5.7%	588,968	594,712	590,000
3-5 years	U.S. Treasury notes	5.4%	458,916	460,500	450,000
Total			\$2,832,919	\$ 2,846,420	\$ 2,825,000

U.S. Treasury Obligations at December 31, 1994

Dollars in Thousands

Maturity	Description	Yield at Purchase	Book Value	Market Value	Face Value
Less than one year	U.S. Treasury notes	4.4%	\$ 1,380,705	\$ 1,366,503	\$ 1,385,000
1-3 years	U.S. Treasury notes	5.8%	1,041,525	1,017,402	1,045,000
Total			\$2,422,230	\$ 2,383,905	\$ 2,430,000

In 1995, the unamortized premium, net of unamortized discount, was \$7.9 million. In 1994, the unamortized discount, net of unamortized premium, was \$7.8 million.

5. Entrance and Exit Fees Receivable, Net

The SAIF receives entrance and exit fees for conversion transactions when an insured depository institution converts 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 and published in the *Federal Register* on March 21, 1990, directed that exit fees paid to the SAIF be

**Savings Association Insurance Fund's
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held in escrow. The FDIC 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 are invested in U.S. Treasury securities pending determination of ownership. The interest earned is also held in escrow. Interest on these investments was \$9.1 million and \$6.5 million for 1995 and 1994, respectively.

The SAIF records entrance fees as revenue after a BIF-to-SAIF conversion transaction. However, due to the requirement that the SAIF exit fees be held in an escrow account, the SAIF does not recognize exit fees or related interest earned as revenue. Instead, the SAIF recognizes a SAIF-to-BIF

conversion transaction by establishing a receivable from the institution and a corresponding escrow account entry to recognize the potential payment to the FICO. As exit fee proceeds are received, the receivable is reduced while the escrow remains pending the determination of funding requirements for interest payments on the FICO's obligations.

Within specified parameters, the regulations allow an institution to pay its entrance/exit fees interest free, in equal annual installments over a maximum period of not more than five years. When an institution elects such a payment plan, the SAIF records the entrance or exit fee receivable at its present value. The discount rate used to determine the present value of the funds for 1995 and 1994 was three percent.

Entrance and Exit Fees Receivable, Net - 1995

Dollars in Thousands

	Beginning Balance 01/01/95	New Receivables	Collections	Net Change in Unamortized Discount	Ending Balance 12/31/95
Entrance fees	\$ 6	\$ 11	\$ (6)	\$ 0	\$ 11
Exit fees	35,686	1,117	(29,751)	1,758	8,810
Total	\$ 35,692	\$ 1,128	\$ (29,757)	\$ 1,758	\$ 8,821

Entrance and Exit Fees Receivable, Net - 1994

Dollars in Thousands

	Beginning Balance 01/01/94	New Receivables	Collections	Net Change in Unamortized Discount	Ending Balance 12/31/94
Entrance fees	\$ 3	\$ 32	\$ (29)	\$ 0	\$ 6
Exit fees	60,652	998	(31,115)	5,151	35,686
Total	\$ 60,655	\$ 1,030	\$ (31,144)	\$ 5,151	\$ 35,692

6. Estimated Liabilities for:

Anticipated Failure of Insured Institutions

The SAIF records an estimated loss for thrifts as well as "Oakar" and "Sasser" banks that have not yet failed but have been identified by the regulatory process as likely (probable) to fail within the foreseeable future as a result of regulatory insolvency (equity less than two percent of assets). This includes institutions that were solvent at year-end, but that have adverse financial trends and, absent some favorable event (such as obtaining additional capital or merging), are likely to fail in the future. The FDIC relies on this

finding regarding regulatory insolvency as the determining factor in defining the existence of the "accountable event" that triggers loss recognition under GAAP.

The FDIC cannot predict the precise timing and cost of failures. An estimated liability and a corresponding reduction in the fund balance are recorded in the period when the liability is deemed probable and reasonably estimable. It should be noted, however, that future assessment revenues will be available to the SAIF to recover some or all

Savings Association Insurance Fund's Financial Statements

of these losses and that these amounts have not been reflected as a reduction in the losses.

The estimated liabilities for anticipated failure of insured institutions as of December 31, 1995 and 1994 were \$111 million and \$432 million, respectively. The estimated liability is derived in part from estimates of recoveries from the sale of the assets of these probable thrift failures. These estimates are regularly re-evaluated in light of changing economic conditions, but because the amount of recoveries is uncertain, the ultimate costs to the SAIF from thrift failures could be affected.

The FDIC estimates that thrifts with combined assets of approximately \$2 billion may fail in 1996 and 1997, and the SAIF has recognized a loss of \$111 million for those failures considered

probable. The level of thrift failures during 1996 and 1997 may vary from this estimate with additional losses reasonably possible ranging up to \$160 million. The further into the future projections of thrift failures are made, the greater the uncertainty of thrifts failing and the magnitude of the loss associated with those failures. The accuracy of these estimates will largely depend on future economic conditions, particularly in the real estate markets and the level of future interest rates.

Litigation Losses

The SAIF records an estimated loss for unresolved legal cases to the extent those losses are considered to be probable in occurrence and reasonably estimable in amount. In addition, the FDIC's Legal Division has determined that losses from unresolved legal cases totaling \$11 million are reasonably possible.

7. Assessments

The 1990 OBR Act removed caps on assessment rate increases and authorized the FDIC to set assessment rates for SAIF members semiannually, to be applied against a member's average assessment base. The FDICIA: 1) required the FDIC to implement a risk-based assessment system; 2) authorized the FDIC to increase assessment rates for SAIF-member institutions as needed to ensure that funds are available to satisfy the SAIF's obligations; and 3) authorized FDIC to increase assessment rates more frequently than semiannually and impose emergency special assessments as necessary to ensure that funds are available to repay U.S. Treasury borrowings.

The FDIC uses a risk-based assessment system that charges higher rates to those institutions that pose greater risks to the SAIF. To arrive at a risk-based assessment for a particular institution, the FDIC places each institution in one of nine risk categories using a two-step process based first on capital ratios and then on other relevant information. The FDIC's Board of Directors reviews premium rates semiannually.

The FICO has priority over the SAIF for receiving and utilizing SAIF assessments to ensure availability of funds for interest on FICO's debt obligations. Accordingly, the SAIF recognized as assessment revenue only that portion of SAIF assessments not required by the FICO. Assessments on the SAIF-insured deposits held by BIF-member "Oakar" or SAIF-member "Sasser"

institutions are not subject to draws by FICO and, thus, are retained in SAIF in their entirety.

Since 1993, each thrift has paid an assessment rate of between 23 and 31 cents per \$100 of domestic deposits, depending on risk classification. For calendar year 1995, the assessment rate averaged approximately 23.2 cents per \$100 of domestic deposits. As of December 31, 1995, the SAIF's reserve ratio is .47 percent of insured deposits.

Secondary Reserve Offset

The FIRREA authorized insured thrifts to offset against any assessment premiums their pro rata share of amounts that previously were part of the FSLIC's "Secondary Reserve." The Secondary Reserve represented premium prepayments that insured thrifts were required by law to deposit with the FSLIC during the period 1961 through 1973 to quickly increase the FSLIC's insurance reserves to absorb losses if the regular assessments were insufficient.

The Secondary Reserve offset reduces the gross SAIF-member assessments due from certain institutions, thereby reducing the assessment premiums available to the FICO and the SAIF. In 1994, the SAIF paid \$11 million in refunds to institutions due secondary reserve credits that had previously been acquired through an unassisted merger. The remaining Secondary Reserve credit is \$399 thousand and \$427 thousand for 1995 and 1994, respectively.

**Savings Association Insurance Fund's
Financial Statements**

SAIF Assessments		
Dollars in Thousands	For the Year Ended December 31	
	1995	1994
SAIF assessments from thrifts	\$1,184,097	\$1,301,499
Less: Secondary Reserve offset/refunds	(13,170)	(14,318)
FICO assessment (a)	(717,909)	(596,000)
Plus: Assessment receivables outstanding	(70)	1,453
Less: Prepaid assessments	(26,832)	(2,265)
SAIF-Member Assessments Earned, (Net)	426,116	690,369
SAIF assessments from "Sasser" banks	121,209	99,895
SAIF assessments from BIF-member "Oakar" banks	422,702	341,838
Total Assessment Revenue	\$ 970,027	\$1,132,102

(a) FICO payments were reduced by \$69 million and \$185 million in 1995 and 1994, respectively, because of cash held by FICO.

8. Pension Benefits, Savings Plans, Postemployment Benefits and Accrued Annual Leave

Eligible FDIC employees (i.e., all permanent and temporary employees with appointments exceeding one year) are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The CSRS is a defined benefit plan offset with the Social Security System in certain cases. Plan benefits are determined on the basis of years of creditable service and compensation levels. The CSRS-covered employees also can contribute to the tax-deferred Federal Thrift Savings Plan (TSP).

The FERS is a three-part plan consisting of a basic defined benefit plan that provides benefits based on years of creditable service and compensation levels, Social Security benefits and the TSP. Automatic and matching employer contributions to the TSP are provided up to specified amounts under the FERS.

Eligible FDIC employees also may participate in an FDIC-sponsored tax-deferred savings plan with matching contributions. The SAIF pays its share of the employer's portion of all related costs.

Although the SAIF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The SAIF also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are

reported and accounted for by the U.S. Office of Personnel Management.

Due to a substantial decline in the FDIC's workload, the Corporation developed a staffing reduction program, a component of which is a voluntary separation incentive plan, or buyout. Employees eligible to participate in the buyout program were placed into two categories, depending on the immediacy of the need for staffing reduction. Participating Category I employees agreed to retirement or resignation by December 31, 1995. There are 328 Category I FDIC employees participating at an estimated cost to the SAIF of \$3.1 million. The cost for Category I employees is presented as "Operating expenses" in 1995. Participating Category II employees must have applied by February 7, 1996, and resign or retire no later than September 30, 1997. Consideration of all Category II applications is not complete; however, the FDIC estimates the possible cost of the buyout program for Category II employees to be about \$5.8 million. The cost for Category II employees will be expensed in 1996. The buyout affects other liabilities (postretirement and accrued annual leave); however, that effect is not estimable at this time.

The liability to employees for accrued annual leave is approximately \$757 thousand and \$685 thousand at December 31, 1995 and 1994, respectively.

**Savings Association Insurance Fund's
Financial Statements**

Pension Benefits and Savings Plans Expenses		
Dollars in Thousands	For the Year Ended December 31	
	1995	1994
Civil Service Retirement System	\$ 549	\$ 329
Federal Employee Retirement System (Basic Benefit)	1,394	663
FDIC Savings Plan	895	436
Federal Thrift Savings Plan	486	202
Total	\$ 3,324	\$ 1,630

9. Postretirement Benefits Other than Pensions

The FDIC provides certain health, dental and life insurance coverage for its eligible retirees, the retirees' beneficiaries and covered dependents. Retirees eligible for health and/or 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. Dental coverage is provided to all retirees eligible for an immediate annuity.

The FDIC is self-insured for hospital/medical, prescription drug, mental health and chemical dependency coverage. Additional risk protection was purchased from Aetna Life Insurance Company through stop-loss and fiduciary liability insurance. All claims are administered on an administrative services only basis with the hospital/medical claims administered by Aetna Life Insurance Company, the mental health and chemical dependency claims administered by OHS Foundation Health Psychcare Inc., and the prescription drug claims administered by Caremark.

The life insurance program, underwritten by Metropolitan Life Insurance Company, provides

basic coverage at no cost to retirees and allows converting optional coverages to direct-pay plans. Dental care is underwritten by Connecticut General Life Insurance Company and provides coverage at no cost to retirees.

The SAIF expensed \$226 thousand and \$586 thousand for net periodic postretirement benefit costs for the years ended December 31, 1995 and 1994, respectively. For measurement purposes, the FDIC assumed the following: 1) a discount rate of 6 percent; 2) an average long-term rate of return on plan assets of 5 percent; 3) an increase in health costs in 1995 of 12 percent, decreasing down to an ultimate rate in 1999 of 8 percent; and 4) an increase in dental costs in 1995 and thereafter of 8 percent. Both the assumed discount rate and health care cost rate have a significant effect on the amount of the obligation and periodic cost reported.

If the health care cost rate were increased one percent, the accumulated postretirement benefit obligation as of December 31, 1995, would have increased by 22.9 percent. The effect of this change on the aggregate of service and interest cost for 1995 would be an increase of 25.6 percent.

**Savings Association Insurance Fund's
Financial Statements**

Net Periodic Postretirement Benefit Cost		
Dollars in Thousands	For the Year Ended December 31	
	1995	1994
Service cost (benefits attributed to employee service during the year)	\$ 431	\$ 664
Interest cost on accumulated postretirement benefit obligation	281	378
Net total of other components	(68)	(129)
Return on plan assets	(418)	(327)
Total	\$ 226	\$ 586

As stated in Note 2, the FDIC established an entity to provide accounting and administration on behalf of the SAIF, the BIF, the FRF and the RTC. The SAIF funds its liability and these funds are being managed as "plan assets."

Accumulated Postretirement Benefit Obligation and Funded Status		
Dollars in Thousands	December 31	
	1995	1994
Retirees	\$ 2,230	\$ 1,979
Fully eligible active plan participants	629	470
Other active participants	5,124	6,552
Total Obligation	7,983	9,001
Less: Plan assets at fair value (a)	8,904	8,486
(Over) Under Funded Status	(921)	515
Unrecognized prior service cost	1,305	0
Unrecognized net gain	273	0
Postretirement Benefit Liability Recognized in the Statements of Financial Position	\$ 657	\$ 515

(a) Consists of U.S. Treasury investments

10. Commitments

The SAIF's allocated share of FDIC lease commitments totals \$2.6 million for future years. The lease agreements contain escalation clauses resulting in adjustments, usually on an annual basis. The SAIF recognized leased space expense of \$1.6 million and \$1.1 million for the years ended December 31, 1995 and 1994, respectively.

Leased Space Fees

Dollars in Thousands					
1996	1997	1998	1999	2000	2001
\$660	\$595	\$408	\$329	\$298	\$306

11. Concentration of Credit Risk

The SAIF is counterparty to financial instruments with entities located in two regions of the United States experiencing problems in both loans and real estate. The SAIF's maximum exposure to possible accounting loss for these instruments is \$3.9 million for Southeast Bank, N.A., Miami, Florida, and \$2.5 million for Olympic National Bank, Los Angeles, California.

**Savings Association Insurance Fund's
Financial Statements**

Insured Deposits

As of December 31, 1995, the total deposits insured by the SAIF is approximately \$711 billion. This would be the accounting loss if all the

depository institutions fail and if any assets acquired as a result of the resolution process provide no recovery.

12. Disclosures about the Fair Value of Financial Instruments

Cash equivalents are short-term, highly liquid investments and are shown at current value. The fair market value of the investment in U.S. Treasury obligations is disclosed in Note 4 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. This is due to their short maturities or comparison with current interest rates. As explained in Note 5, entrance and exit fees receivable are net of discounts calculated using an interest rate comparable to U.S. Treasury Bill or Government bond/note rates at the time the receivables are accrued.

It is not practicable to estimate the fair market value of net receivables from thrift resolutions. These assets are unique, not intended for sale to the private sector and have no established market. The FDIC believes that a sale to the private sector would require indeterminate, but substantial discounts for an interested party to profit from

these assets because of credit and other risks. A discount of this proportion would significantly increase the cost of resolutions to the SAIF. Comparisons with other financial instruments do not provide a reliable measure of their fair market value. Due to these and other factors, the FDIC cannot determine an appropriate market discount rate and, thus, is unable to estimate fair market value on a discounted cash flow basis.

As stated in Note 6, the carrying amount of the estimated liability for anticipated failure of insured institutions is the total of estimated losses for thrifts as well as "Oakar" and "Sasser" banks that have not failed, but the regulatory process has identified as likely to fail within the foreseeable future. It does not consider discounted future cash flows. This is because the FDIC cannot predict the timing of events with reasonable accuracy. For this reason, the FDIC considers the total estimate of these losses to be the best measure of their fair market value.

**Savings Association Insurance Fund's
Financial Statements**

13. Supplementary Information Relating to the Statements of Cash Flows

Reconciliation of Net Income to Net Cash Provided by Operating Activities

Dollars in Thousands	For the Year Ended December 31	
	1995	1994
Net Income	\$1,421,132	\$ 780,986
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities		
Income Statement Items:		
Provision for insurance losses	(321,000)	414,000
Amortization of U.S. Treasury securities (unrestricted)	(8,114)	(2,646)
Loss on sale of U.S. Treasury securities	0	289
Change in Assets and Liabilities:		
(Increase) in amortization of U.S. Treasury securities (restricted)	(450)	(17)
Decrease in entrance and exit fees receivable	26,871	24,963
(Increase) in interest receivable on investments and other assets	(9,771)	(10,824)
Decrease in receivables from thrift resolutions	6,841	168,056
Increase (Decrease) in accounts payable and other liabilities	105,198	(a) (166,953)
(Decrease) in liabilities incurred from thrift resolutions	0	(932)
Increase in exit fees and investment proceeds held in escrow	13,027	13,792
Net Cash Provided by Operating Activities	\$1,233,734	\$1,220,714

(a) SAIF Transferred \$169 million to the FRF

FSLIC Resolution Fund's Financial Statements

Statements of Financial Position

Federal Deposit Insurance Corporation

FSLIC Resolution Fund Statements of Financial Position

Dollars in Thousands

	1995	December 31 1994
Assets		
Cash and cash equivalents (Note 3)	\$ 274,973	\$ 1,278,548
Receivables from thrift resolutions, net (Note 4)	370,443	1,054,107
Investment in corporate owned assets, net (Note 5)	504,341	370,177
Other assets, net (Note 6)	4,620	20,003
Total Assets	\$ 1,154,377	\$ 2,722,835
Liabilities		
Accounts payable and other liabilities	\$ 11,045	\$ 13,262
Liabilities incurred from thrift resolutions (Note 7)	238,387	2,164,438
<i>Estimated Liabilities for: (Note 8)</i>		
Assistance agreements	81,340	277,577
Litigation losses	27,000	2,100
Total Liabilities	357,772	2,457,377
<i>Commitments and contingencies (Notes 14 and 15)</i>		
Resolution Equity (Note 10)		
Contributed capital	44,156,000	43,991,000
Accumulated deficit	(43,359,395)	(43,725,542)
Total Resolution Equity	796,605	265,458
Total Liabilities and Resolution Equity	\$ 1,154,377	\$ 2,722,835

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

FSLIC Resolution Fund's Financial
Statements

Statements of Income and Accumulated Deficit

Federal Deposit Insurance Corporation

FSLIC Resolution Fund Statements of Income and Accumulated Deficit

Dollars in Thousands

For the Year Ended
December 31

	1995	1994
Revenue		
Interest on U.S. Treasury investments	\$ 46,904	\$ 77,191
Revenue from corporate owned assets	77,087	115,280
Limited partnership and other revenue (Note 11)	314,012	275,779
Total Revenue	438,003	468,250
Expenses and Losses		
Operating expenses	11,640	15,535
Interest expense	13,901	37,624
Corporate owned asset expenses	55,181	66,394
Provision for losses (Note 9)	(13,684)	(363,812)
Other expenses	4,818	10,355
Total Expenses and Losses	71,856	(233,904)
Net Income	366,147	702,154
Accumulated Deficit - Beginning	(43,725,542)	(44,427,696)
Accumulated Deficit - Ending	\$ (43,359,395)	\$ (43,725,542)

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

Statements of Cash Flows

Federal Deposit Insurance Corporation

FSLIC Resolution Fund Statements of Cash Flows

Dollars in Thousands

For the Year Ended
December 31

	1995	1994
Cash Flows from Operating Activities		
Cash provided from:		
Interest on U.S. Treasury investments	\$ 47,028	\$ 77,191
Recoveries from thrift resolutions	785,698	2,019,635
Recoveries from corporate owned assets	420,182	416,987
Miscellaneous receipts	3,502	4,722
Cash used for:		
Operating expenses	(14,399)	(19,053)
Interest paid on indebtedness incurred from thrift resolutions	(9,719)	(28,620)
Disbursements for thrift resolutions	(1,790,471)	(2,077,535)
Disbursements for corporate owned assets	(576,996)	(222,037)
Miscellaneous disbursements	(1,840)	(2,578)
Net Cash (Used by) Provided by Operating Activities (Note 17)	(1,137,015)	168,712
Cash Flows from Financing Activities		
Cash provided from:		
U.S. Treasury payments	165,000	0
Cash used for:		
Payments of indebtedness incurred from thrift resolutions	(31,560)	(494,095)
Net Cash Provided by (Used by) Financing Activities	133,440	(494,095)
Net Decrease in Cash and Cash Equivalents	(1,003,575)	(325,383)
Cash and Cash Equivalents - Beginning	1,278,548	1,603,931
Cash and Cash Equivalents - Ending	\$ 274,973	\$ 1,278,548

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

**FSLIC Resolution Fund's Financial
Statements**

Notes to the Financial Statements

*Notes to Financial Statements
FSLIC Resolution Fund
December 31, 1995 and 1994*

1. Legislative History and Operations of the FSLIC Resolution Fund

Legislative History

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted to reform, recapitalize and consolidate the federal deposit insurance system. The FIRREA created the FSLIC Resolution Fund (FRF), the Bank Insurance Fund (BIF), and the Savings Association Insurance Fund (SAIF). It also designated the Federal Deposit Insurance Corporation (FDIC) as the administrator of these three funds. All three funds are maintained separately to carry out their respective mandates. The FRF is responsible for winding up the affairs of the former Federal Savings and Loan Insurance Corporation (FSLIC). The BIF and SAIF provide insurance for member banks and thrifts.

The FIRREA also created the Resolution Trust Corporation (RTC), which managed and resolved all thrifts previously insured by the FSLIC for which a conservator or receiver was appointed during the period January 1, 1989, through August 8, 1992. The Resolution Trust Corporation Refinancing, Restructuring and Improvement Act of 1991 (1991 RTC Act) extended the RTC's general resolution responsibility through September 30, 1993, and beyond that date for those institutions previously placed under the RTC's control. The Resolution Trust Corporation Completion Act of 1993 (1993 RTC Act), enacted December 17, 1993, extended the RTC's general resolution responsibility through a date between January 1, 1995 and July 1, 1995. Resolution responsibility transferred from the RTC to the SAIF on July 1, 1995.

The Resolution Funding Corporation (REFCORP) was established by the FIRREA to provide funds to the RTC for use in thrift resolutions. The Financing Corporation (FICO), established under the Competitive Equality Banking Act of 1987, is a mixed-ownership government corporation whose sole purpose was to function as a financing vehicle for the FSLIC. Effective December 12, 1991, as provided by the 1991 RTC Act, the FICO's ability to serve as a financing vehicle for new debt was terminated.

Operations of the FRF

The primary purpose of the FRF is to liquidate the assets and contractual obligations of the now-defunct FSLIC. The FRF will complete the resolution of all thrifts that failed before January 1, 1989, or were assisted through August 8, 1989. The FIRREA provided that the RTC manage any receiverships resulting from thrift failures that occurred after December 31, 1988, but prior to the enactment of the FIRREA. There are five such receiverships that affect the FRF financial statements because the FRF remains financially responsible for the losses associated with these resolution cases.

The FRF is primarily funded from the following sources: 1) income earned on and funds received from the management and disposition of assets of the FRF; 2) the FRF's portion of liquidating dividends paid by FRF receiverships, provided such funds are not required by the REFCORP or the FICO; and 3) interest earned on one-day U.S. Treasury investments purchased with proceeds of 1) and 2). If these sources are insufficient to satisfy the liabilities of the FRF, payments will be made from the U.S. Treasury in amounts necessary, as are appropriated by Congress, to carry out the objectives of the FRF. To facilitate efforts to wind up the resolution activity of the FRF, Public Law 103-327 provides \$827 million in funding to be available until expended. The FRF received \$165 million under this appropriation on November 2, 1995.

The 1993 RTC Act accelerated the termination date of the RTC from no later than December 31, 1996, to no later than December 31, 1995. All remaining assets and liabilities of the RTC were transferred to the FRF on January 1, 1996, after which any future net proceeds from the sale of such assets will be transferred to the REFCORP for interest payments after satisfaction of any outstanding liabilities of the RTC. The FRF will continue until all of its assets are sold or otherwise liquidated and all of its liabilities are satisfied. Upon the dissolution of the FRF, any funds remaining will be paid to the U.S. Treasury.

FSLIC Resolution Fund's Financial Statements

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 generally accepted accounting principles (GAAP). These statements do not include reporting for assets and liabilities of closed insured thrift institutions for which the FRF acts as receiver or liquidating agent. Periodic and final accountability reports of the FRF's activities as receiver or liquidating agent are furnished to courts, supervisory authorities and others as required.

Use of Estimates

The preparation of the FRF's financial statements in conformity with generally accepted accounting principles requires FDIC management to make 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 in the financial statements.

Allowance for Losses on Receivables from Thrift Resolutions and Investment in Corporate Owned Assets

The FRF records as a receivable the amounts advanced and/or obligations incurred for assisting and closing thrift institutions. The FRF also records as an asset the amounts advanced for investment in corporate owned assets. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. The latter is based on the estimated cash recoveries from the assets of the assisted or failed thrift institution, net of all estimated liquidation costs.

Estimated Liabilities for Assistance Agreements

The FRF establishes an estimated liability for probable future assistance payable to acquirers of troubled thrifts under its financial assistance agreements. Such estimates are presented on a discounted basis.

Litigation Losses

The FRF accrues, as a charge to current period operations, an estimate of probable losses from litigation against the FRF in both its corporate and receivership capacities. The FDIC's Legal Division recommends these estimates on a case-by-case basis. The litigation loss estimates related to receiverships are included in the allowance for losses for receivables from thrift resolutions.

Receivership Administration

The FDIC is responsible for controlling and disposing of the assets of failed institutions in an orderly and efficient manner. The assets, and the claims against them, are accounted for separately to ensure that liquidation 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. Liquidation expenses incurred by the FRF on behalf of the receiverships are recovered from those receiverships.

Cost Allocations Among Funds

Certain operating expenses (including personnel, administrative and other indirect expenses) not directly charged to each fund under the FDIC's management are allocated on the basis of the relative degree to which the operating expenses were incurred by the funds.

The FDIC includes the cost of facilities used in operations in the BIF's financial statements. The BIF charges the FRF a rental fee representing an allocated share of its annual depreciation. The cost of furniture, fixtures and equipment purchased by the FDIC on behalf of the three funds under its administration is allocated among these funds on a pro rata basis. The FRF expenses its share of these allocated costs at the time of acquisition because of their immaterial amounts.

Postretirement Benefits Other Than Pensions

The FDIC established an entity to provide the accounting and administration of postretirement benefits on behalf of the FRF, the BIF, the SAIF and the RTC. The FRF funds its liabilities for these benefits directly to the entity.

**Disclosure about Recent Financial Accounting
Standards Board Pronouncements**

In May 1993, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 114, "Accounting by Creditors for Impairment of a Loan," to be adopted for fiscal years beginning after December 15, 1994. While FDIC adopted SFAS No. 114, most of the FRF assets are specifically outside the scope of this pronouncement. These assets do not meet the definition of a loan within the meaning of the statement or are valued through alternative methods. Any assets subject to Statement No. 114 are immaterial either because of insignificant book value or because any potential adjustment to the carrying value as a result of applying Statement No. 114 would be immaterial.

The FASB issued SFAS No. 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures," in October 1994, to be adopted for fiscal years beginning after December 15, 1994. This statement is an amendment to SFAS No. 114 and was adopted by the FDIC this year.

Other recent pronouncements issued by the FASB have been adopted or are either not applicable or not material to the financial statements.

Wholly Owned Subsidiary

The Federal Asset Disposition Association (FADA) is a wholly owned subsidiary of the FRF. The FADA was placed in receivership on February 5, 1990. However, due to outstanding litigation, a final liquidating dividend to the FRF will not be made until the FADA's litigation liability is settled or dismissed. The investment in the FADA is accounted for using the equity method and is included in "Other assets, net" (Note 6). As of December 31, 1995, the value of the investment has been adjusted for projected expenses relating to the liquidation of the FADA. The FADA's estimate of probable litigation losses is \$2.8 million. Accordingly, a \$2.8 million litigation loss has been recognized as a reduction in the value of the FRF's investment in the FADA. There were no additional litigation losses considered reasonably possible as of December 31, 1995.

Related Parties

The nature of related parties and descriptions of related party transactions are disclosed throughout the financial statements and footnotes.

Reclassifications

Reclassifications have been made in the 1994 financial statements to conform to the presentation used in 1995.

3. Cash and Cash Equivalents

The FRF considers cash equivalents to be short-term, highly liquid investments with original maturities of three months or less. In 1995, cash restrictions included \$403 thousand for health

insurance payable and \$565 thousand for funds held in trust. In 1994, cash restrictions included \$204 thousand for health insurance payable and \$821 thousand for funds held in trust.

4. Receivables from Thrift Resolutions, Net

As of December 31, 1995 and 1994, the FRF, in its receivership capacity, held assets with a book value of \$533 million and \$947 million, respectively. The estimated cash recoveries from the sale of these assets (excluding cash and miscellaneous receivables of \$174 million in 1995

and \$168 million in 1994) are regularly evaluated, but remain subject to uncertainties because of changing economic conditions. These factors could affect the FRF's actual recoveries upon the sale of these assets from the level of recoveries currently estimated.

**FSLIC Resolution Fund's Financial
Statements**

Receivables from Thrift Resolutions, Net		
Dollars in Thousands		
	December 31	
	1995	1994
Assets from Open Thrift Assistance:		
Collateralized loans	\$ 0	\$ 360,000
Notes receivable	130,420	130,657
Subordinated debt instruments	14,301	21,301
Capital instruments	65,000	65,000
Interest in limited partnerships	0	29,624
Preferred stock	417,733	429,628
Interest receivable	2,761	4,717
Allowance for losses (Note 9)	(446,514)	(423,296)
	183,701	617,631
Receivables from Closed Thrifts:		
Resolution transactions	8,600,088	9,114,230
Collateralized advances/loans	279,297	289,494
Other receivables	219,737	218,918
Allowance for losses (Note 9)	(8,912,380)	(9,186,166)
	186,742	436,476
Total	\$ 370,443	\$ 1,054,107

5. Investment in Corporate Owned Assets, Net

The FRF's investment in corporate owned assets is comprised of amounts that: 1) the FSLIC paid to purchase assets from troubled or failed thrifts and 2) the FRF pays to acquire receivership assets, terminate receiverships and purchase covered assets. The majority of these assets are real estate and mortgage loans.

The FRF recognizes income and expenses on these assets. Income consists primarily of the portion of collections on performing mortgages related to interest earned. Expenses are recognized for administering the management and liquidation of these assets.

Investment in Corporate Owned Assets, Net		
Dollars in Thousands		
	December 31	
	1995	1994
Investment in corporate owned assets	\$ 3,664,397	\$ 3,444,413
Allowance for losses (Note 9)	(3,160,056)	(3,074,236)
Total	\$ 504,341	\$ 370,177

**FSLIC Resolution Fund's Financial
Statements**

6. Other Assets, Net		
Dollars in Thousands	December 31	
	1995	1994
Investment in FADA (Note 2)	\$ 15,000	\$ 25,000
Allowance for loss (Note 9)	(11,074)	(12,375)
Investment in FADA, Net	3,926	12,625
Accounts receivable	126	230
Due from other government entities	568	7,148
Total	\$ 4,620	\$ 20,003

7. Liabilities Incurred from Thrift Resolutions

The FSLIC issued promissory notes and entered into assistance agreements to prevent the default and subsequent liquidation of certain insured thrift institutions. These notes and agreements required the FSLIC to provide financial assistance over time. Under the FIRREA, the FRF assumed these

obligations. Notes payable and obligations for assistance agreement payments incurred but not yet paid are in "Liabilities incurred from thrift resolutions." Estimated future assistance payments are included in "Estimated liabilities for: Assistance agreements" (see Note 8).

Liabilities Incurred from Thrift Resolutions		
Dollars in Thousands	December 31	
	1995	1994
Notes payable to Federal Home Loan Banks/U.S. Treasury	\$ 0	\$ 360,000
Capital instruments	725	725
Assistance agreement notes payable	157,800	189,360
Assistance agreement costs payable	0	1,530,043
Interest payable	2,600	2,931
Other liabilities to thrift institutions	77,262	81,379
Total	\$ 238,387	\$ 2,164,438

Maturities of Liabilities

Dollars in Thousands		
1996	1997	1998
\$112,147	\$31,560	\$94,680

8. Estimated Liabilities for:

Assistance Agreements

The "Estimated liabilities for: Assistance agreements" represents, on a discounted basis, an estimate of future assistance payments to acquirers of troubled thrift institutions. The nominal dollar amount before discounting was \$91 million and \$294 million, as of December 31, 1995 and 1994, respectively. The discount rates applied as of December 31, 1995 and 1994, were 5.5 percent and 6.3 percent, respectively, based on U.S. money rates for federal funds.

Future assistance stems from the FRF's obligation to: 1) fund losses inherent in assets covered under the assistance agreements (e.g., by subsidizing asset write-downs, capital losses and goodwill amortization) and 2) supplement the actual yield earned from covered assets as necessary for the acquirer to achieve a specified yield (the "guaranteed yield"). Estimated total assistance costs recognized for current assistance agreements with institutions involving covered assets include estimates for the loss expected on the assets based on their appraised values. The FRF is obligated to fund any losses sustained by the institutions on the sale of the assets. If all underlying assets prove to be of no value, the possible cash requirements and the accounting loss could be as high as \$467 million (see Note 15). The costs and related cash requirements associated with maintaining covered assets are calculated using an applicable cost of funds rate and would change proportionately with market rates.

The estimated liabilities for assistance agreements are affected by several factors, including adjustments to expected notes payable, the terms of the assistance agreements outstanding and, in particular, the marketability of the related covered assets. The variable nature of the FRF assistance agreements will cause the cost requirements to

fluctuate. This fluctuation will impact both the timing and amount of eventual cash flows.

The number of assistance agreements outstanding as of December 31, 1995 and 1994, were 37 and 54, respectively. The last agreement is scheduled to expire in December 1998.

Litigation Losses

The FRF records an estimated loss for unresolved legal cases to the extent those losses are considered to be probable in occurrence and reasonably estimable in amount. In addition, the FDIC's Legal Division has determined that losses from unresolved legal cases totaling \$132 million are reasonably possible. This includes \$125 million in losses for the FRF in its corporate capacity and \$7 million in losses for the FRF in its receivership capacity (see Note 2).

There exists an additional category of contingencies with respect to FRF that arises from supervisory goodwill and other capital forbearances granted to the acquirers of troubled thrifts by the Federal Home Loan Bank Board in the 1980's. Subsequently, FIRREA imposed minimum capital requirements on thrifts and limited the use of supervisory goodwill and other forbearances to meet these capital requirements. There are currently approximately 120 cases pending which result from the elimination of supervisory goodwill and forbearances.

To date, one of these cases has resulted in a final judgment of \$6 million against FDIC, which FDIC paid from FRF in accordance with the court's order. FDIC believes that judgments in such cases are properly paid from the Judgment Fund, a permanent, indefinite appropriation established by 31 U.S.C. 1304. The extent to which FRF will be the source for paying other judgments in such cases is uncertain.

9. Analysis of Changes in Allowance for Losses and Estimated Liabilities

In the following charts, transfers primarily include reclassifications from "Estimated liabilities for: Assistance agreements" to "Liabilities incurred from thrift resolutions" for notes payable and related accrued assistance agreement costs.

Terminations represent final adjustments to the estimated cost figures for those thrift resolutions that were completed and the operations of the receivership ended.

**FSLIC Resolution Fund's Financial
Statements**

Analysis of Changes in Allowance for Losses and Estimated Liabilities - 1995

Dollars in Millions

Allowance for Losses:	Beginning Balance 01/01/95	Provision for Losses	Net Cash Payments	Adjustments/ Transfers/ Terminations	Ending Balance 12/31/95
Open thrift assistance	\$ 423	\$ 16	\$ 0	\$ 7	\$ 446
Closed thrifts	9,186	(7)	0	(267)	8,912
Corporate owned assets	3,074	90	0	(4)	3,160
Investment in FADA	12	(1)	0	0	11
Total Allowance for Losses	12,695	98	0	(264)	12,529

Estimated Liabilities for:

Assistance agreements	278	(137)	(203)	143	81
Litigation losses	2	25	0	0	27
Total Estimated Liabilities	280	(112)	(203)	143	108

Provision for Losses **\$ (14)**

Analysis of Changes in Allowance for Losses and Estimated Liabilities - 1994

Dollars in Millions

Allowance for Losses:	Beginning Balance 01/01/94	Provision for Losses	Net Cash Payments	Adjustments/ Transfers/ Terminations	Ending Balance 12/31/94
Open thrift assistance	\$ 423	\$ 0	\$ 0	\$ 0	\$ 423
Closed thrifts	9,549	(133)	0	(230)	9,186
Corporate owned assets	2,988	86	0	0	3,074
Due from the SAIF	7	0	0	(7)	0
Investment in FADA	11	1	0	0	12
Total Allowance for Losses	12,978	(46)	0	(237)	12,695

Estimated Liabilities for:

Assistance agreements	1,290	(320)	(1,424)	732	278
Litigation losses	70	2	0	(70)	2
Total Estimated Liabilities	1,360	(318)	(1,424)	662	280

Provision for Losses **\$ (364)**

**FSLIC Resolution Fund's Financial
Statements**

10. Resolution Equity

The accumulated deficit includes \$7.5 billion in non-redeemable capital certificates and redeemable capital stock issued by the FSLIC. Capital instruments were issued by the FSLIC and the FRF to the FICO as a means of obtaining capital. Effective December 12, 1991, the FICO's

authority to issue obligations as a means of financing for the FRF was terminated (see Note 1). Furthermore, the implementation of the FIRREA, in effect, removed the redemption characteristics of the capital stock issued by the FSLIC.

Resolution Equity

Dollars in Thousands

	Beginning Balance 01/01/95	Net Income	Treasury Payments	Ending Balance 12/31/95
Contributed capital	\$ 43,991,000	\$ 0	\$ 165,000	\$ 44,156,000
Accumulated deficit	(43,725,542)	366,147	0	(43,359,395)
Total	\$ 265,458	\$ 366,147	\$ 165,000	\$ 796,605

	Beginning Balance 01/01/94	Net Income	Treasury Payments	Ending Balance 12/31/94
Contributed capital	\$43,991,000	\$ 0	\$ 0	\$ 43,991,000
Accumulated deficit	(44,427,696)	702,154	0	(43,725,542)
Total	\$ (436,696)	\$ 702,154	\$ 0	\$ 265,458

11. Limited Partnership and Other Revenue

During 1993, the FDIC's Board of Directors delegated to the RTC the authority to execute partnership agreements on behalf of the FDIC. Under that authority, the FRF secured a limited partnership interest in two partnerships, Mountain

AMD and Brazos Partners, in order to achieve a least cost resolution. The FRF has collected its entire interest in the partnerships. However, funds in excess of the original investment continue to be collected by the FRF.

Limited Partnership and Other Revenue

Dollars in Thousands

	For the Year Ended December 31	
	1995	1994
Gain on limited partnership agreements	\$ 292,124	\$229,651
Interest earned on assistance agreements	10,776	23,798
Other assistance agreements revenue	7,940	300
Interest earned on subrogated claims of depositors	0	20,786
Interest earned on advances to receiverships	1,737	1,054
Other	1,435	190
Total	\$ 314,012	\$275,779

FSLIC Resolution Fund's Financial Statements

12. Pension Benefits, Savings Plans and Accrued Annual Leave

Eligible FDIC employees (i.e., all permanent and temporary employees with appointments exceeding one year) are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The CSRS is a defined benefit plan offset with the Social Security System in certain cases. Plan benefits are determined on the basis of years of creditable service and compensation levels. The CSRS-covered employees also can contribute to the tax-deferred Federal Thrift Savings Plan (TSP).

The FERS is a three-part plan consisting of a basic defined benefit plan that provides benefits based on years of creditable service and compensation levels, Social Security benefits and the TSP. Automatic and matching employer contributions to the TSP are provided up to specified amounts under the FERS.

Eligible FDIC employees also may participate in an FDIC-sponsored tax-deferred savings plan with matching contributions. The FRF pays its share of the employer's portion of all related costs.

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 and accounted for by the U.S. Office of Personnel Management.

The liability to employees for accrued annual leave is approximately \$2.9 million and \$3.2 million at December 31, 1995 and 1994, respectively.

Pension Benefits and Savings Plans Expenses

Dollars in Thousands	For the Year Ended December 31	
	1995	1994
Civil Service Retirement System	\$ 471	\$ 548
Federal Employee Retirement System (Basic Benefit)	2,691	2,222
FDIC Savings Plan	1,357	1,520
Federal Thrift Savings Plan	703	725
Total	\$ 5,222	\$ 5,015

13. Postretirement Benefits Other than Pensions

The FDIC provides certain health, dental and life insurance coverage for its eligible retirees, the retirees' beneficiaries and covered dependents. Retirees eligible for health and/or 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. Dental coverage is provided to all retirees eligible for an immediate annuity.

The FDIC is self-insured for hospital/medical, prescription drug, mental health and chemical dependency coverage. Additional risk protection was purchased from Aetna Life Insurance Company through stop-loss and fiduciary liability insurance. All claims are administered on an administrative services only basis with the

hospital/medical claims administered by Aetna Life Insurance Company, the mental health and chemical dependency claims administered by OHS Foundation Health Psychcare Inc., and the prescription drug claims administered by Caremark.

The life insurance program, underwritten by Metropolitan Life Insurance Company, provides basic coverage at no cost to retirees and allows converting optional coverages to direct-pay plans. Dental care is underwritten by Connecticut General Life Insurance Company and provides coverage at no cost to retirees.

The FRF expensed \$1.8 million and \$1.4 million for net periodic postretirement benefit costs for the years ended December 31, 1995 and 1994,

**FSLIC Resolution Fund's Financial
Statements**

respectively. For measurement purposes, the FDIC assumed the following: 1) a discount rate of 6 percent; 2) an average long-term rate of return on plan assets of 5 percent; 3) an increase in health costs in 1995 of 12 percent, decreasing down to an ultimate rate in 1999 of 8 percent; and 4) an increase in dental costs in 1995 and thereafter of 8 percent. Both the assumed discount rate and health care cost rate have a significant effect on the

amount of the obligation and periodic cost reported.

If the health care cost rate were increased one percent, the accumulated postretirement benefit obligation as of December 31, 1995, would have increased by 22.9 percent. The effect of this change on the aggregate of service and interest cost for 1995 would be an increase of 25.6 percent.

Net Periodic Postretirement Benefit Cost		
Dollars in Thousands	For the Year Ended December 31	
	1995	1994
Service cost (benefits attributed to employee service during the year)	\$ 1,587	\$ 1,325
Interest cost on accumulated postretirement benefit obligation	1,035	752
Net total of other components	(251)	(256)
Return on plan assets	(563)	(442)
Total	\$ 1,808	\$ 1,379

As stated in Note 2, the FDIC established an entity to provide accounting and administration on behalf of the FRF, the BIF, the SAIF and the RTC. The

FRF funds its liability and these funds are being managed as "plan assets."

Accumulated Postretirement Benefit Obligation and Funded Status		
Dollars in Thousands	December 31	
	1995	1994
Retirees	\$ 3,010	\$ 2,798
Fully eligible active plan participants	849	664
Other active participants	6,917	9,262
Total Obligation	10,776	12,724
Less: Plan assets at fair value (a)	12,018	11,455
(Over) Under Funded Status	(1,242)	1,269
Unrecognized prior service cost	3,480	0
Unrecognized net gain	727	0
Postretirement Benefit Liability Recognized in the Statements of Financial Position	\$ 2,965	\$ 1,269

(a) Consists of U.S. Treasury investments

14. Commitments

The FRF's allocated share of FDIC's lease commitments totals \$7.3 million for future years. The lease agreements contain escalation clauses resulting in adjustments, usually on an annual

basis. The FRF recognized leased space expense of \$4.5 million and \$8.9 million for the years ended December 31, 1995 and 1994, respectively.

**FSLIC Resolution Fund's Financial
Statements**

Leased Space Fees

Dollars in Thousands

1996	1997	1998	1999	2000	2001
\$1,845	\$1,668	\$1,145	\$921	\$837	\$862

15. Concentration of Credit Risk

The FRF is counterparty to a group of financial instruments with entities located throughout regions of the United States experiencing problems in both loans and real estate. The FRF's maximum

exposure to possible accounting loss, should each counterparty to these instruments fail to perform and any underlying assets prove to be of no value, is shown as follows:

Concentration of Credit Risk at December 31, 1995

Dollars in Millions

	South east	South- west	North- east	Mid- west	Central	West	Total
Receivables from thrift resolutions, net	\$ 36	\$ 163	\$ 0	\$ 7	\$ 26	\$ 138	\$ 370
Investment in corporate owned assets, net	10	460	0	0	3	31	504
Assistance agreements covered assets, net of estimated capital loss (off-balance-sheet)	0	407	0	0	50	10	467
Total	\$ 46	\$1,030	\$ 0	\$ 7	\$ 79	\$ 179	\$ 1,341

16. Disclosures about the Fair Value of Financial Instruments

Cash equivalents are short-term, highly liquid investments and are shown at current value. The carrying amount of accounts payable, liabilities incurred from thrift resolutions and the estimated liabilities for assistance agreements approximates their fair market value. This is due to their short maturities or comparisons with current interest rates.

It is not practicable to estimate fair market values of net receivables from thrift resolutions. These assets are unique, not intended for sale to the private sector and have no established market. The FDIC believes that a sale to the private sector would require indeterminate, but substantial discounts for an interested party to profit from these assets because of credit and other risks. A discount of this proportion would significantly increase the cost of thrift resolutions to the FRF. Comparisons with other financial instruments do not provide a reliable measure of their fair market value. Due to these and other factors, the FDIC cannot determine an appropriate market discount rate and, thus, is unable

to estimate fair market value on a discounted cash flow basis. As shown in Note 4, the carrying amount is the estimated cash recovery value, which is the original amount advanced (and/or obligations incurred) net of the estimated allowance for loss.

The majority of the net investment in corporate owned assets (except real estate) is comprised of various types of financial instruments (investments, loans, accounts receivable, etc.) acquired from failed thrifts. As with net receivables from thrift resolutions, it is not practicable to estimate fair market values. Cash recoveries are primarily from the sale of poor quality assets. They are dependent on market conditions that vary over time, and can occur unpredictably over many years following resolution. Since the FDIC cannot reasonably predict the timing of these cash recoveries, it is unable to estimate fair market value on a discounted cash flow basis. As shown in Note 5, the carrying amount is the estimated cash recovery value, which is the original amount advanced (and/or obligations incurred) net of the estimated allowance for loss.

17. Supplementary Information Relating to the Statements of Cash Flows

Non-cash financing activities for the years ended December 31, 1995 and 1994, include a decrease in collateralized loans guaranteed by the FRF of \$360 million and \$20 million, respectively (see Note 4).

Reconciliation of Net Income to Net Cash (Used by) Provided by Operating Activities

Dollars in Thousands	For the Year Ended December 31	
	1995	1994
Net Income	\$ 366,147	\$ 702,154
Adjustments to Reconcile Net Income to Net Cash (Used by) Provided by Operating Activities		
Income Statement Item:		
Provision for losses	(13,684)	(363,812)
Change in Assets and Liabilities:		
Decrease in receivables from thrift resolutions	675,943	1,343,143
(Increase) decrease in investment in corporate owned assets	(223,856)	121,049
Decrease in other assets	14,281	160,511
(Decrease) in accounts payable and other liabilities	(2,217)	(93,129)
(Decrease) in liabilities incurred from thrift resolutions	(1,899,484)	(838,703)
(Decrease) in estimated liabilities for assistance agreements	(54,145)	(862,501)
Net Cash (Used by) Provided by Operating Activities	\$ (1,137,015)	\$ 168,712

Comments From the Federal Deposit Insurance Corporation

FDIC

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

Deputy to the Chairman for Finance
and Chief Financial Officer

June 26, 1996

Gene L. Dodaro
Assistant Comptroller General
General Accounting Office
Washington, DC 20548

Dear Mr. Dodaro:

We appreciate the opportunity to comment on the GAO report on its audits of the 1995 and 1994 financial statements of the Bank Insurance Fund (BIF), the Savings Association Insurance Fund (SAIF), and the FSLIC Resolution Fund (FRF), and are pleased that the GAO has found these statements to be fairly stated in all material respects. We are also pleased that the GAO found management's assertion on the effectiveness of the FDIC's internal controls to be fair and appropriate. Although certain internal control weaknesses are noted by the GAO, we believe that significant progress has been made to correct weaknesses identified in the 1994 report, and appreciate the GAO's acknowledgment of management's efforts to address these matters.

Condition of FDIC-Insured Institutions

As stated in the GAO report, insured commercial banks and savings institutions reported record earnings in 1995, continuing a four-year trend of strong earnings performance. Both industries registered improvement in the condition of their balance sheets in 1995, as capital levels rose and troubled assets declined.

The commercial banks' average return on assets (ROA) rose to 1.17 percent. This marks the third consecutive year that the average ROA has been above one percent. In the 60 years the FDIC had been in existence prior to 1993, the industry ROA had never reached the one percent level. The average ROA for savings institutions in 1995 was 0.78 percent, the highest annual ROA reported since 1962. Only six commercial banks and two savings institutions failed in 1995.

Deposit Insurance Premium Differential Between BIF and SAIF Insured Institutions

During 1995 the BIF reached its designated reserve ratio and, in accordance with statutory requirements, the FDIC Board of Directors reduced deposit insurance premiums for BIF

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deposits substantially. In contrast, the SAIF remains significantly undercapitalized and applicable deposit insurance premiums remain high. As the GAO report points out, the disparity between BIF and SAIF insurance premiums and its impact on the financial health of the SAIF is of critical concern. The premium disparity has caused the SAIF to become a structural defect in the deposit insurance system, a defect that weakens the whole system. Since banks and thrifts are receiving the same product--deposit insurance--at vastly different prices, there are strong economic incentives for institutions to reduce reliance on SAIF deposits. It is inevitable that marketplace economics will prompt institutions to find ways to migrate deposits from the SAIF to the BIF.

As deposit migration increases, the SAIF assessment base will become smaller and less diversified, resulting in an increase in the SAIF's risk profile. As SAIF deposits migrate to the BIF without reserves, the BIF will increasingly become diluted and banks will have to cover the costs of capitalizing the fund, potentially leading to higher future premiums. This premium disparity and smaller assessment base could also trigger a default on the Financing Corporation (FICO) bonds. In addition, under current law, the acquisition of SAIF-insured deposits by BIF members reduces the amount of assessment income available for FICO debt service. We cannot predict precisely when a default might occur, but the movement of deposits from the assessment base available to fund FICO payments could reduce, in the relatively near term, SAIF assessment income to a point where it is insufficient to pay the interest on FICO bonds. Only a comprehensive legislative solution--including recapitalization of the SAIF and sharing of the FICO burden, and an eventual merger of the insurance funds--will provide stability in the deposit insurance system, protect the insurance funds, and maintain public confidence in the system.

FDIC's Progress in Responding to Internal Control Weaknesses Identified in the GAO's 1994 Financial Statement Audits

As the GAO acknowledges in its report, the FDIC made significant strides in 1995 to resolve control issues that the GAO found during prior audits. We are pleased that the GAO agrees that weaknesses in controls over safeguarding of assets and proper reporting of asset management and disposition activity by third party asset servicing contractors have been fully resolved. The GAO also noted progress the FDIC made in improving controls over its asset valuation process, particularly revisions made to the FDIC's Asset Disposition Manual, which now provides a more sound basis for estimating recoveries from failed institution assets. The GAO also acknowledged management's ongoing efforts to address other asset valuation issues and internal control issues relating to time and attendance reporting, but stated that additional improvements are needed.

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Discussion of Reportable Conditions Identified in the GAO's 1995 Financial Statement Audits

1. FDIC Asset Recovery Estimation Procedures

The GAO report states that the FDIC's controls do not ensure that recovery estimates for assets acquired from failed financial institutions comply with the FDIC's revised asset recovery estimate methodology or are based on current and complete file documentation. During 1995 FDIC staff worked with the GAO to develop revised guidelines for estimating asset recoveries from failed financial institutions. The new guidelines addressed previous GAO concerns and provided improved consistency and accuracy in asset recovery estimation methodologies, as well as guidance for documentation requirements. The new guidelines were provided to account officers on August 24, 1995. However, because the asset valuation date was September 30, 1995, FDIC management at offices responsible for determining asset recovery estimates had only a short time to review and implement the new guidelines.

FDIC staff thoroughly reviewed the assets sampled by the GAO during the audits to assess the accuracy of its account officers in estimating recoveries. Although the review concluded there were instances of noncompliance with the revised FDIC guidelines, it also found numerous instances where FDIC and GAO were in complete or substantial agreement. Thus, although management acknowledges that improvements can and should be made, management believes that the revised asset valuation methodology was generally understood, that staff performing the evaluations generally conducted them properly, and that the aggregate recovery estimates for assets acquired from failed financial institutions are reasonable.

The GAO report asserts that the BIF asset valuation estimates are overstated by about \$266 million and the FRF asset valuation estimates are overstated by about \$183 million. These amounts represent approximately 1.0% of the BIF fund balance, and 0.4% of the FRF accumulated deficit. The GAO noted, and the FDIC agrees, that the differences in the GAO and FDIC estimates are not material. However, FDIC management believes that the GAO's assertion conveys a greater sense of precision than is warranted by the very nature of the estimation process. Determining precise estimates of recoveries on certain types of assets, such as real property, is inexact at best. Based on various tests of reasonableness that FDIC staff has conducted, management believes that both the FDIC's and GAO's estimates of asset values fall within a reasonable range and that there is no basis for asserting that either set of estimates is more accurate than the other.

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As described below, based on the GAO findings and the FDIC staff review, management reached several conclusions and, as acknowledged in the GAO report, has initiated actions expected to resolve weaknesses in the asset valuation process. The FDIC plans to have the new process in place to perform the asset valuations for the 1996 annual financial statements. The implementation plan includes sufficient time to update FDIC manuals and fully train personnel.

First, management plans to use statistically valid sampling procedures for types of assets for which this is appropriate. By focusing on fewer assets, each asset in the sample will receive a rigorous, well-documented review. The sampling will be done on a rolling basis with valuations conducted at various times during the year. The sample design will provide a high degree of confidence at the BIF/SAIF/FRF fund level that asset valuation estimates are correct.

Second, to minimize timing differences, staff is currently developing procedures to value assets, and update previous estimates of value, as close to year-end as possible.

Third, criteria for valuing assets will be clarified and will be applied consistently. For example, loans will be classified as "performing" or "subperforming" on the basis of clear and objective criteria.

Fourth, the new asset valuation program will be administered by a small, multi-functional, highly skilled and dedicated staff, none of whom will value assets he or she is directly responsible for managing.

Fifth, management will employ an independent quality assurance process in 1996, which will be administered by the Internal Review staff of the Division of Depositor and Asset Services.

Management believes that these changes will address the concerns regarding asset valuation methodology, documentation, management review and timing differences. The revised procedures could marginally increase or decrease asset recovery estimates, and should increase the dependability of the estimates. FDIC staff are consulting with GAO staff to assure that the revised procedures are effective in determining asset values and incorporate appropriate controls.

2. Time and Attendance Reporting

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As was the case in previous audits, the GAO identified deficiencies in adherence to time and attendance (T&A) reporting and post-audit procedures. These deficiencies included failure to adhere strictly to procedures related to T&A preparation, separation of duties between timekeeping and data entry functions, and reconciliation of payroll reports to time cards. The GAO added that these weaknesses could adversely affect the FDIC's ability to allocate expenses properly among the BIF, SAIF and FRF.

The GAO noted that the FDIC recently implemented new T&A reporting procedures intended to address these deficiencies. These new procedures clearly focus accountability for verifying T&A accuracy on supervisors; segregate timekeeping and data entry duties; and redefine post-audit responsibilities. Corporate-wide training was held during the first quarter of 1996 for all supervisors and timekeepers to educate them on the new procedures and their respective responsibilities. Training will be provided later this year for designated auditors.

Management will test the new procedures over the next few months to ensure that the new controls are being strictly enforced and that they are, in fact, achieving their intended results. Information will also be provided to employees on the proper use of accounting information on time cards. In addition, a fully-automated T&A process will be implemented during the next twelve months that will provide more automated edits to facilitate the timely identification and correction of T&A reporting errors.

FDIC management is also studying current expense allocation and recovery methodologies and plans to implement changes as appropriate. As a part of this undertaking, management is developing methods that will reduce reliance on T&A reporting to allocate expenses to funds and receiverships.

3. Electronic Data Processing Controls

Staff from the FDIC and the GAO have discussed electronic data processing controls. Changes and enhancements are being implemented, which will eliminate this internal control weakness. Details of the FDIC's response will be communicated to the GAO through separate correspondence.

Other Management Initiatives

During 1995 and early 1996, FDIC management completed or has underway a series of initiatives designed to improve operational effectiveness. The Resolution Trust Corporation's (RTC) systems and organizational structures have been effectively integrated into those of the FDIC. Asset disposition activities of the FDIC and RTC have been integrated and are benefiting from adoption of best practices recommended by the RTC Transition Task Force. FDIC management is continuing to adjust staffing levels to

Appendix I
Comments From the Federal Deposit
Insurance Corporation

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declining workloads, and is taking care to ensure that qualified personnel are available to perform needed functions.

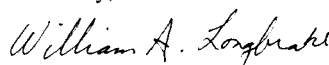
To enhance corporate oversight of contracting activities, a new office, the Acquisition Services Branch, was created and made the responsibility of the new Division of Administration. As part of these actions, significant contracting oversight has been implemented. In addition, the Office of Internal Control Management was established to bring a corporate-wide perspective to internal control issues. This new office is responsible for assuring that all operational and management control weaknesses are resolved in a timely manner. Finally, on the recommendation of Chairman Helfer, the Board of Directors of the FDIC established a Board-level Audit Committee earlier this year to review the FDIC's internal and external audit recommendations, the sufficiency of internal controls, and compliance with laws and regulations, including compliance with the Chief Financial Officers Act of 1990.

Conclusion

The FDIC is committed, on an ongoing basis, to assuring that rigorous financial controls are applied to all FDIC operations, and that strong internal controls are in place to enable management to monitor the operational effectiveness of the FDIC in meeting its statutory and financial reporting obligations. These obligations include assuring the soundness of the BIF and the SAIF, as well as the effectiveness of the ongoing regulatory and supervisory responsibilities of the FDIC.

The GAO's audits and recommendations have identified issues which will assist management in its efforts to improve the operational effectiveness of the FDIC.

Sincerely,


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Chief Financial Officer

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