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United States General Accounting Office

GAO

Report to the Congress

April 1988

FINANCIAL AUDIT

Federal Deposit Insurance Corporation's 1987 and 1986 Financial Statements

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GAO

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

Comptroller General
of the United States

B-114831

April 22, 1988

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

This report presents our unqualified opinion on the Federal Deposit Insurance Corporation's financial statements for the years ended December 31, 1987 and 1986, and our reports on the Corporation's system of internal accounting controls and on its compliance with laws and regulations.

Since the early 1980's, the commercial banking industry has been adversely affected by the weak financial condition of the energy, agricultural, and real estate sectors of the economy, and by the difficulties certain less developed countries have experienced in servicing their debt to larger U.S. commercial banks. Consequently, the Corporation has had to substantially increase its expenditures for regulatory action. Between 1980 and 1985, the Corporation's net income exceeded $1 billion each year, but in 1986, net income declined to less than $300 million, and further declined to less than $50 million in 1987.

The Federal Deposit Insurance Corporation is an independent agency established by the Banking Act of 1933 and classified as a mixed ownership government corporation under 31 U.S.C. 9101. We conducted our examinations pursuant to the provisions of 31 U.S.C. 9105 and in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Board of Directors, Federal Deposit Insurance Corporation.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Contents

Abbreviations

FDIC	Federal Deposit Insurance Corporation
LDC	less developed country

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To the Board of Directors
Federal Deposit Insurance Corporation

We have examined the statements of financial position of the Federal Deposit Insurance Corporation as of December 31, 1987 and 1986, and the related statements of income and the deposit insurance fund, and of the changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. In addition to this report on our examination of the Corporation's 1987 and 1986 financial statements, we are also reporting on our study and evaluation of internal accounting controls and compliance with laws and regulations. During our examination, we identified matters that do not affect the fair presentation of the financial statements, but nonetheless warrant management's attention. We are reporting them separately to the Corporation.

Since the early 1980's, the commercial banking industry's performance has been adversely affected by two primary factors. First, problems in the energy and agricultural sectors of the economy, and their resulting impact on the real estate sector, have severely affected the profitability and financial condition of many U.S. banks, especially in the Southwest and Midwest. In 1987, 2,366 of the nation's 13,654 FDIC-insured commercial banks were unprofitable. Almost two-thirds of the unprofitable banks were located in the Southwest and Midwest. Second, certain less developed countries (LDCs) have been experiencing significant difficulty in servicing their debt to many of the larger commercial banks. In 1987, banks provided $20.6 billion in loan loss reserves on their more than $80 billion in LDC loans and placed many of those loans on nonaccrual status, whereby interest income is not recorded until payment is received. These actions significantly lowered bank profits. The industry's net profit declined from $17.5 billion in 1986 to only $3.7 billion in 1987, a return on assets of only 0.13 percent, the lowest return since 1934.

The banking industry's problems have resulted in a substantial increase in the number of FDIC-insured bank failures and problem banks over the last several years and a substantial decrease in the Corporation's net income. In 1982, 42 insured banks failed or were assisted, at a cost of about $1.2 billion; in 1987, 203 insured banks failed or were assisted, at an estimated cost of about $2.1 billion. At the end of 1987, 1,559 of the 13,654 FDIC-insured commercial banks were on the Corporation's problem bank list, a 378 percent increase in the number of problem banks since the end of 1982. The industry's problems have caused the Corporation to substantially increase its expenditures for assistance and regulatory actions. Between 1980 and 1985, the Corporation's net income exceeded $1 billion each year, but, in 1986, net income declined to less than $300 million, and further declined to less than $50 million in 1987. The deposit insurance fund increased from $11.0 billion at the end of 1980 to almost $18.0 billion at the end of 1985, and has remained at about that level through 1987. However, the ratio of the insurance fund to insured deposits has declined from 1.24 percent at the end of 1981 to 1.10 percent at the end of 1987, the lowest ratio in the Corporation's history, as insured deposits have grown at a faster rate than the insurance fund.

Although the Corporation expects that overall industry profits will improve in 1988, it will need to continue providing substantial financial assistance to financially troubled banks. The Corporation expects the persistent problems in the energy and real estate sectors of the economy, especially in the Southwest, to continue and the number of insured bank failures to remain high. In addition, certain large U.S. commercial banks continue to face problems that could seriously affect their financial condition and result in substantial costs to the deposit insurance fund. As a result of these factors, the Corporation is currently anticipating that it may incur a net loss in 1988. Further, although banks significantly increased LDC loan loss reserves in 1987, the debt servicing problems of some LDC debtors present a continuing and long-term financial concern for the industry and the insurance fund.

The accompanying financial statements reflect the estimated losses related to all banks that have been closed or that have entered into financial assistance agreements with the Corporation through December 31, 1987. The Corporation monitors banks that have marginal or deteriorating financial conditions and follows a policy of minimizing the cost to the insurance fund by promptly providing assistance or participating in the closing of a bank whenever an insured bank has financial difficulties that threaten its existence or when action is needed to limit the insurance fund's exposure. At December 31, 1987, the Corporation had $18.3 billion in its insurance fund available to assist or close marginal or deteriorating banks.

Subsequent to December 31, 1987, in addition to closing or assisting 46 smaller banks, the Corporation provided financial assistance to subsidiary banks of First RepublicBank Corporation of Dallas, Texas, through a $1 billion 6-month loan. The Corporation also stated that all depositors, including those with accounts of more than $100,000, and general creditors would be fully protected. The ultimate cost to the Corporation of resolving First RepublicBank's problems is not currently known. Very preliminary estimates of the cost range up to $2 billion, although, depending upon the structure of the transaction, initial outlays may be much greater than $2 billion. More definitive estimates of the cost will not be available for several months.

In our opinion, the financial statements referred to above present fairly the financial position of the Federal Deposit Insurance Corporation as of December 31, 1987 and 1986, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

March 14, 1988

Report on Internal Accounting Controls

We have examined the financial statements of the Federal Deposit Insurance Corporation for the years ended December 31, 1987 and 1986, and have issued our opinion thereon. As part of our examinations, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. This report pertains only to our study and evaluation of the system of internal accounting controls for the year ended December 31, 1987. Our report on the study and evaluation of internal accounting controls for the year ended December 31, 1986, is presented in GAO/AFMD-87-58, dated August 12, 1987.

The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Corporation's financial statements. For purposes of this report, we have classified the significant internal accounting controls into the following categories:

- assessments,
- assistance to problem banks,
- expenditures,
- financial reporting, and
- treasury.

Our study and evaluation included all of the control categories listed above except for the treasury and expenditures categories. For those categories, we found it more efficient to rely solely on substantive audit tests.

The Corporation's management is responsible for establishing and maintaining an effective system of internal accounting controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system of internal accounting controls are to provide management with reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to operations are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over the Corporation's assets. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with procedures may deteriorate.

Our study and evaluation, made for the limited purpose described in the second paragraph, would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the Corporation's system of internal accounting controls taken as a whole or on the categories of controls identified in the second paragraph.

Our study and evaluation of internal accounting controls disclosed that the Corporation has corrected an internal accounting control weakness reported as a result of our examination of its 1986 financial statements. Specifically, we reported that the Corporation was not promptly reconciling certain Corporation and closed and assisted insured bank accounts as required by its accounting procedures. Consequently, at December 31, 1986, an unreconciled balance of $926 million existed between the Corporation's accounts and those of its closed and assisted insured banks. During 1987, the Corporation improved its controls in this area by revising its procedures and completing the reconciliations. As a result, at December 31, 1987, no significant unreconciled differences existed between the Corporation's and the closed and assisted insured banks' accounts. Accordingly, we no longer consider this matter to be an internal accounting control weakness.

During our examination, we identified several internal accounting control matters which, although not material, nonetheless merit corrective action to strengthen the Corporation's internal accounting controls. Accordingly, we are reporting them separately to the Corporation.

Report on Compliance With Laws and Regulations

We have examined the financial statements of the Federal Deposit Insurance Corporation for the years ended December 31, 1987 and 1986, and have issued our opinion thereon. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of compliance with laws and regulations as we considered necessary in the circumstances. This report pertains only to our review of compliance with laws and regulations for the year ended December 31, 1987. Our report on the review of compliance with laws and regulations for the year ended December 31, 1986, is presented in GAO/AFMD-87-58, dated August 12, 1987.

In our opinion, the Corporation complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected its financial statements. In connection with our examination, nothing came to our attention that caused us to believe that the Corporation was not in compliance with the terms and provisions of laws and regulations for those transactions not tested.

Financial Statements

Statements of Financial Position

(In thousands)

	December 31 1987	1986
ASSETS:		
CASH	$ 18,499	$ 42,477
INVESTMENT IN U.S. TREASURY OBLIGATIONS, NET (Note 2)	16,098,874	16,602,959
ACCRUED INTEREST RECEIVABLE ON INVESTMENTS AND OTHER ASSETS	464,292	503,557
CERTIFICATES, NOTES AND OTHER RECEIVABLES FROM INSURED BANKS (Note 3)	557,638	735,390
NET RECEIVABLES FROM ASSISTANCE TO AN INSURED BANK (Note 4)	1,664,515	1,854,691
NET RECEIVABLES FROM FAILURES OF INSURED BANKS (Note 5)	3,549,268	2,617,542
PROPERTY AND BUILDINGS (Note 6)	73,438	51,010
TOTAL ASSETS	$22,426,524	$22,407,626

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

(In thousands)

	December 31 1987	1986
LIABILITIES AND THE DEPOSIT INSURANCE FUND:		
ACCOUNTS PAYABLE, ACCRUED LIABILITIES AND OTHER	$ 1,296,488	$ 266,708
LIABILITIES INCURRED IN ASSISTANCE TO INSURED BANKS (Note 7)	2,623,472	3,034,108
LIABILITIES INCURRED FROM FAILURES OF INSURED BANKS (Note 8)	204,122	847,242
ESTIMATED LOSSES FROM CORPORATION LITIGATION (Note 9)	600	6,251
TOTAL LIABILITIES	4,124,682	4,154,309
DEPOSIT INSURANCE FUND	18,301,842	18,253,317
TOTAL LIABILITIES AND THE DEPOSIT INSURANCE FUND	$22,426,524	$22,407,626

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

Statements of Income and the Deposit Insurance Fund

(In thousands)

	For the year ended December 31 1987	1986
INCOME:		
Gross assessments earned	$ 1,697,208	$ 1,587,375
Provision for assessment credits (Note 13)	1,250	70,473
Net assessments earned	1,695,958	1,516,902
Interest on U.S. Treasury obligations	1,534,937	1,634,415
Other income	84,922	108,796
TOTAL INCOME	3,315,817	3,260,113
EXPENSES AND LOSSES:		
Administrative operating expenses	202,381	180,267
Merger assistance losses and expenses (Note 10)	20,256	(86,043)
Provision for insurance losses (Notes 3, 4, 5, and 11)	2,996,923	2,827,712
Nonrecoverable insurance expenses (Note 12)	47,732	41,850
TOTAL EXPENSES AND LOSSES	3,267,292	2,963,786
NET INCOME	48,525	296,327
DEPOSIT INSURANCE FUND - January 1	18,253,317	17,956,990
DEPOSIT INSURANCE FUND - December 31	$18,301,842	$18,253,317

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

Statements of Changes in Financial Position

(In thousands)

	For the year ended December 31 1987	1986
FINANCIAL RESOURCES WERE PROVIDED FROM:		
Operations:		
Net Income	$ 48,525	$ 296,327
Add (deduct) items not involving cash in the period:		
Amortization of U.S. Treasury obligations	111,188	125,640
Depreciation on buildings	1,388	1,285
Income maintenance agreement adjustments	-0-	(83,700)
Amortization of merger assistance agreements	14,478	22,108
Provision for insurance losses	2,996,923	2,827,712
Resources provided from operations	3,172,502	3,189,372
Other resources provided from:		
Maturity and sale of U.S. Treasury obligations	9,450,194	3,196,626
Collections on certificates, notes and other receivables	180,955	98,217
Collections on receivables from assistance to an insured bank	465,218	668,323
Collections on receivables from failures of insured banks	2,563,635	1,799,101
Liabilities incurred from failures of insured banks	821,534	753,270
Decrease (increase) in cash	23,978	(19,291)
TOTAL FINANCIAL RESOURCES PROVIDED	$16,678,016	$9,685,618
FINANCIAL RESOURCES WERE APPLIED TO:		
Purchase of U.S. Treasury obligations	$ 9,057,297	$4,083,356
Acquisition of certificates, notes and other receivables	2,000	217,665
Increased receivables from assistance to an insured bank	224,048	160,018
Increased receivables from failures of insured banks	5,318,732	4,417,735
Additions to property and buildings	23,816	5,131
Payments on liabilities incurred in assistance to insured banks	410,636	408,644
Payments on liabilities incurred in failures of insured banks	1,474,495	430,968
Disbursements for Corporation litigation	-0-	1,997
Other increases (decreases)	166,992	(39,896)
TOTAL FINANCIAL RESOURCES APPLIED	$16,678,016	$9,685,618

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

Notes to Financial Statements

FEDERAL DEPOSIT INSURANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 1987 AND 1986

1. Summary of Significant Accounting Policies:

General. These statements do not include accountability for assets and liabilities of closed insured banks for which the Corporation acts as receiver or liquidating agent. Periodic and final accountability reports of the Corporation's activities as receiver or liquidating agent are furnished to courts, supervisory authorities, and others as required.

U.S. Treasury Obligations. Securities are shown at amortized cost which is the purchase price of securities less the amortized premium or plus the accreted discount. Such amortizations and accretions are computed on a daily basis from the date of acquisition to the date of maturity. Interest is also calculated on a daily basis and recorded monthly using the constant-yield method.

Deposit Insurance Assessments. The Corporation assesses insured banks at the rate of 1/12 of one percent per year on the bank's average deposit liability less certain exclusions and deductions. Assessments are due in advance for each six-month period and credited to income each month. Based on operational results, the Depository Institutions Deregulation and Monetary Control Act of 1980 authorizes up to 60 percent of the net assessment income to be transferred in the form of an assessment credit to insured banks each July 1 of the following calendar year. Additionally, the Act authorizes the Corporation's Board of Directors to make adjustments to this percentage within certain limits in order to maintain the Deposit Insurance Fund between 1.25 and 1.40 percent of estimated insured deposits. If this ratio falls below 1.10 percent, the Corporation is mandated to reduce the percentage of net assessment income credited to a limit of 50 percent. If this ratio exceeds 1.40 percent, the Corporation is mandated to increase the percentage of net assessment income credited by such an amount as it determines will result in maintaining that ratio at not more than 1.40 percent.

Allowance for Loss. The Corporation records as a receivable the funds advanced for assisting and closing insured banks, and establishes an estimated allowance for loss shortly after the insured bank is assisted or closed. The allowance for loss represents the difference between the funds advanced and the expected repayment, based on the estimated cash recoveries from the assets of the assisted or failed bank, net of all liquidation costs. The Corporation does not record the estimated loss related to future bank failures because such estimates depend upon factors which cannot be assessed until after the bank is actually assisted or closed. The Corporation's entire Deposit Insurance Fund and borrowing authority are available for any assistance or closing activity.

Depreciation. The Washington Office Buildings 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. The cost of furniture, fixtures, and equipment is expensed at time of acquisition.

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Income Maintenance Agreements. The Corporation records its liability under an income maintenance agreement at the present value of each estimated cash outlay at the time the agreement is accepted. Estimated cash outlays are anticipated future payments the Corporation will provide to offset the difference between the assisted bank's annualized cost of funds and the assisted bank's annualized return on the declining volume of earning assets acquired in a merger transaction, plus an amount to cover overhead costs. The charge is recorded to insurance loss. The present value of the liability is then accreted daily and recorded monthly over the term of the agreement. Any differences between the estimated and actual cash outlays are recorded as payment adjustments. The present value of remaining estimated cash outlays is also reviewed and adjusted each year when interest rate changes occurring in the marketplace appear material or permanent in nature. The interest rate used in 1987 and 1986 to discount future outlays was 6.75%. The originally recorded loss, plus or minus any payment and present value adjustments, will then be prorated between insured banks and the Deposit Insurance Fund as provided in Section 7(d) of the Federal Deposit Insurance Act.

Reclassifications. Reclassifications have been made in the 1986 Financial Statements to conform to the presentation used in 1987.

2. U.S. Treasury Obligations:

All cash received by the Corporation not used to defray operating expenses or for outlays related to assistance to banks and liquidation activities is invested in U.S. Treasury securities. The Corporation's investment portfolio consists of the following (in thousands):

December 31, 1987

Maturity	Description	Yield to Maturity at Market	Book Value	Market Value	Face Value
One Day	Special Treasury Certificates	6.60	$ 1,306,443	$ 1,306,443	$ 1,306,443
Less Than 1 year	U.S.T. Bills, Notes and Bonds	6.78	3,394,085	3,442,391	3,390,000
1-3 years	U.S.T. Notes and Bonds	7.81	5,158,332	5,355,063	5,080,000
3-5 years	U.S.T. Notes and Bonds	8.29	4,586,418	4,475,610	4,300,000
5-10 years	U.S.T. Notes and Bonds	8.55	1,653,596	1,613,677	1,700,000
			$16,098,874	$16,193,184	$15,776,443

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2. U.S. Treasury Obligations (Continued):

December 31, 1986

Maturity	Description	Yield to Maturity at Market	Book Value	Market Value	Face Value
One Day	Special Treasury Certificates	17.28	$ 2,049,700	$ 2,049,700	$ 2,049,700
Less Than 1 year	U.S.T. Bills, Notes and Bonds	6.10	3,283,654	3,370,283	3,270,000
1-3 years	U.S.T. Notes and Bonds	6.43	6,162,104	6,610,032	6,070,000
3-5 years	U.S.T. Notes and Bonds	6.82	3,708,325	3,958,918	3,500,000
5-10 years	U.S.T. Notes and Bonds	7.04	1,399,176	1,450,868	1,200,000
			$16,602,959	$17,439,801	$16,089,700

The unamortized premium, net of unaccreted discount, for 1987 and 1986 was $322,431,000 and $513,259,000, respectively. The amortized premium, net of accreted discount, for 1987 and 1986 was $260,778,000 and $199,148,000, respectively.

3. Certificates, Notes and Other Receivables from Insured Banks:

The Corporation's outstanding principal balances on certificates, notes and other receivables from insured banks are as follows (in thousands):

	December 31 1987	1986
Certificates:		
Net worth certificates	$ -0-	$129,809
Allowance for losses	-0-	(74,503)
	-0-	55,306
Notes receivable to:		
Assist operating banks	27,000	27,000
Facilitate deposit assumptions	87,600	88,136
Facilitate merger agreements	351,148	401,648
	465,748	516,784
Other receivables:		
Special assistance	206,995	205,105
Allowance for losses	(115,105)	(41,805)
	91,890	163,300
	$557,638	$735,390

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3. Certificates, Notes and Other Receivables from Insured Banks (Continued):

The net worth certificate program was established at the Corporation by authorization of the Garn-St Germain Depository Institutions Act of 1982. Under this program, the Corporation would purchase a qualified institution's net worth certificate and, in a non-cash exchange, the Corporation would issue its non-negotiable promissory note of equal value. The total assistance outstanding to qualified institutions as of December 31, 1987 and 1986, is $315,016,000 and $526,094,000, respectively. As of December 31, 1987 and 1986, the financial statements excluded $315,016,000 and $396,285,000, respectively, of net worth certificates, for which no losses are expected because of the non-cash exchange nature of the transactions. The original authority to issue net worth certificates expired October 13, 1986. The Competitive Equality Banking Act of 1987 reinstated the net worth certificate program through October 13, 1991.

4. Net Receivables from Assistance to an Insured Bank:

The Continental Illinois National Bank and Trust Company of Chicago (CINB) assistance program provided by the Corporation, the Federal Reserve Board, the Comptroller of the Currency, and a group of major U.S. banks, received final approval from Continental Illinois Corporation shareholders on September 26, 1984. The key aspects of the assistance program applicable to the Corporation are embodied in an Assistance Agreement and an Implementation Agreement between the Corporation and CINB, Continental Illinois Corporation, and Continental Illinois Holding Corporation. Discussed below are the major aspects of the Corporation's participation in the assistance program.

After consummation of the assistance program on September 26, 1984, CINB transferred to the Corporation $2.0 billion in troubled loans. The Corporation also received a three year $1.5 billion promissory note from CINB which was paid in full on September 26, 1987, by transferring additional troubled loans to the Corporation. The $3.5 billion troubled loan portfolio was, in part, funded by the Corporation's assumption of $3.5 billion of Federal Reserve Bank of Chicago (FRB) indebtedness on behalf of CINB. These borrowings bear interest at specified rates established by the FRB and the U.S. Treasury. The range of rates paid on the debt for 1987 was 5.93% to 7.80%. The Corporation repays these borrowings by making quarterly remittances of its collections, less expenses, on the troubled loans. If there is a shortfall at September 26, 1989, the termination date of the assistance program, the Corporation will make up such deficiency with its own funds.

Net receivables from the Corporation's assistance to CINB are as follows (in thousands):

	December 31 1987	December 31 1986
Loans and related assets	$2,531,644	$2,322,793
Promissory note	-0-	459,994
Dividend receivable	9,973	-0-
Preferred stock	763,750	763,750
Allowance for losses	(1,640,852)	(1,691,846)
	$1,664,515	$1,854,691

4. Net Receivables from Assistance to an Insured Bank (Continued):

The Implementation Agreement provides for the Corporation to be reimbursed each quarter for its expenses related to administering the transferred loan portfolio and for interest paid on the FRB indebtedness. According to the terms of the Implementation Agreement, collections are to be applied quarterly in the following manner: 1) to the administrative expenses paid by the Corporation; 2) to the interest owing on the assumed indebtedness; 3) to fund the special reserve account such that this account plus accrued interest thereon is at least $75 million; and 4) to principal owing under the FRB agreement.

Collection proceeds totaled $449,033,000 for the year ended December 31, 1987. The collection proceeds were applied to administrative costs and interest expense of $19,419,000 and $177,489,000, respectively, and to the payment of principal owing under the FRB agreement amounting to $252,125,000. The Corporation estimated an allowance for loss amounting to $1,640,852,000, as of December 31, 1987, representing the difference between the amount the Corporation will pay the FRB and the collections on the loan portfolio after expenses.

The Corporation holds an option to acquire up to 40.3 million shares of Continental Illinois Corporation common stock. The option is exercisable only if the Corporation suffers a loss on the transferred loan portfolio, including unrecovered administrative costs and interest expense, and cannot be exercised prior to the fifth anniversary of the commencement date, September 26, 1989. The shares subject to the option are owned by Continental Illinois Holding Corporation, which is owned by the former stockholders of Continental Illinois Corporation. If a loss occurs, the Corporation will be entitled to retain any remaining transferred loans and to exercise the option for one share of Continental Illinois Corporation common stock for every $20 of loss at the exercise price of $0.00001 per share of common stock.

In addition to the $3.5 billion in troubled loans, the Corporation purchased $1 billion of two non-voting Continental Illinois Corporation preferred stock issues. The Junior Perpetual Convertible Preference Stock amounted to $720 million and the Adjustable Rate Preferred Stock, Class A amounted to $280 million. The Corporation sold 10.5 million shares of the Junior Perpetual Convertible Preference Stock to an underwriting syndicate for proceeds of $259,350,000 in December 1986. Cash dividends received for the year ended December 31, 1987 on the Junior Perpetual Convertible Preference Stock and the Adjustable Rate Preferred Stock, Class A were $6,450,000 and $19,819,000, respectively.

The Junior Perpetual Convertible Preference Stock had a market value at December 31, 1987, of $268,750,000, which was lower than its $483,750,000 cost. The $215 million reduction in carrying value is included in the allowance for losses.

5. Net Receivables from Failures of Insured Banks:

Net receivables from failures of insured banks are as follows (in thousands):

	December 31 1987	December 31 1986
Depositors' claims paid	$ 3,180,629	$1,829,709
Depositors' claims unpaid	18,717	24,269
Assumption transactions in a fiduciary capacity	6,897,625	5,563,758
Assets purchased in a corporate capacity	280,634	568,308
	10,377,605	7,986,044
Allowance for losses	(6,828,337)	(5,368,502)
	$ 3,549,268	$2,617,542

An analysis of the changes in the allowance for losses by account groups is as follows (in thousands):

	Depositors' claims paid	Fiduciary capacity	Corporate capacity	Total
1987				
Balance, January 1	$ 975,148	$4,005,253	$388,101	$5,368,502
Provision for insurance losses	659,721	1,072,323	68,610	1,800,654
Write-off at termination	(7)	(4,791)	(336,021)	(340,819)
Balance, December 31	$1,634,862	$5,072,785	$120,690	$6,828,337
1986				
Balance, January 1	$465,887	$2,154,103	$388,866	$3,008,856
Provision for insurance losses	509,261	1,851,150	(765)	2,359,646
Write-off at termination	-0-	-0-	-0-	-0-
Balance, December 31	$975,148	$4,005,253	$388,101	$5,368,502

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6. Property and Buildings:

Property and buildings consist of (in thousands):

	December 31 1987	1986
Land	$28,283	$ 4,680
Office buildings	54,281	54,068
Accumulated depreciation	(9,126)	(7,738)
	$73,438	$51,010

The Corporation's 1776 F Street property is subject to notes payable totaling $6,131,000 and $6,314,000 at December 31, 1987 and 1986, respectively.

7. Liabilities Incurred in Assistance to Insured Banks:

The Corporation's outstanding principal balances on liabilities incurred in assistance to insured banks are as follows (in thousands):

	December 31 1987	1986
Federal indebtedness	$2,623,472	$2,904,299
Promissory (exchange) notes	-0-	129,809
	$2,623,472	$3,034,108

Maturities of long-term liabilities for each of the next five years and thereafter are:

1988	1989	1990	1991	1992	1993/Thereafter
$ -0-	$2,623,472	$ -0-	$ -0-	$ -0-	$ -0-

8. Liabilities Incurred from Failures of Insured Banks:

The Corporation's outstanding principal balances on liabilities incurred from failures of insured banks are as follows (in thousands):

	December 31 1987	1986
Notes indebtedness	$185,405	$822,973
Depositors' claims unpaid	18,717	24,269
	$204,122	$847,242

Maturities of long-term liabilities for each of the next five years and thereafter are:

1988	1989	1990	1991	1992	1993/Thereafter
$60,654	$5,824	$6,647	$7,586	$5,397	$99,297

Depositors' claims unpaid of $18,717 are current in nature and are not considered long-term liabilities.

9. Estimated Losses from Corporation Litigation:

The Corporation is involved in both its receivership and corporate capacity in numerous law suits. The merits of each case and the expected outcome have been evaluated by the Corporation's General Counsel, and, where appropriate, a contingent loss has been established. This estimated loss was $112,700,000 in 1987. Of that amount, $112,100,000 was included in the allowance for losses relating to receivables from assistance to an insured bank and from failed banks. The remaining $600,000 is included on the financial statements as estimated losses from corporation litigation.

10. Merger Assistance Losses and Expenses: The Corporation's merger assistance losses and expenses represent (1) the original income maintenance agreement losses recorded at present value and any adjustments resulting from interest rate changes occurring in the marketplace and (2) outright assistance to merged insured banks. These amounts were $20 million and $(86) million in 1987 and 1986, respectively.

11. Provision for Insurance Losses:

An analysis of the provision for insurance losses is as follows (in thousands):

	December 31	
	1987	1986
Provision for insurance losses		
Net worth certificates		
Prior year adjustments	$ (74,503)	$ (62,493)
Special assistance		
Current year provision	1,236,952	191,805
Prior year adjustments	73,300	-0-
Termination adjustments	-0-	(5,000)
	1,310,252	186,805
Net receivables from assistance to an insured bank		
Prior year adjustments	(50,994)	349,846
Net receivables from failures of insured banks		
Current year provision	1,961,947	1,854,632
Prior year adjustments	(161,293)	505,014
Termination adjustments	17,165	-0-
	1,817,819	2,359,646
Corporation litigation		
Current year provision	500	470
Prior year adjustments	(6,151)	(2,559)
Termination adjustments	-0-	(4,003)
	(5,651)	(6,092)
	$2,996,923	$2,827,712

12. Nonrecoverable Insurance Expenses:

The Corporation's nonrecoverable insurance expenses primarily represent costs associated with (1) preparing and executing the activity in payoff cases and (2) administering and liquidating the assets purchased in a corporate capacity.

13. Assessment Credits Due Insured Banks:

Contingent upon a legislatively specified ratio of the Corporation's Deposit Insurance Fund to estimated insured bank deposits, the Corporation credits a legislatively authorized percentage (currently 60 percent) of its net assessment income to insured banks. This credit is distributed, pro rata, to each insured bank as a reduction of the following year's assessment. Net assessment income is determined by gross assessments less administrative operating expenses and expenses and losses related to insurance operations. Certain income and expense amounts in the 1987 and 1986 assessment income credit computation do not correspond to amounts reported on the financial statements because of legislatively mandated adjustments and other adjustments made to reflect results solely related to insurance operations. The provision for assessment credits in the 1987 and 1986 statements of income represents adjustments resulting from audits to prior years' assessment credits.

The Garn-St Germain Depository Institutions Act of 1982 amended Section 7(d)(1) of the Federal Deposit Insurance Act and authorized the Corporation to include certain lending costs in the computation of the net assessment income. The lending costs are the amounts by which the amount of interest earned on each loan made by the Corporation under Section 13 of the Federal Deposit Insurance Act after January 1, 1982, is less than the amount of interest the Corporation would have earned for the calendar year if interest had been paid on the loans at a rate equal to the average current value of funds to the U.S. Treasury for the calendar year.

The Corporation will not pay an assessment credit to insured banks for calendar years 1987 and 1986 based on the net assessment income credit computations for the respective years shown below (in thousands):

Net Assessment Income Credit Computation - Calendar Year 1987

Computation:		
Gross assessment income - C.Y. 1987		$1,691,647
Less: Carry-over of net losses and expenses from C.Y. 1986	$2,548,411	
Administrative operating expenses	202,381	
Merger assistance losses and expenses less amortization and accretion	5,779	
Provision for insurance losses	2,996,010	
Nonrecoverable insurance expenses	42,508	
Lending costs	13	5,795,102
Excess of losses and expenses over gross assessment income		4,103,455
Assessment credit adjustment - prior years		(1,022)
Net excess of losses and expenses over gross assessment income - C.Y. 1987		$4,102,433

13. Assessment Credits Due Insured Banks (Continued):

Net Assessment Income Credit Computation - Calendar Year 1986

Computation:		
Gross assessment income - C.Y. 1986		$1,578,200
Less: Carry-over of net losses and expenses from C.Y. 1985	$1,113,954	
Administrative operating expenses	180,267	
Merger assistance losses and expenses less amortization and accretion	(99,746)	
Provision for insurance losses	2,827,012	
Nonrecoverable insurance expenses	36,783	
Lending costs	3,061	4,061,331
Excess of losses and expenses over gross assessment income		2,483,131
Assessment credit adjustment - prior years		65,280
Net excess of losses and expenses over gross assessment income - C.Y. 1986		$2,548,411

14. Lease Commitments:

Rent for office premises charged to administrative operating and liquidation overhead expenses was $33,570,000 in 1987 and $27,914,000 in 1986. Minimum rentals for each of the next five years and for subsequent years thereafter are as follows (in thousands):

1988	1989	1990	1991	1992	1993/Thereafter
$27,699	$15,842	$12,922	$11,576	$9,460	$39,592

Most office premise lease agreements provide for increase in basic rentals resulting from increased property taxes and maintenance expense.

15. Pension Plan and Accrued Annual Leave:

The Corporation's eligible employees are covered by the Civil Service Retirement and Disability Fund. Total Corporation (employer) matching contributions to the Civil Service Retirement and Disability Fund for all eligible employees were approximately $12,194,000 and $9,662,000 for the calendar years ending December 31, 1987 and 1986, respectively.

Although the Corporation funds a portion of pension benefits under the Civil Service Retirement and Disability Fund relating to its eligible employees and makes the necessary payroll withholdings from them, the Corporation does not account for the assets of the Civil Service Retirement and Disability Fund nor does it have actuarial data with respect to accumulated plan benefits or the unfunded liability relative to its eligible employees. These amounts are reported by the U. S. Office of Personnel Management (OPM) for the Civil Service Retirement and Disability Fund and are not allocated to the individual employers. The OPM also accounts for all health and life insurance programs for retired Corporation eligible employees.

The Corporation's liability to employees for accrued annual leave is approximately $13,763,000 and $10,445,000 at December 31, 1987 and 1986, respectively.

16. Commitments and Contingencies:

The Corporation insures total deposits of about $1.7 trillion in over 13,700 insured commercial banks. The Corporation does not estimate the loss for either the potential assistance to insured banks that the regulatory process has identified as distressed or other insured banks that are financially weak but have not yet been identified by the regulatory process. Rather, as described in Note 1, Allowance for Loss, the Corporation establishes an allowance for loss when assistance is granted or a bank is closed. The allowance for loss on the financial statements includes all banks which were assisted or failed through 1987. The Corporation believes that it is impractical to estimate losses for future bank failures with any reasonable certainty. The Corporation's entire Deposit Insurance Fund and borrowing authority are available for any assistance or closing activity.

17. Subsequent Events:

Subsequent to December 31, 1987, the Corporation, in conjunction with the Federal Reserve Board and the Comptroller of the Currency, entered into discussions with First RepublicBank Corporation regarding its financial condition. These discussions may lead to the development of an assistance program which could be significant. However, the cost of the assistance program cannot be estimated at this time.

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