FDIC

Federal Deposit Insurance Corporation
550 17th Street, N.W., Washington, D.C. 20429-9990 Deputy to the Chairman and CFO

August 30, 2019

MEMORANDUM TO: The Board of Directors

FROM: Bret Edwards
Deputy to the Chairman
and Chief Financial Officer

SUBJECT: Second Quarter 2019 CFO Report to the Board

The attached report highlights the FDIC's financial activities and results for the quarter ended June 30, 2019.

Executive Summary

- During the second quarter of 2019, the Deposit Insurance Fund (DIF) balance rose to $107.4 billion, up $2.6 billion from March 31, 2019. The quarterly increase was primarily due to $1.2 billion in assessment revenue, $1.2 billion in interest and unrealized gains on U.S. Treasury securities, and a $610 million increase in negative provision for insurance losses, partially offset by $459 million in operating expenses.

- The reserve ratio, which is the ratio of the DIF balance to estimated insured deposits, was 1.40 percent as of June 30, 2019. The reserve ratio was four basis points higher than March 31, 2019; growth to the DIF was strong while insured deposit growth stayed flat.

- During the second quarter of 2019, the FDIC was named receiver for one failed financial institution. The assets at inception for this failed institution was $37 million with an estimated loss of $28 million. The corporate cash outlay during the second quarter for this failure was approximately $30 million.

- Through June 30, 2019, overall FDIC Operating Budget expenditures were below the year-to-date budget by nine percent ($90 million). This variance was primarily the result of underspending in the Salaries and Compensation, Outside Services – Personnel, and Equipment expense categories in the Ongoing Operations budget component and the Outside Services – Personnel expense category in the Receivership Funding budget component.

I. **Financial Results** (See pages 6 – 7 for detailed data and charts.)

Deposit Insurance Fund

- For the six months ending June 30, 2019, the DIF's comprehensive income totaled $4.8 billion, matching comprehensive income from the same period last year. Although assessment revenue declined by $2.9 billion year-over-year, this was fully offset by an $800 million increase in negative provision for insurance losses and a $2.1 billion increase in interest and fair value adjustments on U.S. Treasury securities.
- Assessment revenue was $2.6 billion for the first half of 2019, compared to $5.4 billion for the same period last year. The $2.9 billion year-over-year decrease was primarily due to the cessation of the surcharge assessment on large institutions effective October 1, 2018, as a result of the reserve ratio exceeding the required minimum of 1.35 percent as of September 30, 2018.
- The provision for insurance losses was a negative $1.0 billion for the first half of 2019, compared to a negative $206 million for the same period last year. The negative provision for 2019 primarily resulted from a $413 million reduction of receiverships' shared-loss liability estimates due to expirations and pending early terminations, $416 million in unanticipated recoveries from litigation settlements and professional liability claims by receiverships, and a $113 million reduction in future receivership expense estimates.

Assessments

- During June, the DIF recognized assessment revenue of $1.1 billion, representing the estimate for the second quarter 2019 insurance coverage. Gross assessment revenue of $1.4 billion was reduced by $313 million for expected small bank assessment credit usage. Additionally, the DIF recognized a $119 million adjustment for prior period amendments and a $9 million adjustment for higher-than-estimated first quarter 2019 collections, both of which increased assessment revenue.
- On June 28, 2019, the FDIC collected $1.5 billion in DIF assessments for first quarter 2019 insurance coverage.

II. **Investment Results** (See pages 8 – 9 for detailed data and charts.)

DIF Investment Portfolio

- On June 30, 2019, the total liquidity (also total market value) of the DIF investment portfolio stood at $104.0 billion, up $5.0 billion from its December 31, 2018, balance of $99.0 billion. During the first half of the year, interest revenue, receivership dividends, and deposit insurance assessment collections far exceeded resolution-related outlays and operating expenses.
- On June 30, 2019, the DIF investment portfolio's yield was 2.12 percent, up 7 basis points from its 2.05 percent yield on December 31, 2018. The new Treasury securities purchased during the first half of the year had higher yields than the maturing securities' yields.
- In accordance with the approved second quarter 2019 DIF portfolio investment strategy, staff purchased a total of 7 short-maturity conventional Treasury securities, all designated as available-for-sale. The 7 securities had a total par value of $6.1 billion, a weighted average yield of 2.19 percent, and a weighted average maturity of 0.92 years.

III. <u>Budget Results</u> (See pages 10 – 11 for detailed data.)

Approved Budget Modifications

The 2019 Budget Resolution delegated to the Chief Financial Officer (CFO) and selected other officials the authority to make certain modifications to the 2019 FDIC Operating Budget. The following budget reallocations were approved during the second quarter in accordance with the authority delegated by the Board of Directors.

- In April, the CFO approved the realignment of $13.1 million in budget authority from Division of Information Technology (DIT) to the new Office of CIO Management Services (OCMS) to implement a reorganization approved in March 2019 that separated the Business Administration Branch from DIT to establish OCMS as a separate office reporting to the Chief Information Officer (CIO). The budget adjustment involved the realignment of funding in four major expense categories in the Ongoing Operations budget component: Salaries and Compensation, $7.5 million; Outside Services – Personnel, $5.6 million; Travel, $25,259; and Other Expenses, $29,115.

- In April, the CFO also approved a budget realignment of $2.5 million in the Ongoing Operations budget component from the Office of Chief Information Security Officer (OCISO) to DIT, including $1.9 million in the Outside Services – Personnel expense category and $625,568 in the Equipment expense category. This realignment provided funding to DIT for access management activities that are largely managed by DIT and performance of the firewall management function that is shared by DIT and OCISO. Both functions were previously budgeted only in OCISO.

- In May 2019, the CFO approved budget reallocations in the Salaries and Compensation expense category of the Ongoing Operations budgets of all divisions and offices, except OCISO. Net reductions totaling approximately $13.5 million were approved in the Salaries and Compensation budgets of most of the affected organizations based on unused first quarter spending authority. The Salaries and Compensation budgets of several organizations were increased to reflect projected spending in excess of budget authority, including an increase of $3.4 million in Corporate University-Corporate (CU-Corp) due to its heavy use of employees on long-term detail assignments. The net result of these salary adjustments was an $8.1 million reallocation to the Corporate Unassigned contingency reserve.

- In June, the CFO approved the transfer of approximately $208,000 in the Salaries and Compensation expense category of the Ongoing Operations budget component from Office of Chief Information Officer (OCIO) to OCMS to support the transfer of one authorized permanent position from OCIO to OCMS.

- In June, the CFO approved the following mid-year adjustments to 2019 Ongoing Operations budgets.

    - An increase of $4.5 million in the Outside Services – Personnel budget of the Legal Division for a substantial projected increase in expenses associated with ongoing litigation.

    - An increase of $550,000 in the Outside Services – Personnel budget of the Division of Risk Management Supervision (RMS) to provide funding for an interagency agreement to improve the analysis and sharing of cybersecurity threat information with financial institutions.

    - A net increase of $4.9 million in the combined budgets of the CIO organizations. This included an increase of $5.6 million in various expense categories for completion of the migration to a new Backup Data Center and an increase of $730,000 in the Equipment budget of the CIO Council for additional licensing costs. These increases were partially offset by reductions elsewhere across the CIO organization budgets.

- A decrease of $200,000 in the Division of Insurance and Research's Outside Services – Personnel budget to reflect funds not expected to be used in 2019.
- Realignments among expenses categories in the budgets of the Division of Administration, Corporate University, and the Division of Depositor and Consumer Protection, with no net change to the total budgets of each organization.

There were no changes to the Receivership Funding budgets for any organization.

Following these second quarter budget modifications, the balances in the Corporate Unassigned contingency reserves were $4,089,141 in the Ongoing Operations budget component and $14,894,445 in the Receivership Funding budget component.

Approved Staffing Modifications

The 2019 Budget Resolution delegated to the CFO the authority to modify approved 2019 staffing authorizations for divisions and offices, as long as those modifications did not increase the total approved 2019 FDIC Operating Budget.

- In April, the CFO approved the realignment of 45 positions from DIT to OCMS in conjunction with a reorganization creating OCMS.
- In April, the CFO approved a decrease of one authorized permanent RMS Supervisory Examiner position (a revision to the staffing authorization approved in March 2019).
- In June, the CFO approved the transfer of one permanent authorized Senior Advisor position from OCIO to OCMS.

Spending Variances

Significant spending variances by major expense category and division/office are discussed below. Significant spending variances for the six months ending June 30, 2019, are defined as those that either (1) exceed the YTD budget by more than $2 million and represent more than three percent of a major expense category or total division/office budget; or (2) are under the YTD budget for a major expense category or division/office by an amount that exceeds $10 million and represents more than ten percent of the major expense category or total division/office budget.

Significant Spending Variances by Major Expense Category

Ongoing Operations

There was a significant spending variance through the second quarter in one major expense category of the Ongoing Operations budget component.

Spending in the Equipment expense category was under the YTD budget by $14.4 million, or 23 percent. This variance was attributable primarily to underspending by DIT of $15.9 million, or 39 percent, of its YTD budget for Equipment. This included $6 million of underspending for technology refreshment purchases. In addition, equipment purchases were delayed for several projects including the mainframe replacement, a virtual desktops pilot project, and redesign of the wide-area network.

The application segmentation project was cancelled, and budgeted funds for equipment purchases related to that project will not be used.

Receivership Funding

The Receivership Funding component of the 2019 FDIC Operating Budget includes funding for expenses that are incurred in conjunction with institution failures and the management and disposition of the assets and liabilities of the ensuing receiverships, except for salary and benefits expenses for permanent employees assigned to the receivership management function and other expenses required to ensure readiness without regard to whether failures occur.

There was a significant spending variance through the second quarter in one major expense category of the Receivership Funding budget component. Outside Services – Personnel expenses through the second quarter were $35 million, or 50 percent, less than budgeted. This variance primarily reflected underspending by the Division of Resolutions and Receiverships (DRR) ($20.9 million, or 52 percent of its YTD budget) and the Legal Division ($13.7 million, or 48% of its YTD budget). DRR underspending was attributable to the absence of insured institution failures for which funds had been budgeted. The variance for the Legal Division was attributable to lower-than-projected spending for outside counsel because cases were settled before going to trial and more work has been done by FDIC attorneys,

Office of Inspector General

There were no significant spending variances through the second quarter in any major expense category of the Office of Inspector General budget component.

Significant Spending Variances by Division/Office[1]

Three organizations had significant spending variances through the end of the second quarter.

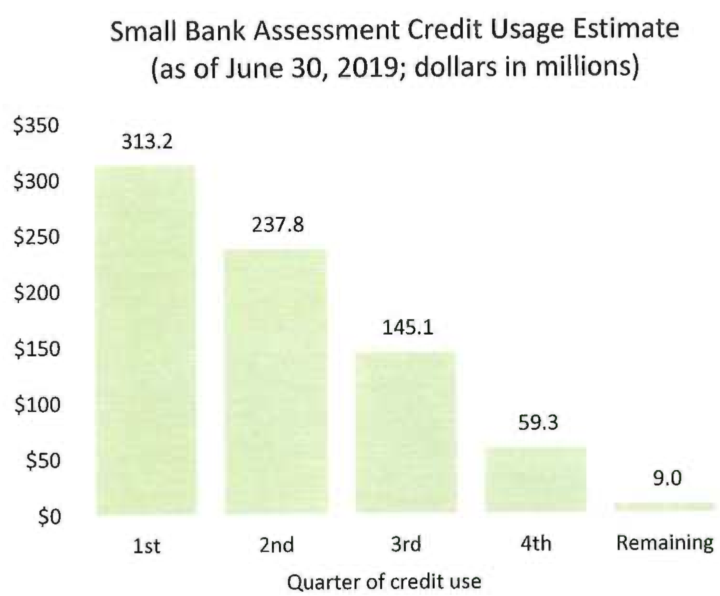
- DRR spent $26.1 million, or 25 percent, less than budgeted, mostly in the Outside Services – Personnel expense category of the Receivership Funding budget component, due to the absence of expenses for insured institution failures.
- The Legal Division spent $17.6 million, or 18%, less than budgeted, mostly in the Outside Services – Personnel expense category of the Receivership Funding budget component, due to lower-than-budgeted outside counsel expenses.
- DIT spent $14.9 million, or 12%, less than budgeted due primarily to underspending of its Equipment budget.

[1]Information on division/office variances reflects variances in the FDIC Operating Budget and do not include variances related to approved multi-year investment projects.

Fund Financial Results

($ in Millions)

Balance Sheet	Deposit Insurance Fund Jun-19	Mar-19	Quarterly Change	Jun-18	Year-Over-Year Change
Cash and cash equivalents	$ 8,795	$ 7,062	$ 1,733	$ 3,535	$ 5,260
Investment in U.S. Treasury securities	94,524	93,507	1,017	88,300	6,224
Assessments receivable	1,060	1,372	(312)	2,679	(1,619)
Interest receivable on investments and other assets, net	694	567	127	558	136
Receivables from resolutions, net	3,204	3,187	17	3,711	(507)
Property and equipment, net	320	324	(4)	321	(1)
Total Assets	$ 108,597	$ 106,019	$ 2,578	$ 99,104	$ 9,493
Accounts payable and other liabilities	241	211	30	232	9
Liabilities due to resolutions	530	554	(24)	905	(375)
Postretirement benefit liability	236	236	0	259	(23)
Contingent liability for anticipated failures	111	115	(4)	85	26
Contingent liability for guarantee payments and litigation losses	33	33	0	35	(2)
Total Liabilities	$ 1,151	$ 1,149	$ 2	$ 1,516	$ (365)
FYI: Unrealized gain (loss) on U.S. Treasury securities, net	500	(194)	694	(1,137)	1,637
FYI: Unrealized postretirement benefit (loss) gain	(14)	(14)	(0)	(46)	32
Fund Balance	$ 107,446	$ 104,870	$ 2,576	$ 97,588	$ 9,858



Pursuant to FDIC rulemaking in response to the Dodd-Frank Act increase of the minimum reserve ratio to 1.35 percent, small banks will receive credits for the portion of their assessments that contributed to growth in the reserve ratio from 1.15 percent to 1.35 percent. Per a proposed rule issued on August 20, 2019, in each quarter that the reserve ratio is at or above 1.35 percent (rather than 1.38 percent, as required under current regulation), the FDIC will automatically apply a small bank's credits to reduce its regular assessment up to the entire amount of the assessment, until the credits are exhausted. The total amount of available credits is $764 million. The chart presents the estimated credit usage by quarter; 72% of the credits are expected to be used in just two quarters of offset.

Fund Financial Results - continued

($ in Millions)

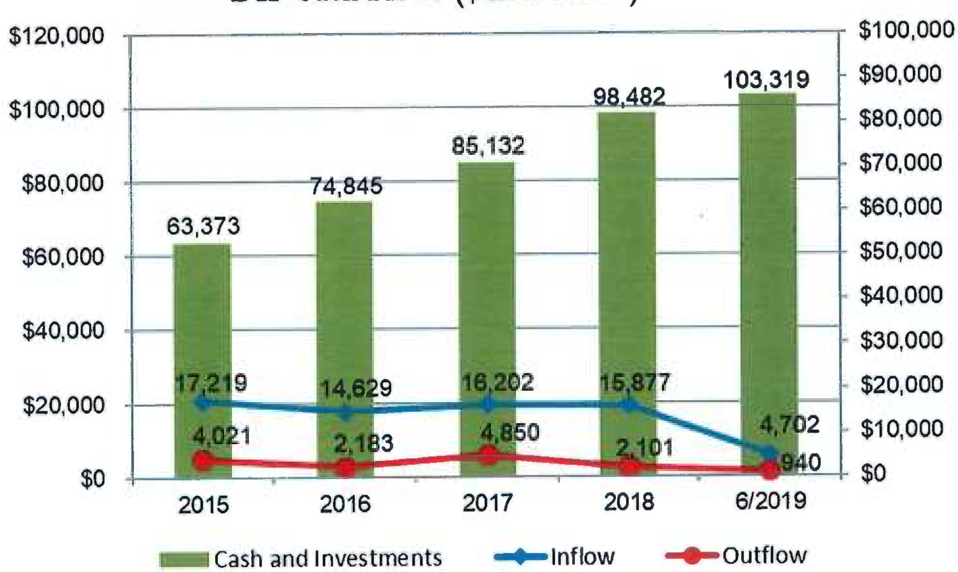
Income Statement (year-to-date)	Deposit Insurance Fund Jun-19	Mar-19	Quarterly Change	Jun-18	Year-Over-Year Change
Assessments	$ 2,556	$ 1,369	$ 1,187	$ 5,448	$ (2,892)
Interest on U.S. Treasury securities	1,042	507	535	719	323
Other revenue	12	2	10	5	7
Total Revenue	$ 3,610	$ 1,878	$ 1,732	$ 6,172	$ (2,562)
Operating expenses	893	434	459	878	15
Provision for insurance losses	(1,006)	(396)	(610)	(206)	(800)
Insurance and other expenses	1	0	1	1	0
Total Expenses and Losses	$ (112)	$ 38	$ (150)	$ 673	$ (785)
Net Income	3,722	1,840	1,882	5,499	(1,777)
Unrealized gain (loss) on U.S. Treasury securities, net	1,115	421	694	(658)	1,773
Unrealized postretirement benefit gain (loss)	0	0	0	0	0
Comprehensive Income	$ 4,837	$ 2,261	$ 2,576	$ 4,841	$ (4)

Selected Financial Data	FSLIC Resolution Fund Jun-19	Mar-19	Quarterly Change	Jun-18	Year-Over-Year Change
Cash and cash equivalents	$ 912	$ 907	$ 5	$ 892	$ 20
Accumulated deficit	(124,576)	(124,582)	6	(124,597)	21
Total resolution equity	913	908	5	893	20
Total revenue	11	5	6	7	4
Operating expenses	0	0	0	0	0
Losses related to thrift resolutions	0	0	0	0	0
Net Income (Loss)	$ 11	5	6	$ 7	$ 4

Receivership Selected Statistics June 2019 vs. June 2018

	DIF			FRF			ALL FUNDS		
($ in millions)	Jun-19	Jun-18	*Change*	Jun-19	Jun-18	*Change*	Jun-19	Jun-18	*Change*
Total Receiverships	263	302	(39)	0	0	0	263	302	(39)
Assets in Liquidation	$ 1,039	$ 1,536	$ (497)	$ 2	$ 2	$ 0	$ 1,041	$ 1,538	$ (497)
YTD Collections	$ 555	$ 993	$ (438)	$ 0	$ 0	$ 0	$ 555	$ 993	$ (438)
YTD Dividend/Other Pmts -	$ 859	$ 2,448	$ (1,589)	$ 0	$ 0	$ 0	$ 859	$ 2,448	$ (1,589)

DIF Cash Flows ($ in millions)



Cash and Investments increased by $39.9 billion from $63.4 billion at year-end 2015 to $103.3 billion at June 30, 2019. The increase was primarily due to assessment collections, interest on U.S. Treasury securities, and recoveries from resolutions, that far exceeded resolution-related outlays and operating expenses.

Deposit Insurance Fund Portfolio Summary (Dollar Values in Millions)			
	6/30/19	12/31/18	Change
Par Value	$103,079	$99,339	$3,740
Amortized Cost	$102,903	$99,063	$3,840
Total Market Value (including accrued interest)	$103,961	$98,954	$5,007
Primary Reserve [1]	$103,961	$98,954	$5,007
Primary Reserve % of Total Portfolio	100.0%	100.0%	0.0%
Yield-to-Maturity [2]	2.12%	2.05%	0.07%
Weighted Average Maturity (in years)	1.34	1.75	-0.41
Effective Duration (in years)			
Total Portfolio	1.30	1.69	-0.39
Available-for-Sale Securities	1.44	1.79	-0.35
Held-to-Maturity Securities [3]	not applicable	not applicable	not applicable

[1] Primary Reserve is the total market value (including accrued interest) of overnight investments, all available-for-sale securities, and held-to-maturity securities maturing within three months.

[2] The Yield-to-Maturity includes the potential yields of any Treasury Inflation-Protected Securities (TIPS), which assumes an average 2.0% annual increase in the CPI over the remaining life of each TIPS.

[3] In early August 2008, management reclassified all of the DIF portfolio's HTM securities as AFS securities effective as of June 30, 2008, because the FDIC could no longer assert it had the positive intent and ability to hold its HTM securities until their maturity dates.

Summary of Other Corporate Investment Portfolios (Dollar Values in Millions)			
	6/30/19	12/31/18	Change
FRF-FSLIC			
Book Value [4]	$868	$857	$11
Yield-to-Maturity	2.24%	2.42%	-0.18%
Weighted Average Maturity	overnight	overnight	no change

[4] Due to the current short-term nature of this portfolio, its respective Par, Book, and Market Values are identical for reporting purposes.

National Liquidation Fund (NLF) Investment Portfolio Summary (Dollar Values in Millions)			
	6/30/19	12/31/18	Change
Book Value [5]	$2,601	$2,988	($387)
Effective Annual Yield	2.44%	2.46%	-0.02%
Weighted Average Maturity (in days)	40	51	(11)

[5] Due to the short-term nature of the NLF portfolio, its Book and Market Values are identical for reporting purposes.

Investment Strategies	
DEPOSIT INSURANCE FUND	**Strategy for the 2nd Quarter 2019** Purchase up to $15 billion (par value) of Treasury securities with maturity dates between September 30, 2019, and December 31, 2023, subject to the following additional provisions: all newly purchased securities will be designated as AFS; no more than $2 billion (adjusted par value) of such securities shall consist of TIPS; and no "soft target" minimum investment for newly purchased Treasury securities in the 3- to 5- year maturity sectors. **Strategy Changes for the 3rd Quarter 2019** Purchase up to $22 billion (par value) of Treasury securities with maturity dates between December 31, 2019, and December 31, 2023, subject to the following additional provisions: all newly purchased securities will be designated as AFS; no more than $2 billion (adjusted par value) of such securities shall consist of TIPS; and no "soft target" minimum investment for newly purchased Treasury securities in the 3- to 5- year maturity sectors.
NATIONAL LIQUIDATION FUND	**Strategy for the 2nd Quarter 2019** Maintain an overnight deposit target floor balance within a range of $100 million to $300 million. Strategically invest the remaining funds in the zero- to 12-month maturity sector. **Strategy Changes for the 3rd Quarter 2019** No strategy changes for the third quarter of 2019.

Executive Summary of 2019 Budget and Expenditures by Budget Component and Major Expense Category Through June 30, 2019 (Dollars in Thousands)					
Major Expense Category	Annual Budget	YTD Budget	YTD Expenditures	% of YTD Budget Used	YTD Variance
FDIC Operating Budget					
Ongoing Operations					
Salaries & Compensation	$1,234,521	$620,422	$596,680	96%	($23,742)
Outside Services - Personnel	256,119	123,485	116,545	94%	(6,939)
Travel	85,236	41,952	38,356	91%	(3,596)
Buildings	106,187	51,310	52,527	102%	1,217
Equipment	114,199	62,468	48,105	77%	(14,363)
Outside Services - Other	16,091	8,461	9,428	111%	967
Other Expenses	13,111	6,848	6,121	89%	(727)
Total Ongoing Operations	**$1,825,464**	**$914,946**	**$867,762**	**95%**	**(47,184)**
Receivership Funding					
Salaries & Compensation	$3,804	$2,267	$1,555	69%	($712)
Outside Services - Personnel	156,634	70,654	35,619	50%	(35,035)
Travel	3,272	1,632	590	36%	(1,042)
Buildings	5,488	2,743	1,004	37%	(1,739)
Equipment	1,160	579	267	46%	(312)
Outside Services - Other	1,023	509	581	114%	72
Other Expenses	3,619	1,806	632	35%	(1,174)
Total Receivership Funding	**$175,000**	**$80,190**	**$40,248**	**50%**	**($39,942)**
Office of Inspector General					
Salaries & Compensation	$37,013	$18,506	$15,809	85%	($2,697)
Outside Services - Personnel	1,595	798	1,320	165%	522
Travel	1,218	609	688	113%	79
Buildings	0	0	0		0
Equipment	2,686	1,343	643	48%	(700)
Outside Services - Other	0	0	0		0
Other Expenses	470	235	151	64%	(84)
Total Office of Inspector General	**$42,982**	**$21,491**	**$18,611**	**87%**	**($2,880)**
Total FDIC Operating Budget	**$2,043,446**	**$1,016,627**	**$926,621**	**91%**	**($90,006)**

Executive Summary of 2019 Budget and Expenditures by Division/Office Through June 30, 2019 (Dollars in Thousands)					
Division/Office	Annual Budget	YTD Budget	YTD Expenditures	% of YTD Budget Used	YTD Variance
FDIC Operating Budget					
Risk Management Supervision	$576,351	$292,157	$279,469	96%	($12,688)
Resolutions & Receiverships	209,661	105,213	79,032	75%	(26,181)
Administration	268,303	134,412	132,476	99%	(1,936)
Legal	194,787	96,344	78,744	82%	(17,600)
Information Technology	239,877	124,647	109,783	88%	(14,864)
Depositor & Consumer Protection	179,951	90,934	87,007	96%	(3,927)
Insurance & Research	55,816	27,727	26,799	97%	(928)
CIO Council	51,890	25,304	25,293	100%	(11)
Finance	42,166	21,339	19,540	92%	(1,799)
Inspector General	42,982	21,491	18,611	87%	(2,880)
Chief Information Security Officer	48,200	22,632	21,691	96%	(941)
Executive Support [1]	35,582	16,034	12,171	76%	(3,863)
Complex Financial Institutions	20,609	9,746	9,139	94%	(607)
Corporate University - Corporate	25,375	16,864	16,378	97%	(486)
Corporate University - CEP	19,364	4,548	3,934	86%	(614)
Executive Offices [2]	13,548	7,235	6,554	91%	(681)
Corporate Unassigned	18,984	0	0		0
Total FDIC Operating Budget	**$2,043,446**	**$1,016,627**	**$926,621**	**91%**	**($90,006)**

1) Executive Support includes the Offices of Minority and Women Inclusion, Communications, Ombudsman, Legislative Affairs, Financial Institution Adjudication, CIO Management Services, and FDiTech Lab.

2) Executive Offices include the offices of the Chairman, Vice Chairman, Independent Director, Deputy to the Chairman and Chief Operating Officer, Deputy to the Chairman and Chief Financial Officer, Deputy to the Chairman for Policy, and Chief Information Officer.