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

November 7, 2006

TO: Board of Directors

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

SUBJECT: Proposed 2007 Corporate Operating Budget

Proposal

This memorandum requests that the Board of Directors approve a 2007 Corporate Operating Budget totaling $1,107,489,659, including $1,032,489,659 for ongoing operations and $75,000,000 for receivership funding.[1] The proposed budget is approximately $48 million (4.6 percent) higher than the approved 2006 Corporate Operating Budget. All of the proposed increase is in the ongoing operations component of the proposed 2007 budget. The budget for the receivership funding component of the proposed 2007 budget is unchanged from 2006. In addition, approval is requested for an authorized staffing level of 4,716 in 2007, up 82 positions from the currently-approved authorized staffing level of 4,634 for 2006.[2]

Background

The proposed 2007 budget was developed based on an analysis of the projected 2007 workload for each of the Corporation's three major business lines—Insurance, Supervision, and Receivership Management—as well as projected workload and expenses for the Corporation's major program support functions. As part of the Corporation's annual strategic planning process, corporate workload assumptions and guidance on 2007 initiatives were established by FDIC senior management at the outset of the 2007 budget formulation process. Divisions and offices used those workload assumptions and planned initiatives to determine their 2007 budget requirements.

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[1] Certain factors that affect the Salaries and Compensation expense category of the proposed 2007 Corporate Operating Budget have not yet been finally determined. For example, the Corporation's costs for employee health insurance are not yet known, and 2007 locality pay differentials have not yet been approved. When finally determined, these factors will require corresponding changes in estimated expenses for the Salaries and Compensation major expense category in the 2007 Corporate Operating Budget. As in prior years, the proposed 2007 Budget Resolution delegates authority to the Deputy to the Chairman and Chief Financial Officer to adjust the total Board-approved 2007 Corporate Operating Budget to account for such factors.

[2] The currently-approved 2006 authorized staffing level reflects staffing increases approved by the Deputy to the Chairman and Chief Financial Officer (CFO) during 2006. These increases were approved in accordance with authority delegated to the CFO and have been reported to the Board in accordance with the requirements of the 2006 Budget Resolution.

The number of FDIC-insured financial institutions is projected to continue to decline, from a projected 8,773 insured institutions at the end of 2006 to 8,674 insured institutions by the end of 2007. The total number of FDIC-supervised institutions is also projected to decline from 5,239 at the end of 2006 to 5,203 at the end of 2007. The Division of Supervision and Consumer Protection (DSC) projects that it will perform approximately the same number of risk management (safety and soundness) examinations in 2007 as in 2006, but will conduct about 400 more compliance examinations. The latter is attributable to a cyclical peak in scheduled comprehensive (CRA and fair lending) compliance examinations. The proposed 2007 budget includes the resources required to conduct an estimated 2,435 risk management examinations and 2,373 compliance examinations at FDIC-supervised institutions. Funding is also included for the reconfigured staffing platform adopted in 2005 to address future resolutions and receivership management workload requirements. Those staffing levels are expected to be more than sufficient to handle the most likely scenarios for the failure/near failure of insured institutions in 2007, and the Corporation has in place contingency plans to respond to a larger number of failures and near failures, if necessary.

Funding for 2007 expenditures will come from two sources: the Deposit Insurance Fund (DIF) and the FSLIC Resolutions Fund (FRF). In addition, receiverships will be billed for services provided by the Corporation in accordance with established service billing procedures. Budgeted spending from the 2007 Corporate Operating Budget and estimated spending from Board-approved investment project budgets is projected to represent about 44 percent of projected 2007 interest revenue for the DIF.

2007 Budget Highlights

The largest component of the proposed 2007 Corporate Operating Budget continues to be personnel-related expenditures. The proposed budget for salaries and compensation is about $659 million, which is $26 million (4.1 percent) higher than the 2006 budget due primarily to the cost of pay increases negotiated for 2007. The Salaries and Compensation expense category represents about 60 percent of the proposed 2007 Corporate Operating Budget, about the same as in 2006. The proposed budget for contractor-provided services is the second largest component of the proposed budget and is about $241 million, which is about $15 million, or 6.7 percent, higher than the 2006 budget. The Outside Services – Personnel expense category represents 22 percent of the proposed 2007 budget, up from 21 percent in 2006. The remainder of the proposed 2007 budget by major expense category is for Buildings and Leased Space ($70 million), down about $825,000 (1.2 percent) from 2006, due primarily to further savings from the Virginia Square – Phase II project; Travel ($61 million), up $5 million (9.1 percent) due largely to increased travel expenditures associated with the Corporate Employee Program and planned assistance with compliance examinations by employees in the Division of Resolutions and Receiverships (DRR); Equipment ($46 million), up $956,000 (2.1 percent); Outside Services – Other ($16 million), up $427,000 (2.7 percent); and Other Expenses ($14 million), up $1.7 million (13.4 percent) due primarily to an expected increase in employee training expenditures under the new Professional Learning Accounts (PLA) program.

Although most of the proposed budget increase for 2007 is required to address normal inflation in personnel and non-personnel-related expenses, the proposed 2007 budget includes increased funding over 2006 in selected, high priority areas:

- Funding for an additional 47 compliance examiners in DSC[3] (above the 314 positions authorized in 2006). DSC has determined that current compliance examiner staffing is inadequate to address ongoing workload requirements due to the large number of new consumer regulations added in recent years, the need to monitor supervised institutions to ensure that they take appropriate corrective actions to address significant violations identified during compliance examinations, and other factors. Funds are also provided in the proposed Corporate University (CU) budget to develop advanced, post-commissioning training for current compliance examiners to enhance their skills.

- Funding for additional DSC staff, including six additional large bank specialist positions and six new positions to establish a new Examination Policy Staff in the Washington office. The additional large bank specialist positions are part of a multi-year effort to ensure that the FDIC has sufficient staff expertise to perform its insurance and supervisory responsibilities with respect to large and complex insured institutions. Funds are also provided in the proposed CU budget to develop advanced internal training for large bank specialists. The proposed new Examination Policy Staff will be responsible for monitoring and assessing the results of examinations to identify issues that cut across regions and identifying options for consistently addressing those issues on a national basis; facilitating the development of risk identification tools for use by DSC operational staff; improving the internal flow of information for policy development purposes; and making appropriate strategic recommendations regarding enhancements to the examination process.

- Continuing increases in contract funding for the Corporation's information technology (IT) security and privacy program. The proposed 2007 budget for the Division of Information Technology (DIT) includes approximately \$27.4 million, up from \$22.2 million in 2006, for contracted services related to IT security and privacy. About \$5.2 million is required for systems-related work, primarily for the remediation of existing systems to address security and privacy concerns. In addition, authorized 2007 DIT staffing will be increased to add two privacy specialists.

- Increased contract funding in the proposed DIT budget for the operation, maintenance, and enhancement of existing IT systems. Overall funding for systems development and operations/maintenance activities will increase by \$6.2 million (12.3 percent) in 2007. This will address two primary needs: completion of system changes required to support the implementation of deposit insurance reform[4] and increased funding for the operation and maintenance of existing systems. In addition, the proposed DSC budget includes

[3]An additional 12 compliance examiner positions would be added in 2008 and 2009 (total of 24), subject to workload reassessment and reconfirmation during the 2008 and 2009 budget formulation processes. The additional compliance examiner staffing proposed to be added from 2007 through 2009 does *not* address the additional compliance examination workload associated with the cyclical peak ("bubble") in compliance examinations that will occur in 2007 and 2008. Staff will be deployed from the Division of Resolutions and Receiverships to assist with this workload in accordance with the Corporation's readiness strategy.

[4]The Board increased the approved 2006 Corporate Operating Budget by approximately \$6.5 million in March 2006 for system changes related to the implementation of deposit insurance reform. DIT estimates that about \$5.7 million of that amount will actually be spent. The proposed 2007 Corporate Operating Budget includes an additional \$4.7 million in funding for the completion of system changes required in connection with deposit insurance reform.

approximately $1.8 million for the FDIC's share of an interagency initiative to develop an enhanced IT system to support the Shared National Credit program.

- Funding for the implementation of the new PLA program. This program was originally expected to be implemented in mid-2006, but was delayed until 2007. The proposed 2007 budget reflects an increase of about $1.0 million over the 2006 budget for externally-provided training in conjunction with this initiative.[5]

- A one-time increase of approximately $4.8 million above the baseline funding provided annually to the Division of Administration (DOA) for the maintenance, upgrade, and build-out of leased and owned facilities. These funds will be used to consolidate space in the New York Regional Office and to relocate to substantially downsized office space in the Dallas Regional Office. In both cases, these expenditures will ultimately result in net savings to the Corporation through reduced leasing costs.

The proposed 2007 budget also reflects a further reduction of approximately $7.4 million in annual leasing expenditures as a result of the move from leased office space in downtown Washington to the Seidman Center (Phase II) facility (the first increment of savings from this initiative was reflected in the 2006 budget). These savings are partially offset in the proposed 2007 budget by increased expenditures for the operation and maintenance of the new facility.

Receivership Funding

In 2003, the Board adopted the concept of an annual corporate operating budget with two components: Ongoing Operations and Receivership Funding. Funds approved by the Board for one component cannot be reprogrammed to pay for expenditures incurred for the other component. The Receivership Funding component provides funding for expenditures that are incurred in connection with the failure (or near failure) of FDIC-insured financial institutions and the management of receiverships established in connection with those failures. The segregation of annual operating expenditures into these two components has facilitated more effective cost management by isolating the more stable ongoing operational expenses from the more volatile annual expenses associated with bank closings and subsequent asset liquidation activities. In 2007, we propose to implement a minor change by adding to the Receivership Funding component of the operating budget all expenditures incurred in connection with the management of "owned real estate" acquired in connection with an institution failure. In the past, these expenditures have been handled "off budget." This proposed change is not expected to have a material impact on 2007 Receivership Management expenditures.

The approved 2006 Corporate Operating Budget included $75 million for Receivership Funding. There have been no failures thus far in 2006, and the amount of work remaining from previous failures continues to diminish. As a result, 2006 Receivership Funding expenditures are projected to total only about $14.8 million. Nevertheless, the proposed 2007 Corporate Operating Budget includes level

[5]Proposed 2007 funding for the PLA program is based upon an assumed 50 percent utilization of total employee PLA entitlements. In addition, the proposed budgets of certain divisions/offices include a total of approximately $1.0 in additional funding for externally-provided training (including associated travel) that these organizations indicated will be required for certain employees outside of the PLA program.

funding of $75 million for Receivership Funding to support current receivership liquidation activities and to resolve new insured institution failures. This funding will ensure that resources are available to be able to expeditiously address unexpected events. As in the past, additional funding will be sought for this component of the operating budget from the Board of Directors, as necessary.

Projected Investment Budget Spending

In December 2002, the Board established an Investment Budget that was separate and distinct from the annual corporate operating budget. The Investment Budget consists of individual investment project budgets that are separately approved by the Board (prior to 2003, funding for such projects was included in annual corporate operating budgets). These projects are funded on a multi-year basis, and the funds approved by the Board cannot be reprogrammed among projects or for any other purpose. Expenditures to define the requirements and funding estimates for a proposed new investment project are classified as a planning project and are generally paid from the ongoing operations component of the annual corporate operating budget. The Capital Investment Review Committee (CIRC) monitors the progress of both planning and investment projects and reports on them quarterly to the Board.

The Investment Budget currently includes five projects, and two of them (Virginia Square – Phase II and the New Financial Environment) have been completed and are in the final stages of project closeout. Neither of those projects is expected to incur any expenses in 2007. Investment Budget spending has declined from a high of about $108 million in 2004 (when there were 10 approved investment projects underway) to an estimated $24.3 million in 2006. Spending for the remaining three projects is projected to be only about $8 million in 2007. However, planning for three proposed new investment projects is nearing completion, and cases are expected to be submitted to the Board to establish investment project budgets for each of those projects in the near future. If approved by the Board, 2007 spending for those projects is projected to be $18.4 million, bringing total estimated Investment Budget spending in 2007 to approximately $26.4 million.

In 2004, the Board was asked to approve substantial additional funding for several IT investment projects that it had previously approved. In conjunction with its approval of those revised project budgets, the Board asked the CIRC to assess why the initial cost estimates for some of those projects had been flawed. The CIRC ultimately determined that the proposed projects and their associated cost estimates had been presented to the Board too soon, before the project requirements and potential technical solutions had been well defined and before sound cost estimates for those projects had been developed on the basis of that information. Accordingly, the CIRC decided that the planning period for future new investment projects (paid from the annual operating budget) should be extended to permit the project scope and requirements to be better defined and to allow the development of better project cost estimates.

In order to provide for consistency in budgeting and accounting for future planning and investment projects, the CIRC is proposing that the planning period for potential new investment projects be tied specifically to the initial phase of the new and more rigorous system development life cycle methodology recently implemented by DIT as part of its transformation program. That methodology defines four major phases for each system development project – inception, elaboration, construction, and transition – and identifies specific work products that are developed in each phase. The CIRC recommends that the planning period for potential new investment projects initiated in 2007 and future years extend through the end of the first (inception) phase of the project, with all expenditures during that phase paid from the annual corporate operating budget. Expenditures for the final three phases (other than regular Salaries and Compensation) would be budgeted for and paid from a separately-approved investment project budget.[6]

If the Board accepts that recommendation, the CIRC will submit each new investment project budget request to the Board near the end of the inception phase of the project. Based upon guidance from DIT, the CIRC will return systematically to the Board at the end of the second (elaboration) phase of the project to update the project cost estimate and, if necessary, request additional budget authority. In the past, investment budget requests were generally submitted to the Board before any inception phase activities were undertaken and were based entirely on preliminary in-house cost estimates. Investment budget requests will still be based on in-house cost estimates when they are initially submitted to the Board at the end of the inception phase of a project, but those estimates should be much more reliable because they will be based on the results of more disciplined requirements definition and analysis of potential technical solutions. DIT advises that the updated project cost estimate available at the end of the second (elaboration) phase of a project should be highly reliable, particularly since it will reflect actual market input from contractors competing to support the project.

Overview of Attached Exhibits

Attachment 1 displays the proposed 2007 Corporate Operating Budget by major expense category. Attachments 2 and 3 display the proposed budget by division/office (with and without the receivership funding component). Attachment 4 shows the projected allocation of the proposed budget by major program and fund. Attachment 5 shows proposed year-end 2006 and 2007 authorized staffing levels for each division/office.

Also attached is the proposed 2007 Budget Resolution.

Contact

If you have questions, please contact Thomas E. Peddicord, Deputy Director, Division of Finance, at

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[6]Three planning projects have been underway during 2006 while the CIRC has been deliberating on how best to define the planning phase of a project. These projects are the Claims Administration System (CAS); the Learning Management System (LMS); and a Franchise Marketing enhancement to the current ASTEP investment project that is still in development. Each of those projects inadvertently continued past the inception phase into the elaboration phase of development because the project sponsors initially expected the CIRC to extend the planning phase of an investment project through the end of the elaboration phase. The CIRC ultimately decided against that approach, however, because of a concern that the Board should have the opportunity to consider a proposed investment project earlier in the process. In the transition to the new definition, elaboration activities for each of the three projects will continue to be funded from the 2006 Corporate Operating Budget to permit the project sponsors to continue those projects while they prepare Board cases seeking approval of investment project budgets for those projects, but no operating budget funds will be provided for those projects in 2007. Continuation of elaboration tasks for the Franchise Marketing enhancement to ASTEP will be paid from the current ASTEP investment project budget, beginning in January 2007, pending submission of a case to the Board in the first quarter of 2007 requesting an increase in the currently-approved ASTEP project budget for the additional proposed functionality.

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Attachments