FDIC
Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429

Deputy to the Chairman and Chief Financial Officer

December 3, 2014

TO: Board of Directors

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

SUBJECT: Proposed 2015 Corporate Operating Budget

Proposal

This memorandum requests that the Board of Directors approve the proposed 2015 Corporate Operating Budget totaling $2,318,696,913, including $1,793,696,913 for ongoing operations and $525,000,000 for receivership funding.[1] The total proposed 2015 Corporate Operating Budget is $72,755,478 (3.0 percent) lower than the 2014 Corporate Operating Budget, largely due to substantially reduced resource requirements for the receivership funding budget component. The proposed ongoing operations component of the budget is $2,244,522 (0.1 percent) higher than the 2014 ongoing operations budget, while the proposed receivership funding component of the budget is $75,000,000 (12.5 percent) lower than the 2014 receivership funding budget.

Approval is also requested for a total authorized 2015 corporate staffing level of 6,875 full-time equivalent (FTE) positions (5,941 permanent, 934 non-permanent), down 325 positions (net) from the currently authorized 2014 staffing level of 7,200 positions.[2] This reflects an increase from 2014 of 61 permanent positions, offset by a decrease of 386 non-permanent positions.

Background

Structure of the Corporate Operating Budget

The FDIC's annual operating budget is composed of two separate and distinct 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 segregation of annual operating expenditures into these two components facilitates more effective cost management by isolating the Corporation's more stable ongoing operational

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[1]Certain factors that affect the Salaries and Compensation category of the proposed 2015 Corporate Operating Budget have not yet been determined (e.g., the Corporation's share of 2015 employee health insurance costs). When these factors are finally determined, they may require corresponding changes in estimated expenses for the Salaries and Compensation major expense category of the 2015 Corporate Operating Budget. As in prior years, the proposed 2015 Budget Resolution delegates authority to the Deputy to the Chairman and Chief Financial Officer to adjust the total Board-approved 2015 Corporate Operating Budget to account for such factors.

[2]The requested approval encompasses the proposed individual division and office staffing authorizations shown in Exhibit 6. In addition, the proposed 2015 Budget Resolution provides divisions and offices with the same limited flexibility they have in 2014 to temporarily exceed their approved permanent 2015 staffing authorizations.

expenses from the highly variable annual expenses associated with bank closings and subsequent receivership management activities.

The receivership funding component provides funding for expenses incurred in connection with the failure (or near failure) of FDIC-insured institutions and the management of receiverships established in connection with those failures.[3] The separation of the receivership funding component is an acknowledgement that the number of failures and the expenses associated with those failures in any year are to a large extent outside of the control of the FDIC and that the actual expenses incurred for resolutions and receivership management activities may vary considerably from the estimates made during the annual planning and budget process. Over the past decade, annual receivership funding expenses have ranged from a low of $11 million to a high of $2.0 billion. The FDIC expects to fully recover its 2015 receivership funding expenditures through its billing of failed institution receiverships for services it provides.

2015 Workload Analysis and Projections

The proposed 2015 budget and staffing authorizations are based on an analysis of projected workload associated with the FDIC's major ongoing mission responsibilities. These include the Corporation's risk management and consumer protection supervision programs and its resolution and receivership management program as well as responsibilities assigned to the Corporation by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (DFA). The latter include monitoring the risks in large, systemically important financial institutions (SIFIs), reviewing the resolution plans submitted by companies covered by DFA, and preparing, if necessary, to undertake their orderly liquidation.

The Corporation's supervision workload varies based upon the number and size of the institutions supervised by the FDIC and the number of those institutions with composite CAMELS (risk management) ratings of 3, 4, and 5. Those factors largely determine the number of risk management and compliance examinations to be conducted each year and the amount of examiner time spent on those examinations.[4] The primary drivers of the Corporation's resolutions and receivership management workload are the number and complexity of failures of FDIC-insured institutions, the number of active receiverships being managed by the FDIC, and the amount of post-failure workload remaining for those receiverships.

The number of FDIC-supervised institutions declined substantially during the recent financial crisis due to bank failures and industry consolidation, from 5,527 at year-end 2007 to 4,171 on November 12, 2014, a reduction of 1,356 insured institutions (24.5 percent). Although the number of institution failures has dropped substantially since 2010, industry consolidation is expected to continue to reduce the number of FDIC-supervised institutions in 2015 and beyond. The reduction in the number of supervised institutions did not initially reduce the FDIC's

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[3]Salary and benefits expenses for the permanent in-house staff associated with the Corporation's Receivership Management business line (primarily in the Division of Resolutions and Receiverships and the Legal Division) are funded from the ongoing operations component of the budget, because the maintenance of this in-house staff would be necessary, regardless of whether any failures actually occurred.

[4]The projected number of compliance and Community Reinvestment Act (CRA) examinations to be conducted annually is based largely on the number of institutions supervised by the FDIC. Compliance and CRA ratings have only a limited impact on this workload.

supervision workload, because this factor was more than offset from 2007 through 2010 by the dramatic increase in the number of troubled and problem institutions that required more frequent and lengthy examinations and supervisory oversight. Since 2010, however, the number of 3-, 4-, and 5-rated institutions has declined substantially (although it remains elevated by historical norms) and is expected to continue a steady decline in 2015 and beyond.

As a result, the number of risk management examinations will decline by a projected 8.8 percent, from 2,322 in 2014 to 2,117 in 2015.[5] This will permit a significant decrease in the authorized non-permanent supervision staff for risk management in 2015, with further reductions in non-permanent risk management supervision positions projected in 2016 and beyond. Compliance and CRA examination workload is less directly affected by unfavorable ratings and is projected to be relatively stable in 2015. The proposed 2015 Corporate Operating Budget includes the resources needed to conduct an estimated 1,444 compliance and CRA examinations, down 2.7 percent from current estimates for 2014. New benchmarks will also be implemented to focus compliance examination resources on the bank products and services that pose the most potential harm to consumers.

The FDIC's resolutions and receivership management workload is also expected to continue to decline in 2015. Insured institution failures fell to pre-crisis levels this year, with only 17 failures occurring through November 12, 2014 (down from 24 in 2013). No change is expected next year in this downward trend. Receivership management workload is projected to remain elevated for several years, however, due to the continuing work associated with post-failure receiverships and loss share agreements being managed by the FDIC. The Corporation's inventory of assets in liquidation fell from approximately $11.3 billion (book value) at the beginning of 2014 to $8.3 billion (book value) as of September 30, 2014, but as of that date, the Corporation was managing 487 active receiverships and overseeing 540 active loss share agreements emanating from insured institution failures, compared to 480 receiverships and 560 loss share agreements at the beginning of 2014.[6] A high level of residual receivership management work typically remains for several years beyond an institution's failure date.

<u>2015 Budget Highlights</u>

Overview of the Proposed 2015 Budget by Component

The proposed 2015 Corporate Operating Budget totals $2,318,696,913, including $1,793,696,913 for ongoing operations and $525,000,000 for receivership funding. As noted above, this represents an increase of $2,244,522 (0.1 percent) in the ongoing operations budget component and a decrease of $75,000,000 (12.5 percent) in the receivership funding budget component.

In the ongoing operations budget component, a negotiated 4.0 percent increase in 2015 in the average salaries of most FDIC employees will be largely offset by the elimination of authorized non-permanent positions dedicated to risk management supervision and by a significant

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[5]The workload associated with enforcement activity has declined somewhat more slowly than exam workload because of the long timeframes associated with individual enforcement actions.

[6]The value of the assets covered by the loss share agreements fell from approximately $78.2 billion at the beginning of 2014 to $60.6 billion (book value) on September 30, 2014.

reduction in the budget for Outside Services-Personnel (down $14.3 million, or 5.3 percent). Most of the proposed reductions in Outside Services-Personnel will occur in the Division of Information Technology budget, reflecting reductions in costs associated with transitioning to new contract service providers. The ongoing operations component of the budget also includes a small contingency reserve ($25 million, or 1.4 percent of the proposed 2015 ongoing operations budget),[7] to be administered by the Deputy to the Chairman and Chief Financial Officer (CFO) to provide funding for unanticipated operational requirements that emerge during the year.

The most significant factor contributing to the decrease in the proposed receivership funding budget is the expected decline in insured financial institution failures in 2015. The Corporation will need fewer temporary employees and contractors in the Division of Resolutions and Receiverships (DRR) and its supporting organizations next year. The proposed reductions are consistent with the Corporation's established business model for resolutions and receivership management, which relies primarily on contractors and staff on time-limited appointments to handle temporary spikes in workload.

The proposed 2015 receivership funding budgets for the Salaries and Compensation and Outside Services-Personnel expense categories are approximately $89 million and $377 million, respectively, down over $35 million and $23 million from 2014. The proposed 2015 receivership funding budget is also down significantly from 2014 levels in the Travel, Buildings and Leased Space, Equipment, Outside Services-Other and Other expense categories. The receivership funding budget includes a contingency reserve of $22,710,143, or 4.3 percent of the proposed receivership funding budget, to be administered by the CFO to address unforeseen requirements which may arise during 2015.

The FDIC cannot, of course, control the variable workload associated with the receivership funding component of the annual corporate operating budget, nor can it project with certainty the specific number and type of failures that will occur in 2015 or the actual expenses that will be incurred in connection with those failures. The proposed 2015 receivership funding budget may not, therefore, prove to be a reliable estimate of 2015 expenses for this budget component. Based upon what is known today, however, the proposed receivership funding budget will be sufficient to cover 2015 resolutions and receivership management expenses. The Board will be asked to approve additional funding if it is determined during the year that increased budget authority is needed for the receivership funding component.

[7]The 2014 ongoing operations budget approved by the Board in December 2013 also included a $25 million contingency reserve that has been largely unspent.

Overview of Proposed 2015 Budget by Major Expense Category

Exhibit 1 itemizes the proposed 2015 Corporate Operating Budget by major expense category. As in prior years, personnel-related expenses and contractor services constitute the largest expense categories in the proposed budget:

- The proposed 2015 Salaries and Compensation budget is $1,315,596,953, which is $15,437,025 (1.2 percent) lower than the 2014 Salaries and Compensation budget. This is attributable largely to the fact that the Corporation is reducing the size of its receivership workforce. The proposed 2015 budget includes funding for approximately 325 fewer full-time equivalent employees (net) than are included in the current 2014 budget. The Salaries and Compensation expense category represents 68.4 percent of the proposed 2015 ongoing operations budget, 17.0 percent of the proposed 2015 receivership funding budget, and 56.7 percent of the overall proposed 2015 Corporate Operating Budget.

- The proposed 2015 Outside Services-Personnel budget (for contractor-provided services) is $631,839,379, which is $37,475,676 (5.6 percent) lower than the 2014 budget. This decrease primarily reflects expectations for a continuing reduction in 2015 in insured institution failures and a gradual reduction in post-failure receivership management workload, both of which will reduce contractor support requirements. The Outside Services-Personnel expense category represents about 14.2 percent of the proposed 2015 ongoing operations budget, 71.8 percent of the proposed 2015 receivership funding budget, and 27.2 percent of the overall proposed 2015 Corporate Operating Budget.

The remainder of the proposed 2015 Corporate Operating Budget consists of $104,548,787 for Travel expenses, down $11,635,803 (10.0 percent) from 2014, largely due to lower projected failure activity and reductions in the number of bank exams; $115,135,264 for Buildings and Leased Space expenses, down $2,599,893 (2.2 percent) from 2014, driven by lower leased space requirements at the site of failures; $90,394,576 for Equipment expenses, down $2,917,656 (3.1 percent) from 2014, as a result of reduced receivership management activity; $21,432,836 for Outside Services-Other expenses, down $1,717,856 (7.4 percent) from 2014, primarily due to decreased receivership management activity; and $39,749,118 for Other Expenses, down $971,569 (2.4 percent) from 2014, primarily due to reduced receivership management activity.

<u>2015 Staffing Authorizations</u>

Overview of Proposed Changes in Authorized 2015 Staffing

The proposed 2015 Corporate Operating Budget includes a total authorized staffing level of 6,875 FTE positions (5,941 permanent, 934 non-permanent), as shown in Exhibit 6. This represents a net decrease of 325 positions from the current 2014 authorized staffing level. If approved by the Board, authorized permanent staffing will increase in 2015 by 61 positions, while authorized non-permanent staffing will decline by 386 positions from current 2014 authorized staffing levels.

The largest increase in permanent staffing is the proposed addition of 38 positions in the Division of Risk Management Supervision (RMS), consisting of 30 new Case Manager positions and six new Assistant Regional Director positions in conjunction with the re-centralization of responsibility for the review of all risk management examination reports and additional responsibilities for large bank oversight; 14 new positions in the complex financial institutions branch to review the resolution planning activities of systemically-important financial institutions; and three new positions in the Washington office to support an enhanced Information Technology (IT) examination program and increased attention to cybersecurity concerns. These increases are partially offset by a reduction of 15 field office supervisory examiner positions in conjunction with the re-centralization of examination report review responsibilities.

Other proposed 2015 permanent staffing increases include 10 additional positions in the newly-created resolution policy branch of the Office of Complex Financial Institutions (OCFI), seven positions in the Legal Division, three positions each in the Division of Information Technology (DIT) and the Division of Administration (DOA), and one position each in Office of the Chief Information Officer (CIO) and the Information Security and Privacy Staff (ISPS). These increases were partially offset by a reduction of two positions in the Division of Finance (DOF).

Although most divisions are proposing to reduce their non-permanent staffing in 2015, an increase of 30 non-permanent positions is proposed in RMS for IT Examination Specialists to address identified skill gaps in the IT examination workforce and to support enhancements to the IT examination program for large banks and technology service providers. This increase is offset by a proposed reduction of 165 currently-authorized non-permanent positions in RMS (80 examination specialists, 18 field office supervisory positions, and 67 other positions) due to the continuing gradual decline in the number of problem institutions, enforcement actions, and related activities. An increase of nine new authorized non-permanent positions is also proposed for DOA to provide additional human resources and acquisition services support.

These non-permanent staffing increases are more than offset by net reductions in the proposed non-permanent staffing authorizations for several other organizations: DRR (-160 positions), the Legal Division (-66 positions), DIT (-23 positions), DCP (-9 positions), ISPS (-1 position) and Corporate University (-1 position). These non-permanent staffing reductions are largely attributable to continuing reductions in the staff resources needed to handle and support bank failure activities.

Staffing Flexibility

For the past three years, in conjunction with its approval of the annual corporate operating budget and staffing authorizations, the Board has provided divisions and offices with limited flexibility to temporarily exceed their permanent staffing authorizations in order to address succession management and other human capital concerns. Continuation of that delegation of authority is proposed for 2015. The key elements of that delegation are as follows:

- Each division and office may exceed its permanent staffing authorization by up to two percent at any point during the year (the average annual attrition rate for most divisions and offices).[8]

- The CFO may approve a division or office request for a cap higher than two percent if that organization is fully staffed up to the two percent limit and can demonstrate to the CFO, using objective quantitative data and analysis, that its attrition is likely to exceed two percent during the coming year because of projected retirements[9] or other known factors.

- If an organization's current permanent staffing is already more than two percent above its permanent staffing authorization due to previously approved "temporary over-hire" or "incumbency only" authorizations, that organization's "over-hire" authority is temporarily "grandfathered" at the higher level, and it may temporarily exceed the two percent limit only until its excess permanent staffing drops below two percent as the result of attrition from positions designated to be abolished under the current "temporary over-hire" or "incumbency only" authorizations.

Continuation of this delegation of authority in 2015 will permit the corporate-wide "over-hiring" of up to 79 permanent employees nationwide above authorized 2015 permanent staffing levels (absent approval by the CFO of higher limits in certain organizations).

<u>Projected 2015 Investment Budget Spending</u>

In December 2002, the Board established an Investment Budget that was separate and distinct from the annual corporate operating budget. The Investment Budget provides funding on a multi-year basis for major investment projects (mostly IT systems development projects) that are individually approved by the Board. Funds may not be reallocated among projects, and any unused budget authority for a project expires when it is completed. The Capital Investment Review Committee (CIRC) monitors the progress of approved IT investment projects and reports on them quarterly to the Board.

The Investment Budget currently includes four active investment projects; the Examination Tools Suite project, the Claims Administration System project, the System of Uniform Reporting of Compliance and CRA Exams (SOURCE) Modernization project, and the 550 HVAC Retrofit project. Investment Budget spending has declined from a high of $108 million in 2004 (when there were 10 approved investment projects underway) to $16 million spent during the first 10 months of 2014.

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[8]For RMS and DCP, this authority is based on their permanent, non-examiner staffing authorization, excluding all authorized permanent non-supervisory field examination positions. In addition, in accordance with a special authorization approved by the Chairman in 2013, RMS and DCP may temporarily exceed their permanent field examiner staffing authorizations by 30 positions and 20 positions, respectively, in 2015. This authorization will expire at the end of 2016.

[9]Requests based on retirement projections are required to utilize the projections in the Division of Finance's annual *FDIC Retirement Analysis*.

Overview of Attached Exhibits

Exhibit 1 displays the proposed 2015 Corporate Operating Budget by major expense category. Exhibit 2 displays the proposed 2015 Corporate Operating Budget by division and office. Exhibits 3 and 4 display the proposed budget by division and office for the two separate budget components (ongoing operations and receivership funding). Exhibit 5 shows the projected allocation of the proposed budget by major program and funding source. Exhibit 6 shows proposed 2015 staffing authorizations (permanent and non-permanent) for each division and office. Also attached is the proposed 2015 Budget Resolution reflecting the recommendations outlined above.

Contact Information

If you have questions or need additional information, please contact Thomas E. Peddicord, Deputy Director, Division of Finance, at (703) 562-6252.

Attachments