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

December 18, 2018

TO: Board of Directors

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

SUBJECT: Proposed 2019 FDIC Operating Budget

Proposal

This memorandum requests that the Board of Directors approve the proposed 2019 FDIC Operating Budget totaling $2,043,446,006.[1] The proposed budget includes $1,825,463,818 for ongoing operations, $175,000,000 for receivership funding, and $42,982,188 for the Office of the Inspector General (OIG). The total proposed operating budget is $48,686,581 (2.3 percent) lower than the 2018 FDIC Operating Budget, largely due to substantially reduced resource requirements for the receivership funding budget component. The proposed ongoing operations component of the budget is $1,570,856 (0.1 percent) lower than 2018. The proposed receivership funding component of the budget is $50,000,000 (22.2 percent) lower than 2018. The 2019 OIG budget is $2,884,275 (7.2 percent) higher than 2018.[2]

Approval is also requested for a total authorized 2019 staffing level of 5,901 full-time equivalent (FTE) positions (5,893 permanent, 8 non-permanent), down 182 positions (net) from the currently authorized 2018 staffing level of 6,083 positions.[3] This reflects a decrease from 2018 of 72 permanent positions and 110 non-permanent positions.

Finally, approval is requested for a modification to the Board-established policies and procedures governing the Corporation's Investment Budget to increase from $3 million to $10 million the threshold for individual investment projects subject to those policies and procedures. The performance of information technology (IT) projects with less than $10 million in total costs would continue to be monitored by the CIO Council, although projects below that threshold that presented strategic risk to the Corporation or particularly challenging execution risks could continue to be assigned to the CIRC for oversight.

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[1]Certain factors that affect the Salaries and Compensation category of the proposed 2019 FDIC Operating Budget have not yet been determined (e.g., the FDIC's share of 2019 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 2019 FDIC Operating Budget. As in prior years, the proposed 2019 Budget Resolution delegates authority to the Deputy to the Chairman and Chief Financial Officer to adjust the total Board-approved 2019 FDIC Operating Budget to account for such factors.
[2]The discussion in this case of the OIG budget component is for informational purposes only, since the OIG budget is separately appropriated by the Congress and is not subject to Board approval.
[3]The requested approval encompasses the proposed individual division and office staffing authorizations shown in Exhibit 5.

Background

Structure of the FDIC Operating Budget

The FDIC's proposed annual operating budget is composed of three separate and distinct components: ongoing operations, receivership funding, and the OIG budget. Funds approved for each individual budget component cannot be reprogrammed from one budget component to another component. The segregation of annual operating expenditures into these three components facilitates more effective cost management by isolating the FDIC's more stable ongoing operational expenses from the highly variable annual expenses associated with bank closings and subsequent receivership management activities and the separate appropriations process applicable to the OIG.

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 these failures.[4] The separation of the receivership funding component is an acknowledgement that the number of failures and the expenses associated with these failures in any given 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, therefore, 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 $150 million to a high of $2.0 billion. The FDIC expects to fully recover all of its 2019 receivership funding expenditures through the billing of failed institution receiverships for services it provides.

2019 Workload Analysis and Projections

The proposed 2019 budget and staffing authorizations are based on an analysis of projected workload associated with the FDIC's major ongoing mission responsibilities. These include the FDIC's risk management and consumer protection supervision programs, its resolution and receivership management program, its large bank resolution planning responsibilities, and its deposit insurance and research programs.

The FDIC's supervision workload varies based upon the number, size, and complexity of the institutions it supervises and the number of those institutions with composite CAMELS (risk management) ratings of 3, 4, and 5.[5] The number of risk management examinations is projected to decline by 6.6 percent, from 1,580 in 2018 to 1,476 in 2019, due primarily to continuing institutional consolidation and a decrease in the frequency of examinations for most institutions

[4]Expenses for salaries and benefits for the permanent in-house staff associated with the FDIC's Receivership Management business line (primarily in the Division of Resolutions and Receiverships and the Legal Division) and for the maintenance of other base resolution and receivership management capabilities, such as information systems, are funded from the ongoing operations component of the budget, because they would be incurred regardless of whether any failures actually occurred.

[5]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.

with total assets between $1 billion to $3 billion. The reduction in workload resulting from the smaller number of examinations is partially offset by the additional work associated with the continuing growth in the average size and complexity of FDIC-supervised institutions, particularly those with more than $10 billion in assets. Compliance and CRA examination workload is projected to decline by 5.5 percent, from 1,249 in 2018 to 1,180 in 2019. Although institutional consolidation is also gradually reducing the number of compliance and CRA exams to be conducted each year, the impact of consolidation is partially offset by variation in the number of exams that must be conducted from year to year under FDIC policy.

The primary drivers of the FDIC'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. No insured financial institutions have failed thus far in 2018. Receivership management workload is projected to remain somewhat elevated due to the continuing work associated with post-failure receiverships and loss share agreements being managed by the FDIC from prior years. The FDIC's inventory of assets in liquidation declined from approximately $2.3 billion (book value) at the beginning of 2018 to $1.2 billion (book value) as of October 31, 2018. As of that date, the FDIC was still managing 279 active receiverships emanating from insured institution failures, compared to 338 receiverships at the beginning of 2018. Historically, a high level of residual receivership management work continues for several years beyond an institution's failure date.

In carrying out its large bank resolution planning responsibilities, the FDIC monitors the risks in large, systemically important financial institutions (SIFIs), reviews the resolution plans submitted by large banks and bank holding companies, and prepares to undertake, if necessary, their orderly liquidation. The FDIC's resolution planning workload is projected to remain relatively constant in 2019.

The workload associated with the FDIC's deposit insurance and research programs is also expected to remain constant in 2019.

<u>Highlights of the Proposed 2019 Operating Budget</u>

Overview of the Proposed 2019 Budget by Component

The proposed 2019 FDIC Operating Budget totals $2,043,446,006, including $1,825,463,818 for ongoing operations, $175,000,000 for receivership funding, and $42,982,188 for the OIG. As noted earlier, this represents a decrease of $1,570,856 (0.1 percent) in the ongoing operations budget component, a decrease of $50,000,000 (22.2 percent) in the receivership funding budget component, and an increase of $2,884,275 (7.2 percent) in the budget for the OIG. The ongoing operations component of the budget includes a $12.5 million contingency reserve to be administered by the Deputy to the Chairman and Chief Financial Officer to address unanticipated funding requirements that emerge during the year, down from $25 million in 2018.

The reduction in the receivership funding budget component reflects an expectation that the low level of new failure activity and the gradual reduction of residual workload from active receiverships that has occurred in recent years will continue in 2019 and that the FDIC will no longer need temporary employees and will need substantially less contractor support next year in the Division of Resolutions and Receiverships (DRR) and its supporting organizations to carry out its resolution and receivership management responsibilities.[6]

As noted previously, the separate OIG budget component is provided for informational purposes only since the OIG budget is separately appropriated by the Congress and is not subject to Board approval. The increase in the OIG budget component primarily reflects the OIG's plans to fill vacant positions to supplement IT expertise for audits, evaluations, and investigations and supports the OIG's technology refresh and enhancement of its IT environment and Electronic Crimes Unit.[7]

Overview of the Proposed 2019 Budget by Major Expense Category

Exhibit 1 itemizes the proposed 2019 FDIC Operating Budget by major expense category. The proposed 2019 budget is lower than the 2018 budget in all expense categories:

- The proposed 2019 Salaries and Compensation budget is $1,279,445,911, which is $226,137 (0.0 percent) lower than the 2018 Salaries and Compensation budget. The costs associated with an average annual salary increase of 4.0 percent for most FDIC employees in 2019 will be offset by the elimination of 182 authorized positions. The Salaries and Compensation expense category represents 62.6 percent of the proposed 2019 FDIC Operating Budget and 67.9 percent of the ongoing operations budget component, excluding the OIG.

- The proposed 2019 Outside Services-Personnel budget (for contractor-provided services) is $420,603,232, which is $23,223,429 (5.2 percent) lower than the 2018 budget. This decrease primarily reflects expectations for a continued low level of insured institution failures and a gradual reduction in post-failure receivership management workload in 2019, both of which will reduce contractor support requirements in the receivership funding budget component. The budget for contract services will increase by $5,807,199 (2.3 percent) from 2018 to 2019 in the ongoing operations budget component, primarily due to funding for expenses associated with increased IT security and modernization initiatives. The Outside Services-Personnel expense category represents about 20.6 percent of the proposed 2019 FDIC Operating Budget and 14.4 percent of the ongoing operations budget component, excluding the OIG.

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[6]The FDIC cannot control the variable workload associated with the receivership funding component of the annual FDIC operating budget, nor can it project with certainty the specific number and type of failures that will occur in 2019 or the actual expenses that will be incurred in connection with those failures. The proposed 2019 receivership funding budget may not, therefore, prove to be a reliable estimate of 2019 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]OIG funding is appropriated on the fiscal year basis applicable to the rest of the Federal Government (October-September). Its 2019 FDIC budget is based on 75 percent of its pending FY 2019 appropriation and 25 percent of its requested FY 2020 appropriation. The OIG's FY 2020 appropriation request and staffing level are unchanged from FY 2019.

- The proposed 2019 Travel budget is $89,494,997, down $8,416,016 (8.6 percent) from 2018, largely due to decreased travel related to examinations. The proposed travel budgets of the Division of Risk Management Supervision (RMS) and the Division of Depositor and Consumer Protection (DCP) account for 74 percent of this proposed reduction. The Travel expense category represents about 4.4 percent of the proposed 2019 FDIC Operating Budget and 4.7 percent of the ongoing operations budget component, excluding the OIG.

- The proposed 2019 Buildings and Leased Space budget is $112,716,912, down $558,462 (0.5 percent) from 2018, due to low levels of insured institution failures and the continued reduction in post-failure receivership management workload. The proposed ongoing operations budget for Buildings and Leased space will increase by $921,412 (0.9 percent) from 2018 to 2019. The Buildings and Leased Space expense category represents about 5.5 percent of the proposed 2019 FDIC Operating Budget and 5.9 percent of the ongoing operations budget component, excluding the OIG.

- The proposed 2019 Equipment budget is $107,650,277, down $11,268,669 (9.5 percent) from 2018, due largely to the completion in 2018 of major equipment purchases for the new backup data center. The Equipment expense category represents about 5.3 percent of the proposed 2019 FDIC Operating Budget and 5.7 percent of the ongoing operations budget component, excluding the OIG.

- The proposed 2019 Outside Services-Other budget is $16,650,948, down $872,661 (5.0 percent) from 2018. The Outside Services-Other expense category represents about 0.8 percent of the proposed 2019 FDIC Operating Budget and 0.9 percent of the ongoing operations budget component, excluding the OIG.

- The proposed 2019 Other Expenses budget is $16,883,729, down $4,103,207 (19.6 percent) from 2018, due primarily to reduced receivership management activity. The Other Expenses category represents about 0.8 percent of the proposed 2019 FDIC Operating Budget and 0.7 percent of the ongoing operations budget component, excluding the OIG.

Highlights of the Proposed 2019 Staffing Authorizations

The proposed 2019 FDIC Operating Budget includes a total authorized staffing level of 5,901 FTE positions (5,893 permanent, 8 non-permanent), as shown in Exhibit 5. This represents a net decrease of 182 positions, or 3.0 percent, from the current 2018 authorized staffing level. If approved by the Board, authorized 2019 permanent staffing will decrease by 72 positions (net) and authorized 2019 non-permanent staffing will decline by 110 positions from current 2018 authorized staffing levels. But, authorized staffing for IT examinations and large bank supervision will increase by a total of 46 permanent positions.

The proposed reductions in authorized permanent staffing reflect individual division and office assessments of their projected workload in 2019 and future years. The reduction of 72 authorized permanent positions will be achieved entirely by the elimination of vacant positions. It includes net decreases of 23 positions in RMS; 21 positions in DCP; six positions each in DRR, the Division of Administration (DOA), and the Legal Division; four positions in the Division of Insurance and Research (DIR); two positions in the Division of Finance (DOF); and one position each in the Office of Minority and Women Inclusion (OMWI), the Office of Legislative Affairs (OLA), the Office of Complex Financial Institutions (OCFI), and Corporate University (CU).

Proposed 2019 non-permanent staffing authorizations reflect the elimination of 110 non-permanent positions, 93 percent of the current authorized non-permanent staffing level. This includes decreases of 59 positions in RMS, 29 positions in the Legal Division, and 22 positions in DRR. The proposed 2019 non-permanent staffing authorization is more than 3,200 positions below the peak number of non-permanent positions authorized in 2011. This reduction is consistent with the current post-crisis profile of the banking industry and reflects the completion of most of the FDIC's residual workload from the recent financial crisis.

Authorized 2019 field examination staffing in RMS is proposed to decline to 1,508 permanent positions, a net reduction from 2018 of 41 positions (12 permanent, 29 non-permanent). This includes 1,184 positions to perform community bank supervision responsibilities (down 87 positions from 2018), 301 positions supervising FDIC-supervised large banks with over $10 billion in assets (up 23 positions from 2018), and an additional 23 IT examiner and specialist positions to augment the FDIC's current IT examination workforce. The reduction of 87 community bank examination positions primarily reflects a statutory decrease in the frequency of examinations for most institutions with total assets between $1 billion to $3 billion. To a lesser extent, it also reflects continued institutional consolidation within the U.S. banking industry. The proposed addition of 23 positions to the IT examination workforce reflects the growing complexity, interconnectedness, and operational and cybersecurity risk posed to the financial system by technology service providers.

Authorized 2019 field examination staffing in DCP is proposed to decline to 454 positions (all permanent), a reduction of 14 permanent positions from 2018. The proposed reduction is entirely attributable to continued institutional consolidation.

<u>Proposed 2019 Funding Increases for IT Stabilization, Security and Modernization</u>

The proposed budget continues the emphasis begun this year on stabilizing and enhancing the resiliency and cost effectiveness of the FDIC's existing operational and communications infrastructure and internal IT operations. It includes over $37 million in one-time funding to carry out a lengthy list of initiatives directed primarily toward this purpose in order to provide a foundation for a projected multi-year focus, beginning in 2020, on the modernization of legacy business applications. The major stabilization and resiliency initiatives funded in the proposed budget include completion of and migration to a new backup data center, installation of an upgraded nationwide telecommunications network, expansion of Wi-Fi capabilities in all FDIC Headquarters facilities, and planning for Wi-Fi expansion in regional and field offices.

The proposed 2019 budget also includes $1.5 million to develop, in close collaboration with all clients and stakeholders, an IT Modernization Plan. That plan will provide a five-year roadmap and timetable for the update and migration of existing business applications from obsolete or outdated technologies to new technologies and platforms that will promote business process innovation and efficiencies and will be consistent with the Corporation's target enterprise architecture. The plan will encompass migration of remaining applications off of the current mainframe computer platform and evaluation of the potential adoption and use of software as a service and hosted computing.

In addition, the proposed budget builds on prior-year funding increases to enhance the Corporation's IT security program, with further proposed increases to IT security funding in the budgets of both the Division of Information Technology and the Office of the Chief Information Security Officer. This increased funding will be used to complete implementation of a Data Protection Program to safeguard the FDIC's sensitive information, optimize the operations of the Security Operations Center, expand security monitoring of cloud environments, enhance the security of laptop computers and other mobile devices, and improve the quality and timeliness of the FDIC's responses to critical security incidents.

Proposed Investment Budget Modification

In December 2002, the Board established an Investment Budget that was separate and distinct from the annual operating budget. Under the Investment Budget procedures, the Board approves funding for major projects (mostly IT systems development projects) on an individual basis. This funding remains available on a multi-year basis, but is accompanied by enhanced controls and governance requirements because of the inherently higher execution risk that has historically characterized these projects. Funding is approved on an individual project basis and may not be reallocated among projects. 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 of Directors. Prior to 2003, incremental funding was provided for such projects through the annual operating budget, and several major projects incurred millions of dollars in expenses over multiple years before being terminated prior to completion without success.

The Investment Budget currently includes three active investment projects: the Structure Information Management System (SIMS) Redesign project, the Claims Administration System Deposit Resolution Optimization (CASDRO) Project, and the System of Uniform Reporting of Compliance and CRA Examinations (SOURCE) Modernization project. Investment Budget spending is projected to be approximately $9.4 million in 2019. Actual Investment Budget spending has declined from a high of $108 million in 2004 (when there were 10 approved investment projects underway) to $4.7 million during the first ten months of 2018.

Since its inception in 2002, a $3 million threshold has been used to determine if an investment project was large enough to require Board approval for multi-year funding and enhanced governance by the CIRC and other bodies. Smaller projects have been funded through the annual operating budget and overseen by an interdivisional council chaired by the Chief Information Officer. This bifurcated process has generally worked well. But, the CIRC feels that the current $3 million threshold for investment projects is too low and has recommended that the threshold be increased to $10 million for proposed new investment projects. This case seeks approval of that recommendation, in part in support of the planned IT Modernization initiative outlined above.

A total of 20 IT investment projects have been approved by the Board since the Investment Budget became operational in 2003, including 17 that have been successfully completed and three that are still in process. Approximately 95% of total Investment Budget spending since 2003 has been on projects with an overall cost of more than $10 million. Of the 20 approved projects, 13 had total costs greater than $10 million (including two major facilities projects), three had overall costs between $3 million and $10 million, and four had total costs less than $3 million.[8] The average investment budget for IT investment projects with total costs over $10 million that have been approved since 2002 has been $25.7 million.

The enhanced governance provided for approved investment projects ensured that, when a project encountered significant performance or other issues, those problems were promptly surfaced at the senior management level and effectively addressed. As a result, although many of the 17 investment projects that were approved and completed under the Investment Budget since 2003 experienced significant cost and schedule variances from their initial project estimates, they were all ultimately placed successfully into production, in many cases as a direct result of the enhanced governance and oversight required for them. A retrospective review of the actual performance of those projects and their associated risk levels suggests that the IT projects with costs greater than $10 million were the primary beneficiaries of the enhanced governance required under the Investment Budget.

The cost of developing a new IT system has also increased substantially since 2002 due to inflation and the imposition of new security and other requirements, and an increasing number of more routine proposed new IT projects now have estimated multiyear costs that exceed the current $3 million threshold. If the CIRC's recommendation to increase the Investment Budget project threshold to $10 million is approved, the governance and oversight of projects with costs of $3 million to $10 million will become the responsibility of the CIO Council. They will also be monitored as part of the regular operational reviews that will be led by the Chief of Staff. In addition, if a project with less than $10 million in estimated costs is deemed to have high or unusual execution risk, that project may, under the provisions of the CIRC's existing charter, also be assigned to the CIRC for oversight and monitoring.

The IT Modernization Plan to be completed in 2019 is expected to identify a requirement to modernize several core business systems over the next several years. The proposed change in the investment project threshold will ensure that the largest and most significant of these projects

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[8]Three of the four projects under $3 million were grandfathered into the Investment Budget when it was created and reflected only the cost of completing much larger IT development projects begun prior to 2002. The fourth was the CHRIS T&A project ($2.7 million), which was elevated to the investment budget and placed under CIRC governance in spite of its projected costs falling short of the established threshold. Two of the three projects with costs between $3 million and $10 million were major enhancements to previously-completed investment projects, the Central Data Repository (call reports) and the Claims Administration System. The third was the Legal Information Management System ($4.6 million).

receive the benefit of the enhanced governance and oversight required for Investment Budget projects, while smaller system projects are subject to reduced levels of governance and oversight more appropriate to their size and risk levels. It would be difficult for the CIRC to effectively oversee all of these smaller projects under established Investment Budget procedures.

There is one other methodological change in the development of new IT systems that may substantially mitigate the risks associated with smaller projects. The trend in recent years in the development of new application systems has been to utilize a series of small releases as part of an "agile" development process. Under the "agile" methodology, new applications are often implemented through a series of small releases that are placed into production incrementally, as soon as they are completed. This incremental methodology substantially mitigates the risk associated with smaller IT projects, since relatively small amounts of time and money are spent on each release and the benefits of the release are realized immediately, before work is done on subsequent releases.

Overview of Attached Exhibits

The following is a summary of the exhibits accompanying this case:

- Exhibit 1 displays the proposed 2019 FDIC Operating Budget by major expense category.
- Exhibit 2 displays the proposed 2019 FDIC Operating Budget by division and office.
- Exhibit 3 displays the proposed 2019 budgets by division and office for the ongoing operations and OIG budget components.
- Exhibit 4 displays the proposed 2019 budgets by division and office for the receivership funding budget component.
- Exhibit 5 displays the proposed 2019 staffing authorizations (permanent and non-permanent) for each division and office.
- Exhibit 6 displays the projected allocation of the proposed budget by major program.

Also attached are two proposed Board resolutions, the 2019 Budget Resolution reflecting the budget and staffing authorizations outlined above and a second resolution approving the proposed change in the Investment Budget threshold.

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