FDIC

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

May 15, 2017

MEMORANDUM TO: The Board of Directors

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

Craig R. Jarvill
Director, Division of Finance

SUBJECT: First Quarter 2017 CFO Report to the Board

The attached report highlights the FDIC's financial activities and results for the quarter ended March 31, 2017.

Executive Summary

- During the first quarter of 2017, the Deposit Insurance Fund (DIF) balance was $84.9 billion, up $1.8 billion from year-end 2016. The quarterly increase was primarily due to $2.7 billion of assessment revenue and $227 million of interest on U.S. Treasury securities, partially offset by $765 million in provision for insurance losses and $442 million of operating expenses.

- The reserve ratio, which is the ratio of the DIF balance to estimated insured deposits, was 1.20 percent for the first quarter 2017, unchanged from the fourth quarter 2016, due in part to strong growth in estimated insured deposits.

- During the first quarter of 2017, the FDIC was named receiver for three failed institutions. The combined assets at inception for these failed institutions were $469 million with estimated losses of $91 million. The corporate cash outlay during the first quarter for these failures was approximately $101 million.

- Through March 31, 2017, overall FDIC Operating Budget expenditures were below budget by 7 percent ($36 million). This variance was primarily the result of vacancies in budgeted positions in the Ongoing Operations component of the budget and lower-than-budgeted usage of contractual services in the Receivership Funding component of the budget.

I. <u>Financial Results</u> (See pages 6 - 7 for detailed data and charts.)

Deposit Insurance Fund

- For the first quarter of 2017, the DIF's comprehensive income totaled $1.8 billion compared to comprehensive income of $2.5 billion for the same period last year. This $754 million decline was primarily the result of an $808 million increase in provision for insurance losses and $405 million lower unrealized gain on U.S. Treasury securities, partially offset by a $409 million increase in assessment revenue and an $80 million increase in interest revenue.

- The provision for insurance losses was $765 million for the first quarter of 2017 primarily resulting from a $976 million increase in the contingent liability for anticipated failures, partially offset by a $182 million decrease in the estimated losses for actual failures. The latter adjustment was primarily attributable to unanticipated recoveries of $46 million in professional liability claims and tax refunds by the receiverships, a $50 million decrease in the receiverships' shared-loss liabilities, and settlement of receivership representation and warranty indemnifications for $80 million less than estimated.

Assessments

- During March, the DIF recognized a total of $2.7 billion in assessment revenue. Of this amount, $1.5 billion represented the estimate for first quarter 2017 insurance coverage. Also, the DIF recognized $1.2 billion in estimated large bank surcharges for the first quarter 2017.

- On March 30, 2017, the FDIC collected $1.5 billion in DIF assessments and $1.2 billion in surcharge assessments for fourth quarter 2016 insurance coverage.

II. <u>Investment Results</u> (See pages 8 - 9 for detailed data and charts.)

DIF Investment Portfolio

- On March 31, 2017, the total liquidity (also total market value) of the DIF investment portfolio stood at $78.9 billion, up $3.6 billion from its December 31, 2016, balance of $75.3 billion. During the quarter, interest revenue, receivership dividends, and deposit insurance assessment collections exceeded resolution-related outlays and operating expenses.

- On March 31, 2017, the DIF investment portfolio's yield was 1.27 percent, up 15 basis points from its 1.12 percent yield on December 31, 2016. The new Treasury securities purchased during the quarter generally had higher yields than the maturing securities' yields, some considerably higher.

- In accordance with the approved first quarter 2017 DIF portfolio investment strategy, staff purchased a total of 20 short- to intermediate-maturity conventional Treasury securities, all designated as available-for-sale. The 20 securities had a total par value of $11.0 billion, a weighted average yield of 1.80 percent, and a weighted average maturity of 3.96 years.

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

Approved Budget Modifications

The 2017 Budget Resolution delegated to the Chief Financial Officer (CFO) and selected other officials the authority to make certain modifications to the 2017 FDIC Operating Budget. The following budget reallocations were approved during the first quarter in accordance with the authority delegated by the Board of Directors.

- In January 2017, several divisions and offices reallocated their approved budgets within their existing expense categories to better align their budgets with anticipated spending by expense category for the year. Most of these administrative realignments were very small amounts.

    - The largest realignments in the Ongoing Operations budget component were made by the Chief Information Officer (CIO) Council, the Division of Information Technology (DIT), and the Information Security and Privacy Staff (ISPS). The CIO Council reallocated $2.5 million (4.9 percent of its total Ongoing Operations budget) from the Outside Services–Personnel expense category to the Equipment expense category for the purchase of subscriptions for an Enterprise Shared Services platform to deliver an Enterprise Public Inquires and Complaints (EPIC) application. The FDIC will use EPIC to track and manage inquiries and complaints, replacing three legacy systems in the process. DIT reallocated $1.5 million (0.7 percent of its total Ongoing Operations budget) from the Outside Services–Personnel expense category to the Buildings ($1,354,229), Equipment ($175,000), and Outside Services – Other ($13,679) expense categories, largely to align projected spending across expenses categories related to the off-site data service center. ISPS redistributed $1.5 million, or 4.0 percent of its budget, from the Outside Services–Personnel expense category to the Equipment category for IT security subscription costs for the year. Eight other organizations made small administrative reallocations between expense categories within their approved Ongoing Operations budgets.

    - The largest realignment in the Receivership Funding budget component was made by the Division of Resolutions and Receiverships (DRR) which realigned $770,000, or 0.5 percent of its total Receivership Funding budget, from Outside Services–Personnel to the Other Expenses category to provide additional funds for receivership tax preparation services. DIT realigned $271,393 of its budget from Equipment to various other expense categories based on updated spending projections.

    - The Office of Inspector General also realigned $148,966, or 0.4 percent of its budget, from the Equipment expense category to the Outside Services – Personnel and Outside Services – Other expense categories.

  Budget resources initially realigned constituted approximately 0.3 percent of the total 2017 FDIC Operating Budget. None of these initial budget realignments increased or decreased the total Board-approved budget for the Ongoing Operations, Receivership Funding, or Office of Inspector General Budget components or for any individual division/office total budget.

- The CFO approved in January 2017 the realignment of $22,267,557 from the Ongoing Operations budgets of DIT (-$20,861,977) and ISPS (-$1,405,580) to the Corporate Unassigned contingency reserve. These funds were originally provided to DIT and ISPS for Technology Refreshment (Tech Refresh), but the CIO requested time to reassess annual Tech Refresh requirements. These funds will be managed separately within the Corporate Unassigned contingency reserve and released to DIT and ISPS quarterly based upon Tech Refresh spending plans submitted in advance. This new procedure will enhance the transparency of spending for Tech Refresh.

- The CFO also approved in January the realignment of $326,930 from DIT ($324,930 in Salaries and Compensation and $2,000 in Other Expenses) to the Office of Communications (OCOM) in conjunction with a transfer of functions (see below).

- In March, DIT realigned an additional $1,960,000 from its Outside Services – Personnel expense category to the Outside Services–Other ($1,460,000) and Buildings ($500,000) expense categories to reflect its projected expenses for telecommunication services and the off-site data center, respectively.

- Later in March, DIT realigned an additional $3,976,301 from its Outside Services–Personnel expense category to the Equipment expense category for subscriptions and Wide Area Network services ($2,865,971) and the Outside Services–Other expense category for telecommunication services ($1,110,330).

- The CFO approved in March a reallocation of $3,158,376 from the Corporate Unassigned contingency reserve to DIT's Ongoing Operations budget, to provide funding for various high-priority security and continuity of operations initiatives. The funds were reallocated to DIT's Outside Services–Personnel ($2,632,878) and Equipment ($525,498) budgets.

Following all budget reallocations during the first quarter, the remaining budget available within the Corporate Unassigned contingency reserve for the Ongoing Operations budget component was $44,109,181 (including $22,267,557 set aside for Tech Refresh and $21,841,624 in undesignated reserves). The Corporate Unassigned reserve within the Receivership Funding budget component was unchanged at $30,358,032.

Approved Staffing Modifications

The 2017 Budget Resolution delegated to the CFO the authority to modify approved 2017 staffing authorizations for divisions and offices, as long as those modifications did not increase the total approved 2017 FDIC Operating Budget. The following changes were approved by the CFO in accordance with the authority delegated to him by the Board of Directors:

- In January 2017, the CFO approved the transfer of one authorized permanent position from ISPS to the Division of Administration in conjunction with the transfer of the FDIC's intelligence support function, including the responsibilities of the Federal Senior Intelligence Coordinator position.

- The CFO also approved in January the transfer of two authorized permanent positions from DIT to OCOM in conjunction with the transfer to OCOM of responsibility for the ongoing administration and modernization of the FDIC's websites.

Spending Variances

Significant spending variances by major expense category and division/office are discussed below. Significant spending variances for the three months ending March 31, 2017, are defined as those that either (1) exceed the YTD budget by more than $3 million and represent more than five 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 $15 million and represents more than fifteen percent of the major expense category or total division/office budget.

Significant Spending Variances by Major Expense Category

Ongoing Operations

There were no significant spending variances during the first quarter in any major expense category of the Ongoing Operations budget component of the 2017 FDIC Operating Budget.

Receivership Funding

The Receivership Funding component of the 2017 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.

There was a significant spending variance in only one of the seven major expense categories during the first quarter in the Receivership Funding budget component of the 2017 FDIC Operating Budget:

- Outside Services-Personnel expenditures were $15 million, or 30 percent, less than budgeted. This variance was attributable to both DRR and the Legal Division. DRR spent $8 million less than budgeted because Owned Real Estate was liquidated faster than forecast, therefore reducing contractual support expenses for those properties; fewer loss share/LLC agreement compliance reviews were conducted than had been planned, fewer security sales occurred (with less associated contractual support expenses) than anticipated; and less-than-projected expenses related to records management initiatives were incurred. The Legal Division spent $7 million less than budgeted because of lower-than-anticipated outside legal counsel requirements for professional liability cases and receivership claims activities.

Office of Inspector General

There were no significant spending variances during the first quarter in any major expense category of the Office of Inspector General budget component of the 2017 FDIC Operating Budget.

Significant Spending Variances by Division/Office[1]

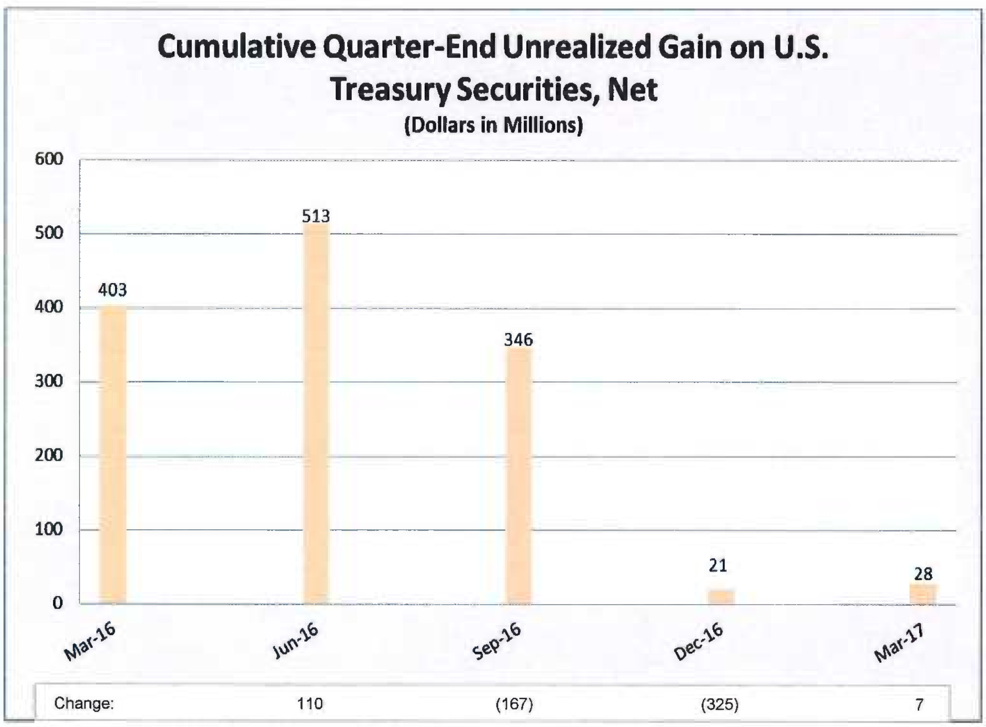
No organization had significant spending variances during the first quarter.

[1] Information on division/office variances reflects variances in the total FDIC Operating Budget (both the ongoing operations and receivership funding budget components).

Fund Financial Results

($ in Millions)

Balance Sheet	Deposit Insurance Fund				
	Mar-17	Dec-16	Quarterly Change	Mar-16	Year-Over-Year Change
Cash and cash equivalents	$ 3,374	$ 1,333	$ 2,041	$ 3,519	$ (145)
Investment in U.S. Treasury securities	75,076	73,512	1,564	63,833	11,243
Assessments receivable, net	2,709	2,666	43	2,238	471
Interest receivable on investments and other assets, net	458	526	(68)	474	(16)
Receivables from resolutions, net	6,760	7,790	(1,030)	9,638	(2,878)
Property and equipment, net	340	358	(18)	370	(30)
Total Assets	$ 88,717	$ 86,185	$ 2,532	$ 80,072	$ 8,645
Accounts payable and other liabilities	208	238	(30)	217	(9)
Liabilities due to resolutions	2,011	2,073	(62)	4,059	(2,048)
Postretirement benefit liability	232	232	-	233	(1)
Contingent liability for anticipated failures	1,335	477	858	443	892
Contingent liability for litigation losses and other	3	3	0	0	3
Total Liabilities	$ 3,789	$ 3,023	$ 766	$ 4,952	$ (1,163)
FYI: Unrealized gain (loss) on U.S. Treasury securities, net	28	21	7	403	(375)
FYI: Unrealized postretirement benefit (loss) gain	(26)	(26)	-	(34)	8
Fund Balance	$ 84,928	$ 83,162	$ 1,766	$ 75,120	$ 9,808



The unrealized gain on U.S. Treasury securities dropped dramatically beginning in November 2016. Following the election results earlier that month, Treasury yields increased considerably, as investors perceived that future fiscal policies and programs could result in faster economic growth, higher inflation, and increased Treasury security issuance, all of which would underpin higher interest rates and Treasury yields. The higher Treasury yields in late 2016 and year-to-date 2017 resulted in lower market prices for the investments and the correspondingly lower unrealized gains.

Fund Financial Results - continued

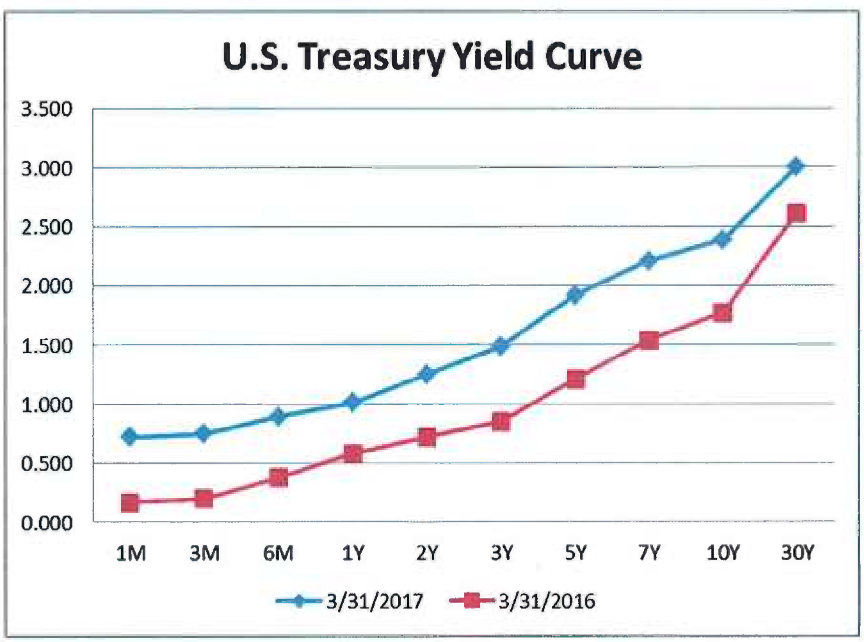
($ in Millions)

Income Statement (year-to-date)	Deposit Insurance Fund			
	Mar-17	Dec-16	Mar-16	Year-Over-Year Change
Assessments	$ 2,737	$ 9,987	$ 2,328	$ 409
Interest on U.S. Treasury securities	227	671	147	80
Other revenue	2	16	5	(3)
Total Revenue	$ 2,966	$ 10,674	$ 2,480	$ 486
Operating expenses	442	1,715	415	27
Provision for insurance losses	765	(1,568)	(43)	808
Insurance and other expenses	0	3	0	0
Total Expenses and Losses	$ 1,207	$ 150	$ 372	$ 835
Net Income	1,759	10,524	2,108	(349)
Unrealized gain (loss) on U.S. Treasury securities, net	7	29	412	(405)
Unrealized postretirement benefit gain (loss)	-	8	-	-
Comprehensive Income	$ 1,766	$ 10,561	$ 2,520	$ (754)

Selected Financial Data	FSLIC Resolution Fund				
	Mar-17	Dec-16	Quarterly Change	Mar-16	Year-Over-Year Change
Cash and cash equivalents	$ 879	$ 874	$ 5	$ 872	$ 7
Accumulated deficit	(124,609)	(124,611)	2	(124,617)	8
Total resolution equity	880	878	2	872	8
Total revenue	1	5		1	0
Operating expenses	0	3		1	(1)
Losses related to thrift resolutions	0	(1)		(1)	1
Net Income (Loss)	$ 1	$ 7		$ 1	0

Receivership Selected Statistics March 2017 vs. March 2016

$ in millions	DIF			FRF			ALL FUNDS		
	Mar-17	Mar-16	*Change*	Mar-17	Mar-16	*Change*	Mar-17	Mar-16	*Change*
Total Receiverships	375	439	(64)	-	-	-	375	439	(64)
Assets in Liquidation	$ 3,006	$ 4,433	$ (1,427)	$ 2	$ 2	-	$ 3,008	$ 4,435	$ (1,427)
YTD Collections	$ 379	$ 372	$ 7	-	$ 1	$ (1)	$ 379	$ 373	$ 6
YTD Dividend/Other Pymts - Cash	$ 1,203	$ 1,789	$ (586)	-	-	-	$ 1,203	$ 1,789	$ (586)



Short-maturity yields have risen reflecting the Federal Reserve's December 2016 and March 2017 hike in the federal funds target rate, while longer-maturity sector securities have risen due to the expectation of higher inflation.

Deposit Insurance Fund Portfolio Summary (Dollar Values in Millions)			
	3/31/17	12/31/16	Change
Par Value	$78,191	$74,430	$3,761
Amortized Cost	$78,411	$74,947	$3,464
Total Market Value (including accrued interest)	$78,865	$75,335	$3,530
Primary Reserve [1]	$78,865	$75,335	$3,530
Primary Reserve % of Total Portfolio	100.0%	100.0%	0.0%
Yield-to-Maturity [2]	1.27%	1.12%	0.15%
Weighted Average Maturity (in years)	1.85	1.60	0.25
Effective Duration (in years)			
Total Portfolio	1.79	1.55	0.24
Available-for-Sale Securities	1.87	1.66	0.21
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 (AFS), and held-to-maturity (HTM) securities maturing within three months.

[2] The Yield-to-Maturity includes the potential yield of 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)			
	3/31/17	12/31/16	Change
FRF-FSLIC			
Book Value [4]	$836	$831	$5
Yield-to-Maturity	0.76%	0.40%	0.36%
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)			
	3/31/17	12/31/16	Change
Book Value [5]	$7,864	$8,746	($882)
Effective Annual Yield	0.69%	0.58%	0.11%
Weighted Average Maturity (in days)	63	78	(15)

[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 1st Quarter 2017** Purchase up to $14 billion (par value) of Treasury securities with maturity dates between June 30, 2017, and June 30, 2022, subject to the following additional provisions: all newly purchased securities will be designated as available-for-sale; no more than $2 billion (adjusted par value) of such securities shall consist of Treasury Inflation-Protected Securities; and target at least $5 billion (par value) of newly purchased securities maturing between January 1, 2020, and June 30, 2022. **Strategy Changes for the 2nd Quarter 2017** Purchase up to $14 billion (par value) of Treasury securities with maturity dates between <u>September 30, 2017</u>, and <u>December 31, 2022</u>, subject to the following additional provisions: all newly purchased securities will be designated as available-for-sale; no more than $2 billion (adjusted par value) of such securities shall consist of Treasury Inflation-Protected Securities; and target at least <u>$4 billion</u> (par value) of newly purchased securities maturing between January 1, 2020, and <u>December 31, 2022</u>.
NATIONAL LIQUIDATION FUND	**Strategy for the 1st Quarter 2017** 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 2nd Quarter 2017** No strategy changes for the second quarter of 2017.

Executive Summary of 2017 Budget and Expenditures
by Budget Component and Major Expense Category
Through March 31, 2017
(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	$1,247,608	$312,340	$295,114	94%	($17,226)
Outside Services - Personnel	259,850	54,248	55,595	102%	1,347
Travel	95,448	23,398	21,564	92%	(1,834)
Buildings	97,303	22,103	23,702	107%	1,599
Equipment	90,346	13,369	13,716	103%	347
Outside Services - Other	16,458	3,259	3,346	103%	87
Other Expenses	14,057	3,098	3,555	115%	457
Total Ongoing Operations	**$1,821,070**	**$431,815**	**$416,592**	**96%**	**($15,223)**
Receivership Funding					
Salaries & Compensation	$37,356	$9,491	$7,662	81%	($1,829)
Outside Services - Personnel	230,170	49,656	34,551	70%	(15,105)
Travel	3,246	715	880	123%	165
Buildings	17,722	4,396	3,002	68%	(1,394)
Equipment	1,429	158	111	70%	(47)
Outside Services - Other	1,273	321	288	90%	(33)
Other Expenses	8,804	2,201	322	15%	(1,879)
Total Receivership Funding	**$300,000**	**$66,938**	**$46,816**	**70%**	**($20,122)**
Office of Inspector General					
Salaries & Compensation	$32,770	$8,193	$7,456	91%	($737)
Outside Services - Personnel	1,418	354	241	68%	(113)
Travel	1,486	371	315	85%	(56)
Buildings	0	0	0	N/A	0
Equipment	487	122	221	181%	99
Outside Services - Other	169	42	4	10%	(38)
Other Expenses	423	106	88	83%	(18)
Total Office of Inspector General	**$36,753**	**$9,188**	**$8,325**	**91%**	**($863)**
Total FDIC Operating Budget	**$2,157,823**	**$507,941**	**$471,733**	**93%**	**($36,208)**

Executive Summary of 2017 Budget and Expenditures
by Division/Office
Through March 31, 2017
(Dollars in Thousands)

Division/Office	Annual Budget	YTD Budget	YTD Expenditures	% of YTD Budget Used	YTD Variance
FDIC Operating Budget					
Risk Management Supervision	$594,602	$147,552	$141,173	96%	($6,379)
Resolutions & Receiverships	276,015	69,055	54,395	79%	(14,660)
Administration	273,098	63,919	65,942	103%	2,023
Legal	234,860	59,399	49,318	83%	(10,081)
Information Technology	203,962	45,363	46,641	103%	1,278
Depositor & Consumer Protection	183,929	47,023	43,208	92%	(3,815)
Insurance & Research	54,246	13,826	11,397	82%	(2,429)
CIO Council	50,362	10,652	11,616	109%	964
Finance	40,985	10,401	9,583	92%	(818)
Inspector General	36,753	9,188	8,325	91%	(863)
Information Security & Privacy Staff	36,273	8,004	7,523	94%	(481)
Executive Support [1]	25,266	6,042	5,508	91%	(534)
Complex Financial Institutions	21,838	5,024	4,420	88%	(604)
Corporate University - Corporate	20,737	5,073	6,175	122%	1,102
Corporate University - CEP	19,401	4,575	4,150	91%	(425)
Executive Offices [2]	11,029	2,845	2,359	83%	(486)
Corporate Unassigned	74,467	0	0	N/A	0
Total FDIC Operating Budget	**$2,157,823**	**$507,941**	**$471,733**	**93%**	**($36,208)**

1) Executive Support includes the Offices of Minority and Women Inclusion, Communications, Ombudsman, Legislative Affairs, Corporate Risk Management, and Financial Institution Adjudication.

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, and Chief Information Officer.