FDIC

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

August 22, 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: Second Quarter 2017 CFO Report to the Board

The attached report highlights the FDIC's financial activities and results for the quarter ended June 30, 2017.

Executive Summary

- During the second quarter of 2017, the Deposit Insurance Fund (DIF) balance increased by $2.7 billion, from $84.9 billion at March 31, 2017 to $87.6 billion at June 30, 2017. The quarterly increase was primarily due to $2.6 billion of assessment revenue, $251 million of interest on U.S. Treasury securities, and a $233 million decrease in provision for insurance losses, partially offset by $450 million of operating expenses.

- The reserve ratio, which is the ratio of the DIF balance to estimated insured deposits, was 1.24 percent for the second quarter 2017, compared to the first quarter 2017 reserve ratio of 1.20 percent.

- During the second quarter of 2017, the FDIC was named receiver for three failed institutions. The combined assets at inception for these failed institutions were $4.6 billion with estimated losses of $1.0 billion. The corporate cash outlay during the second quarter for these failures was approximately $2.6 billion.

- Through June 30, 2017, overall FDIC Operating Budget expenditures were below budget by 5 percent ($53 million). This variance was primarily the result of vacancies in budgeted positions in the Ongoing Operations budget. In the Receivership Funding budget component, the variance was attributable to lower-than-anticipated expenses for outside legal services and facility-related expenses.

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

Deposit Insurance Fund

- For the six months ending June 30, 2017, the DIF's comprehensive income totaled $4.4 billion compared to comprehensive income of $5.3 billion for the same period last year. This $884 million decline was primarily the result of a $1.2 billion increase in provision for insurance losses (year-to-date 2017 positive $532 million versus year-to-date 2016 negative $670 million) and a $527 million lower contribution to year-to-date comprehensive income from unrealized (loss)/gain on U.S. Treasury securities (year-to-date 2017 unrealized loss of $5 million versus year-to-date 2016 unrealized gain of $522 million), partially offset by a $715 million increase in assessment revenue and a $167 million increase in interest revenue.

- The provision for insurance losses was $532 million for the first half of 2017, largely attributable to a $683 million adjustment for higher-than-anticipated losses for the current year failures, partially offset by a $103 million reduction to the receivership's representation and warranty liabilities and $63 million in unanticipated recoveries by receiverships.

Assessments

- During June, the DIF recognized assessment revenue of $2.6 billion. Of this amount, $1.4 billion represented the estimate for second quarter 2017 insurance coverage and $1.2 billion represented estimated surcharges on banks with $10 billion or more in assets. Additionally, the DIF recognized a $43 million adjustment for lower-than-estimated collections for first quarter 2017 insurance coverage (regular assessments: $37 million and surcharges: $6 million), which decreased assessment revenue.

- On June 30, 2017, the FDIC collected $1.4 billion in DIF assessments and $1.2 billion in surcharge assessments for first quarter 2017 insurance coverage.

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

DIF Investment Portfolio

- On June 30, 2017, the total liquidity (also total market value) of the DIF investment portfolio stood at $78.8 billion, up $3.5 billion from its December 31, 2016, balance of $75.3 billion. During the first half of the year, interest revenue, receivership dividends, and deposit insurance assessment collections exceeded resolution-related outlays and operating expenses.

- On June 30, 2017, the DIF investment portfolio's yield was 1.35 percent, up 23 basis points from its 1.12 percent yield on December 31, 2016. The new Treasury securities purchased during the first half of the year generally had higher yields than the maturing securities' yields, some considerably higher.

- In accordance with the approved second quarter 2017 DIF portfolio investment strategy, staff purchased a total of 13 short- to intermediate-maturity conventional Treasury securities, all designated as available-for-sale. The 13 securities had a total par value of $8.4 billion, a weighted average yield of 1.49 percent, and a weighted average maturity of 2.73 years.

III. Budget Results (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 second quarter in accordance with the authority delegated by the Board of Directors.

- In April 2017, the CFO approved the following budget increases and realignments, primarily through the realignment of funds from the Corporate Unassigned contingency reserve:

  - An increase of $2,718,112 to the Outside Services-Personnel expense category of the Ongoing Operations budget of the Division of Information Technology (DIT). This increase provided funding for a technical inventory of IT assets at the FDIC's primary and back-up data centers ($1,200,000), acquisition support to replace the current backup data center ($500,000), and contract support to enhance the existing enterprise architecture ($481,378) and program management ($536,734) functions.

  - An increase of $3,872,639 to the Buildings and Leased Space expense category of the Ongoing Operations budget of the Division of Administration (DOA) to provide funding for the Virginia Square Loading Dock project ($2,172,639), the Garage Barriers project ($1,300,000), and a lighting upgrade at the San Francisco Regional Office ($400,000). This increase was substantially offset by the subsequent return by DOA in June of approximately $3.2 million in unused budget authority (see below).

  - Increases of $1,644,845 in the Outside Services-Personnel category and $3,409,328 in the Equipment category of DIT's Ongoing Operations budget and $565,580 in the Equipment category of the Ongoing Operations budget of the Information Security and Privacy Staff (ISPS) to provide funding for second quarter equipment and software upgrades as part of DIT's and ISPS's ongoing technology refreshment programs.

  - Realignment of $447,620 from the Outside Services-Personnel category to the Equipment category of DIT's Ongoing Operations budget for software purchases related to DIT's IT asset inventory project.

  - Increases of $1,841,375 to the Outside Services-Personnel category and $461,440 to the Equipment category of DIT's Ongoing Operations Budget to provide additional funding for the Office 365 initiative to migrate e-mail and SharePoint capabilities to the cloud.

- In May 2017, the CFO approved increases of $3,116,205 to the Outside Services-Personnel category and $1,525,320 to the Equipment category of ISPS's Ongoing Operations budget to address identified shortfalls in its operating budget and to fund several high-priority security initiatives.

- In June 2017, the CFO approved the following budget increases and realignments, primarily through the realignment of funds to and from the Corporate Unassigned contingency reserve:

  - Realignment of $199,680 from the Outside Services-Personnel category to the Equipment category of ISPS's Ongoing Operations budget to provide funding for software subscription purchases.

- An increase of $127,544 to the Outside Services-Personnel category of DIT's Ongoing Operations budget to identify options for the migration of e-mail to the cloud for the Office of Inspector General.

- Reallocations among the Salaries and Compensation categories of both the Ongoing Operations and Receivership Funding budget components of various divisions and offices to better reflect projected 2017 funding requirements, based upon an analysis by the Division of Finance of year-to-date salaries and fringe benefits expenses. Due to the large number of vacancies in budgeted positions resulting from the early 2017 hiring freeze, these reallocations resulted in net reductions of $8,995,218 in the Ongoing Operations Salaries and Compensation budget and $166,358 in the Receivership Funding Salaries and Compensation budget. In each budget component, these projected surplus funds were realigned to the Corporate Unassigned contingency reserve.

- Increases of $880,678 in the Outside Services-Personnel category and $11,080,000 in the Equipment category of DIT's Ongoing Operations budget to provide funding for third and fourth quarter equipment and software upgrades as part of DIT's ongoing technology refreshment program.

- The transfer of $851,512 from the Outside Services – Personnel budget of DIT to the same budget category in the Office of Communications (OCOM) in conjunction with the transfer of responsibility for internet services and web content operations from DIT to OCOM.

- An increase of $473,468 to the Outside Services-Personnel category of DIT's Ongoing Operations budget to provide funding for an EndPoint Hardening planning project and a short-term solution to address an audit finding on IT security.

- A net reallocation of $5,706,725 was made to the Corporate Unassigned contingency reserve within the Ongoing Operations budget component, largely due to the reduced contract spending requirements in the Outside Services-Personnel category of the Division of Resolutions and Receiverships, DOA, and the Office of Complex Financial Institutions. The reallocation also included other realignments among various expense categories and divisions and offices. In the Receivership Funding budget component, a small realignment of DOA's budget was made between expense categories.

Following all second quarter budget modifications, the balances in the Corporate Unassigned contingency reserves were $26,414,590 in the Ongoing Operations budget component and $30,524,390 in the Receivership Funding budget component.

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. In the second quarter, there were no approved staffing modifications.

Spending Variances

Significant spending variances by major expense category and division/office are discussed below. Significant spending variances for the six months ending June 30, 2017, are defined as those that either (1) exceed the YTD budget by more than $2 million and represent more than three percent of a major expense category or total division/office budget; or (2) are under the YTD budget for a major expense category or division/office by an amount that exceeds $10 million and represents more than ten percent of the major expense category or total division/office budget.

Significant Spending Variances by Major Expense Category

<u>Ongoing Operations</u>

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

<u>Receivership Funding</u>

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 second quarter in the Receivership Funding budget component:

- Outside Services-Personnel expenditures were $20 million, or 20 percent, less than budgeted. This variance was mostly attributable to the Legal Division, which spent $16 million, or 16 percent, less than budgeted, primarily due to the lower-than-anticipated use of outside legal counsel.

<u>Office of Inspector General</u>

There were no significant spending variances during the second 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]

The Legal Division was the only division or office that had a significant spending variance through June 30, 2017. It spent $17 million, or 15%, less than budgeted largely due to a lower than anticipated use of outside legal counsel.

Other Matters

An analysis of 2017 funding requirements for employee pay and benefits was completed in June, in accordance with the 2017 Budget Resolution. The analysis determined that the costs related to fringe benefits had been overestimated during the preparation of the 2017 FDIC Operating Budget by approximately $2.5 million in the Salaries and Compensation expense category. This variance was primarily due to the inclusion of a small general fringe benefit cost increase that had only partially materialized as of May 31st. The CFO elected not to exercise his delegated authority to adjust the 2017 FDIC Operating Budget to address this variance, since the net projected budget overage is not material relative to the total budget.

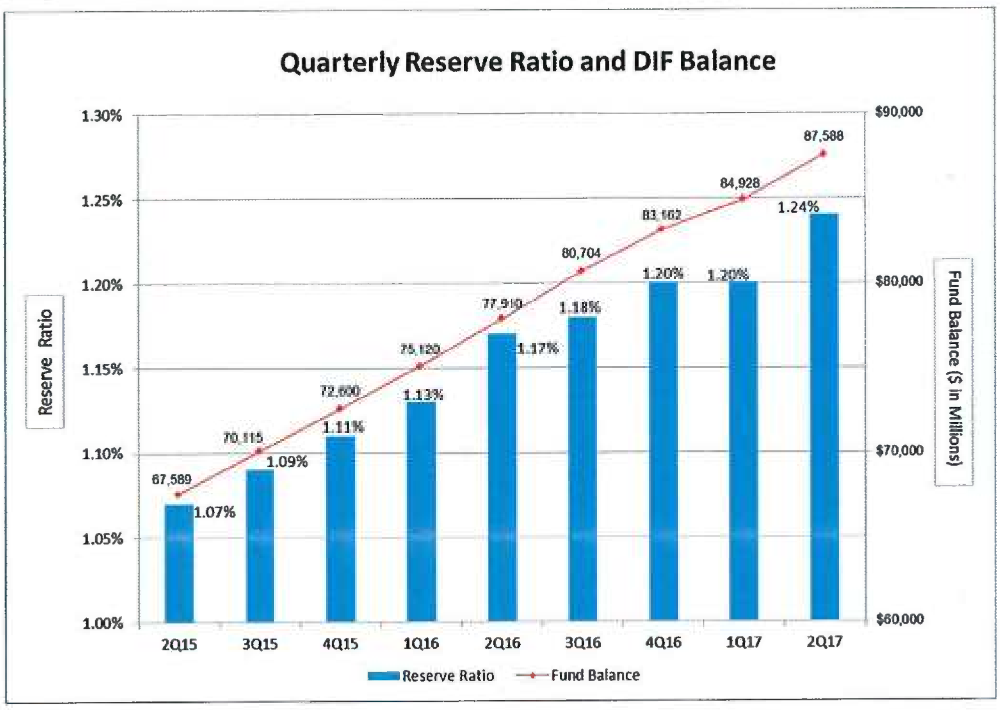
[1]Information on division/office variances reflects variances in the FDIC Operating Budget.

FDIC CFO REPORT TO THE BOARD – Second Quarter 2017

Fund Financial Results

($ in Millions)

Balance Sheet	Deposit Insurance Fund				
	Jun-17	Mar-17	Quarterly Change	Jun-16	Year-Over-Year Change
Cash and cash equivalents	$ 3,362	$ 3,374	$ (12)	$ 5,510	$ (2,148)
Investment in U.S. Treasury securities	75,043	75,076	(33)	64,690	10,353
Assessments receivable, net	2,677	2,709	(32)	2,254	423
Interest receivable on investments and other assets, net	399	458	(59)	309	90
Receivables from resolutions, net	8,944	6,760	2,184	9,477	(533)
Property and equipment, net	324	340	(16)	361	(37)
Total Assets	$ 90,749	$ 88,717	$ 2,032	$ 82,601	$ 8,148
Accounts payable and other liabilities	242	208	34	246	(4)
Liabilities due to resolutions	2,535	2,011	524	3,775	(1,240)
Postretirement benefit liability	232	232	-	233	(1)
Contingent liability for anticipated failures	117	1,335	(1,218)	437	(320)
Contingent liability for litigation losses and other	35	3	32	0	35
Total Liabilities	$ 3,161	$ 3,789	$ (628)	$ 4,691	$ (1,530)
FYI: Unrealized gain (loss) on U.S. Treasury securities, net	16	28	(12)	513	(497)
FYI: Unrealized postretirement benefit (loss) gain	(26)	(26)	-	(34)	8
Fund Balance	$ 87,588	$ 84,928	$ 2,660	$ 77,910	$ 9,678



The DIF reserve ratio was 1.24 percent for the second quarter 2017, up from the first quarter 2017 reserve ratio of 1.20 percent. The estimated insured deposits declined by 0.4 percent during second quarter 2017.

The second quarter 2017 reserve ratio is at the highest level since fourth quarter 2005.

	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17
Estimated Insured Deposits ($ in Millions)	6,336,141	6,409,239	6,522,388	6,663,048	6,675,378	6,817,020	6,914,661	7,076,788	7,045,151

Fund Financial Results - continued

($ in Millions)

Income Statement (year-to-date)	Deposit Insurance Fund Jun-17	Mar-17	Quarterly Change	Jun-16	Year-Over-Year Change
Assessments	$ 5,371	$ 2,737	$ 2,634	$ 4,656	$ 715
Interest on U.S. Treasury securities	478	227	251	311	167
Other revenue	6	2	4	9	(3)
Total Revenue	$ 5,855	$ 2,966	$ 2,889	$ 4,976	$ 879
Operating expenses	892	442	450	856	36
Provision for insurance losses	532	765	(233)	(670)	1,202
Insurance and other expenses	0	0	0	2	(2)
Total Expenses and Losses	$ 1,424	$ 1,207	$ 217	$ 188	$ 1,236
Net Income	4,431	1,759	$ 2,672	4,788	(357)
Unrealized gain (loss) on U.S. Treasury securities, net	(5)	7	(12)	522	(527)
Unrealized postretirement benefit gain (loss)	-	-	0	-	-
Comprehensive Income	$ 4,426	$ 1,766	$ 2,660	$ 5,310	$ (884)

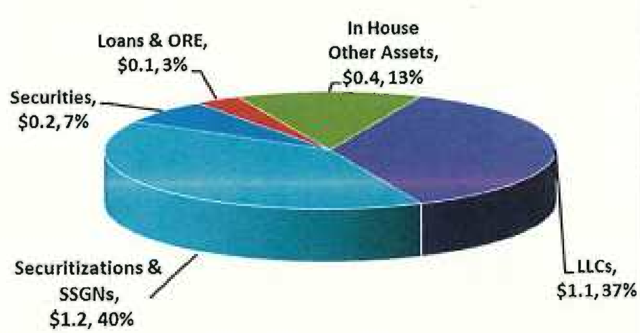
Selected Financial Data	FSLIC Resolution Fund Jun-17	Mar-17	Quarterly Change	Jun-16	Year-Over-Year Change
Cash and cash equivalents	$ 881	$ 879	$ 2	$ 872	$ 9
Accumulated deficit	(124,607)	(124,609)	2	(124,618)	11
Total resolution equity	882	880	2	872	10
Total revenue	3	1	2	1	2
Operating expenses	0	0	0	2	(2)
Losses related to thrift resolutions	0	0	0	(1)	1
Net Income (Loss)	$ 3	$ 1	2	$ -	3

Receivership Selected Statistics June 2017 vs. June 2016

$ in millions	DIF			FRF			ALL FUNDS		
	Jun-17	Jun-16	*Change*	Jun-17	Jun-16	*Change*	Jun-17	Jun-16	*Change*
Total Receiverships	372	422	(50)	-	-	-	372	422	(50)
Assets in Liquidation	$ 5,421	$ 4,136	$ 1,285	$ 2	$ 2	$ -	$ 5,423	$ 4,138	$ 1,285
YTD Collections	$ 718	$ 837	$ (119)	$ -	$ 2	$ (2)	$ 718	$ 839	$ (121)
YTD Dividend/Other Pymts - Cash	$ 1,402	$ 2,430	$ (1,028)	$ -	$ -	$ -	$ 1,402	$ 2,430	$ (1,028)

Receivership Assets in Liquidation Balance at March 31, 2017

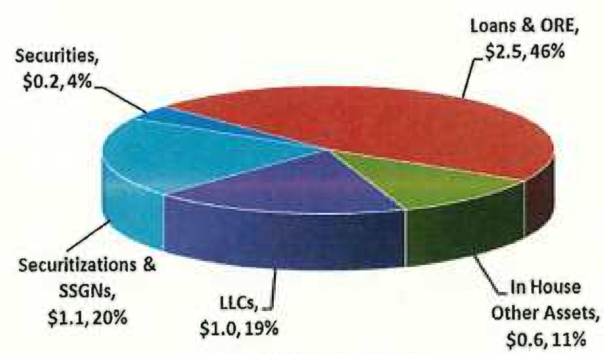
(in billions)



Total Portfolio = $3.0

Receivership Assets in Liquidation Balance at June 30, 2017

(in billions)



Total Portfolio = $5.4

Deposit Insurance Fund Portfolio Summary (Dollar Values in Millions)			
	6/30/17	12/31/16	Change
Par Value	$78,021	$74,430	$3,591
Amortized Cost	$78,424	$74,947	$3,477
Total Market Value (including accrued interest)	$78,793	$75,335	$3,458
Primary Reserve [1]	$78,793	$75,335	$3,458
Primary Reserve % of Total Portfolio	100.0%	100.0%	0.0%
Yield-to-Maturity [2]	1.35%	1.12%	0.23%
Weighted Average Maturity (in years)	1.92	1.60	0.32
Effective Duration (in years)			
Total Portfolio	1.85	1.55	0.30
Available-for-Sale Securities	1.94	1.66	0.28
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 (AFS) securities, 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)			
	6/30/17	12/31/16	Change
FRF-FSLIC			
Book Value [4]	$838	$831	$7
Yield-to-Maturity	0.88%	0.40%	0.48%
Weighted Average Maturity	overnight	overnight	no change

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

National Liquidation Fund (NLF) Investment Portfolio Summary (Dollar Values in Millions)			
	6/30/17	12/31/16	Change
Book Value [5]	$8,047	$8,746	($699)
Effective Annual Yield	0.85%	0.58%	0.27%
Weighted Average Maturity (in days)	43	78	(35)

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

Investment Strategies	
DEPOSIT INSURANCE FUND	**Strategy for the 2nd Quarter 2017** Purchase up to $14 billion (par value) of Treasury securities with maturity dates between September 30, 2017, and December 31, 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 $4 billion (par value) of newly purchased securities maturing between January 1, 2020, and December 31, 2022. **Strategy Changes for the 3rd Quarter 2017** Purchase up to <u>$13 billion</u> (par value) of Treasury securities with maturity dates between <u>December 31, 2017</u>, and December 31, 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 $4 billion (par value) of newly purchased securities maturing between <u>July 1, 2020</u>, and December 31, 2022.
NATIONAL LIQUIDATION FUND	**Strategy for the 2nd 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 3rd Quarter 2017** No strategy changes for the third quarter of 2017.

Executive Summary of 2017 Budget and Expenditures
by Budget Component and Major Expense Category
Through June 30, 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	$608,796	$592,536	97%	($16,260)
Outside Services - Personnel	$253,920	$114,587	$110,588	97%	($3,999)
Travel	$95,448	$46,988	$43,506	93%	($3,482)
Buildings	$101,176	$46,957	$45,697	97%	($1,260)
Equipment	$92,293	$33,456	$33,997	102%	$541
Outside Services - Other	$16,545	$8,346	$8,105	97%	($241)
Other Expenses	$14,080	$6,755	$6,605	98%	($150)
Total Ongoing Operations	**$1,821,070**	**$865,885**	**$841,034**	**97%**	**($24,851)**
Receivership Funding					
Salaries & Compensation	$37,356	$18,600	$16,368	88%	($2,232)
Outside Services - Personnel	$230,152	$100,074	$80,042	80%	($20,032)
Travel	$3,284	$1,585	$2,429	153%	$844
Buildings	$17,700	$8,915	$4,896	55%	($4,019)
Equipment	$1,431	$461	$395	86%	($66)
Outside Services - Other	$1,273	$661	$763	115%	$102
Other Expenses	$8,804	$4,398	$3,041	69%	($1,357)
Total Receivership Funding	**$300,000**	**$134,694**	**$107,934**	**80%**	**($26,760)**
Office of Inspector General					
Salaries & Compensation	$32,770	$16,385	$15,688	96%	($697)
Outside Services - Personnel	$1,418	$709	$507	72%	($202)
Travel	$1,486	$743	$650	87%	($93)
Buildings	$0	$0	$0		$0
Equipment	$487	$244	$337	138%	$93
Outside Services - Other	$169	$84	$4	5%	($80)
Other Expenses	$423	$211	$150	71%	($61)
Total Office of Inspector General	**$36,753**	**$18,376**	**$17,336**	**94%**	**($1,040)**
Total FDIC Operating Budget	**$2,157,823**	**$1,018,955**	**$966,304**	**95%**	**($52,651)**

Executive Summary of 2017 Budget and Expenditures by Division/Office Through June 30, 2017 (Dollars in Thousands)					
Division/Office	Annual Budget	YTD Budget	YTD Expenditures	% of YTD Budget Used	YTD Variance
FDIC Operating Budget					
Risk Management Supervision	$591,543	$291,001	$281,820	97%	($9,181)
Depositor & Consumer Protection	$181,141	$90,554	$87,220	96%	($3,334)
Information Technology	$224,911	$102,798	$102,248	99%	($550)
Administration	$273,360	$130,146	$128,184	98%	($1,962)
Resolutions & Receiverships	$271,786	$136,544	$122,717	90%	($13,827)
Legal	$233,804	$115,515	$98,672	85%	($16,843)
Insurance & Research	$53,106	$25,964	$24,303	94%	($1,661)
Finance	$40,548	$20,158	$19,393	96%	($765)
Inspector General	$36,753	$18,376	$17,336	94%	($1,040)
Information Security & Privacy Staff	$41,969	$16,288	$15,816	97%	($472)
Corporate University - CEP	$19,082	$9,222	$9,004	98%	($218)
Corporate University - Corporate	$25,133	$12,280	$11,883	97%	($397)
Executive Support [1]	$26,207	$12,071	$11,346	94%	($725)
Executive Offices [2]	$11,023	$5,461	$4,712	86%	($749)
Complex Financial Institutions	$20,156	$9,622	$8,938	93%	($684)
CIO Council	$50,362	$22,955	$22,712	99%	($243)
Corporate Unassigned	$56,939	$0	$0		$0
Total FDIC Operating Budget	**$2,157,823**	**$1,018,955**	**$966,304**	**95%**	**($52,651)**

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.