FDIC

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

August 27, 2020

MEMORANDUM TO: The Board of Directors

FROM: Bret Edwards
Deputy to the Chairman
and Chief Financial Officer

SUBJECT: Second Quarter 2020 CFO Report to the Board

The attached report highlights the FDIC's financial activities and results for the quarter ended June 30, 2020.

Executive Summary

- During the second quarter of 2020, the Deposit Insurance Fund (DIF) balance rose to $114.7 billion, up $1.445 billion from the March 31, 2020, balance of $113.2 billion. The quarterly increase was primarily due to $1.8 billion in assessment revenue partially offset by $465 million in operating expenses.

- The reserve ratio, which is the ratio of the DIF balance to estimated insured deposits, was 1.30 percent as of June 30, 2020. The reserve ratio decreased by nine basis points from March 31, 2020, as extraordinary growth in estimated insured deposits far outpaced the increase in the fund balance and was responsible for the decline in the reserve ratio. Since the DIF reserve ratio has dropped below its minimum of 1.35 percent, the FDIC must establish and implement a Restoration Plan to return the fund to its minimum reserve ratio within 8 years. The FDIC will present a fund Restoration Plan to the Board in the near future.

- With a fund balance of $114.7 billion as of June 30, 2020, the DIF is currently well-positioned to cover possible short and mid-term risks. However, there remains uncertainty about the effects of the COVID-19 health crisis on the economy and the banking industry over the long-term. Effects from a weakened economic outlook, elevated unemployment levels, and diminished repayment capacity of borrowers may stress the balance sheets of several institutions across the United States. The FDIC continues to evaluate a range of possible outcomes for economic stress, the risks those outcomes pose to insured financial institutions, and the extent to which such risks may draw on the resources of the DIF.

- During the second quarter of 2020, the FDIC was named receiver for one failed institution. The assets at inception for this failed institution were $156 million with an estimated loss to the DIF as of June 30, 2020, of $47 million. The corporate cash outlay during the second quarter for this failure was approximately $145 million.

- Through June 30, 2020, overall FDIC Operating Budget expenditures were below the year-to-date budget by about $69.4 million, or seven percent. This variance was primarily the result of underspending of $58 million in the Ongoing Operations budget component. The largest variances were in the Salaries and Compensation expense category ($18 million, or 2.8 percent) due to unfilled vacancies in authorized positions and the Travel expense category ($21.5 million, or 55 percent) due to travel restrictions during the COVID-19 pandemic.

I. **Financial Results** (See pages 6 – 7 for detailed data and charts.)

Deposit Insurance Fund

- For the six months ending June 30, 2020, the DIF's comprehensive income totaled $4.3 billion, compared to comprehensive income of $4.8 billion for the same period last year, a decrease of $533 million. While assessment revenue increased year-over-year by $606 million, this was more than offset by the year-over-year change in negative provision for insurance losses of $971 million. The provision balance for 2020 is a negative $35 million, reflecting minor adjustments to loss estimates for prior year failures. In contrast, the provision balance for 2019, a negative $1 billion, reflected large decreases in loss estimates for prior year bank failures, primarily arising from shared-loss liability reductions and unanticipated recoveries from litigation settlements and professional liability claims by receiverships.

- The $1.1 billion unrealized gain on U.S. Treasury securities for the first half of 2020 was a result of yields declining considerably across most maturity sectors of the Treasury yield curve, resulting in increases in the securities' market values relative to their book values.

Assessments

- During June, the DIF recognized assessment revenue of $1.6 billion for the estimate of second quarter 2020 insurance coverage. The last application of small bank assessment credits occurred in the first quarter 2020 and this quarter there was no reduction made for credits. Additionally, the DIF recognized a $158 million adjustment for higher-than-estimated collections for the first quarter 2020 insurance coverage, which increased assessment revenue.

- On June 30, 2020, the FDIC collected $1.5 billion in DIF assessments for first quarter 2020 insurance coverage.

II. **Investment Results** (See pages 8 – 9 for detailed data and charts.)

DIF Investment Portfolio

- On June 30, 2020, the total liquidity (also total market value) of the DIF investment portfolio stood at $111.5 billion, up $4.5 billion from its December 31, 2019, balance of $107.0 billion. During the quarter, interest revenue, receivership dividends, and deposit insurance assessment collections far exceeded resolution-related outlays and operating expenses.

- On June 30, 2020, the DIF investment portfolio's yield was 1.61 percent, down 37 basis points from its 1.98 percent yield on December 31, 2019. The new Treasury securities purchased during the second quarter of the year had significantly lower yields than the maturing securities' yields.

- In accordance with the approved second quarter 2020 DIF portfolio investment strategy, staff purchased a total of nine conventional Treasury securities. The nine securities had a total par value of $13 billion, a weighted average yield of 0.236 percent, and a weighted average maturity of 1.72 years.

III. **Budget Results** (See pages 10 – 11 for detailed data.)

Approved Budget Modifications

The 2020 Budget Resolution delegated to the Chief Financial Officer (CFO) and selected other officials the authority to make certain modifications to the 2020 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 June, the CFO approved the following mid-year adjustments to 2020 Ongoing Operations budgets:
  - Adjustments to the Salaries and Compensation budgets of several organizations to address projected variances in that expense category, including an increase of $2.1 million in Corporate University (CU) to provide funding for the salaries and benefits of long-term detailees from other organizations, a net increase of $1.5 million in the budgets of various Executive Offices to cover the costs of detailees, and a decrease of $3.8 million in the Legal Division budget to reflect the large number of unfilled vacancies. These adjustments did not change the total corporate budget for Salaries and Compensation.
  - A net increase of $4.6 million for one-time initiatives in the combined budgets of the organizations reporting to the Chief Information Officer (CIOO), bringing the total 2020 budget for one-time initiatives up to $34.6 million. This increase includes additional funding of $2.2 million for two projects, one to improve resolution information tracking and another to automate purchase and assumption settlement processes; $2.6 million for infrastructure support; and various increases and decreases to reflect updated project estimates for previously-approved initiatives.
  - A net increase of $5.8 million for continuing operations expenses in the combined budgets of the CIOO, representing an increase of about 2.5% in the CIOO's non-salaries budget. This included increases in the Outside Services-Personnel category of $5 million for the Division of Information Technology (DIT) and $1 million for the Office of Chief Information Security Officer (OCISO) to address projected higher-than-budgeted full-year operational expenses across multiple functions. These increases were partially offset by decreases in the Equipment and Travel budgets totaling $1.8 million.
  - A net increase of $3.1 million in the DRR budget, including an increase of $3.5 million in the Outside Services-Personnel expense category and a decrease of $427,000 in the Travel expense category. The increase in the Outside Services-Personnel expense category will support enhancements to DRR's policies, procedures and ability to quickly respond to failure activity.
  - A net increase of $160,000 in the Division of Finance budget, including an increase of $260,000 in Outside Services-Personnel and a decrease of $100,000 in Travel. The increased budget will be used to respond to OIG audit recommendations related to crisis readiness and provide additional support for the Model Risk Management Program.
  - A decrease of $795,605 in the Travel budget of Division of Insurance and Research to reflect funds not expected to be used in 2020.
  - Realignments among major expense categories in the budgets of the Division of Administration and the Office of Minority and Women Inclusion, with no net change to the total budgets of each organization.
- The CFO also approved in June a $6.9 million net decrease in the Receivership Funding budget component for the Legal Division. This included decreases of $7.25 million in the Outside Services-Personnel expense category and $65,000 in the Travel expense category to reflect lower projected litigation-related expenses due to pre-trial settlements, bringing professional liability investigations work in-house, and pandemic-related delays. These decreases were partially offset by an increase of $0.4 million in the Salaries and Compensation

budget to cover the unbudgeted salaries of a small number of term employees whose appointments expired during the first half of the year.

Following these second quarter budget modifications, the balances in the Corporate Unassigned contingency reserves were $17,203,552 in the Ongoing Operations budget component and $18,917,515 in the Receivership Funding budget component.

Approved Staffing Modifications

The 2020 Budget Resolution delegated to the CFO the authority to modify approved 2020 staffing authorizations for divisions and offices, as long as those modifications did not increase the total approved 2020 FDIC Operating Budget.

- In April, the CFO approved the realignment of two positions from OCISO to DIT in conjunction with the transfer of operational management responsibility for certain information security functions.

- In April, the CFO approved a decrease of two authorized permanent positions in the Division of Depositor and Consumer Protection (DCP) in conjunction with a field territory restructuring and DCP's annual realignment of field supervisory positions to ensure appropriate field supervisory spans-of-control. In the same month, the CFO approved an increase of two additional examiner positions for large bank supervision, resulting in a net zero impact on total authorized staffing.

- In April, the CFO approved an increase of eight authorized permanent positions in the Division of Risk Management Supervision (RMS), including six additional examiner positions for large bank supervision and two Supervisory Examiner positions in conjunction with RMS's annual realignment of field supervisory positions to ensure appropriate field supervisory spans-of-control.

- In May, the CFO approved an increase of two permanent authorized positions in OCISO to help accelerate its workforce transformation in conjunction with the IT Modernization program.

- In June, the CFO approved an increase of seven permanent authorized positions in DRR, including two positions transferred from the Division of Complex Institution Supervision and Resolution (CISR) and five new positions, in conjunction with the transfer of responsibility for ensuring compliance with Part 360.9 requirements.

Following these changes, authorized staffing totaled 5,770 for the Corporation (comprised of 5,765 permanent and 5 non-permanent positions).

Spending Variances

Significant spending variances by major expense category and division/office are discussed below. Significant spending variances for the quarter ending June 30, 2020, are defined as those that either (1) exceeded the YTD budget for a major expense category or division/office by more than $2 million and represented more than three percent of the major expense category or total division/office budget; or (2) were under the YTD budget for a major expense category or division/office by more than $10 million and represented more than 10 percent of the major expense category or total division/office budget.

Significant Spending Variances by Major Expense Category

<u>Ongoing Operations</u>

There was a significant spending variance through the second quarter in the Travel expense category of the Ongoing Operations budget component. Spending in the Travel expense category was under the YTD budget by $21.5 million, or 55 percent. The variance in the Travel expense category was primarily attributable to FDIC's travel restrictions and mandatory telework in response to the COVID-19 pandemic in the second quarter of 2020, which restricted most business travel including those related to onsite examination, regulatory meetings, and in-person training. The variance primarily reflects underspending by RMS ($13.8 million, or 54 percent of its 2020 YTD budget), DCP ($3.9 million, or 59 percent of its 2020 YTD budget), CU ($1.5 million, or 57 percent of its 2020 YTD budget), and CISR ($1.2 million, or 75 percent of its 2020 YTD budget).

Significant Spending Variances by Division/Office[1]

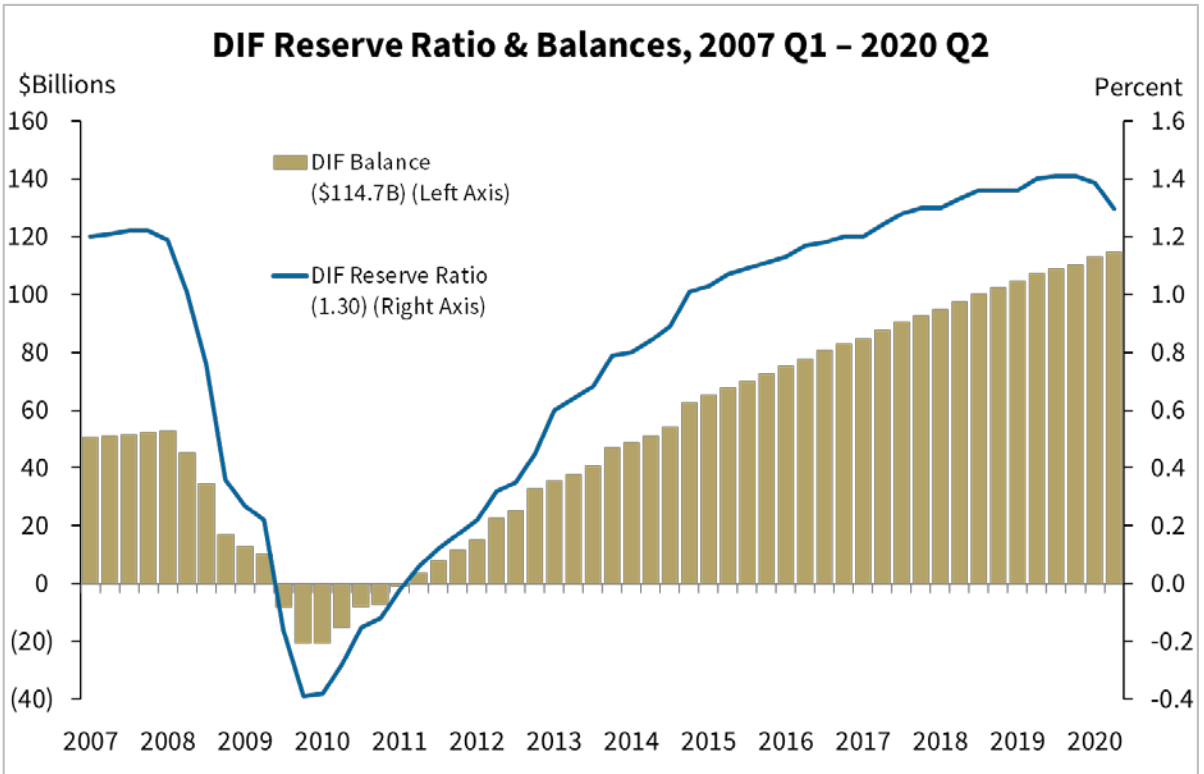
Only one organization had significant spending variances through the second quarter. The Legal Division underspent its YTD budget by $10.9 million or 13.4 percent. The variance was primarily attributable to $1.8 million in underspending in the Salaries and Compensation category in the Ongoing Operations component due to vacancies in budgeted positions and $9.0 million in underspending in the Outside Services – Personnel category in the Receivership Funding component due to settlements, a decision to perform new professional liability investigations with FDIC staff, and delays in pending litigation due to the COVID-19 pandemic.

[1]Information on division/office variances reflects variances in the FDIC Operating Budget and does not include variances related to approved multi-year investment projects.

Fund Financial Results

($ in Millions)

Balance Sheet	Jun-20	Mar-20	Deposit Insurance Fund Quarterly Change	Jun-19	Year-Over-Year Change
Cash and cash equivalents	$ 5,144	$ 9,490	$ (4,346)	$ 8,795	$ (3,651)
Investment in U.S. Treasury securities	105,024	99,733	5,291	94,524	10,500
Assessments receivable	1,632	1,357	275	1,060	572
Interest receivable on investments and other assets, net	1,369	709	660	694	675
Receivables from resolutions, net	1,860	2,456	(596)	3,204	(1,344)
Property and equipment, net	320	326	(6)	320	0
Operating lease right-of-use assets	118	120	(2)	0	118
Total Assets	$ 115,467	$ 114,191	$ 1,276	$ 108,597	$ 6,870
Accounts payable and other liabilities	221	215	6	241	(20)
Operating lease liabilities	127	127	0	0	127
Liabilities due to resolutions	73	213	(140)	530	(457)
Postretirement benefit liability	289	289	0	236	53
Contingent liability for anticipated failures	74	107	(33)	111	(37)
Contingent liability for guarantee payments and litigation losses	32	34	(2)	33	(1)
Total Liabilities	$ 816	$ 985	$ (169)	$ 1,151	$ (335)
FYI: Unrealized gain (loss) on U.S. Treasury securities, net	1,654	2,037	(383)	500	1,154
FYI: Unrealized postretirement benefit (loss) gain	(61)	(61)	0	(14)	(47)
Fund Balance	$ 114,651	$ 113,206	$ 1,445	$ 107,446	$ 7,205



Source: FDIC.
Note: The reserve ratio is calculated as the ratio of the DIF to insured deposits and is calculated as of quarter-end.

Fund Financial Results - continued

($ in Millions)

Income Statement (year-to-date)	Deposit Insurance Fund				
	Jun-20	Mar-20	Quarterly Change	Jun-19	Year-Over-Year Change
Assessments	$ 3,162	$ 1,372	$ 1,790	$ 2,556	$ 606
Interest on U.S. Treasury securities	961	507	454	1,042	(81)
Other revenue	6	3	3	12	(6)
Total Revenue	$ 4,129	$ 1,882	$ 2,247	$ 3,610	$ 519
Operating expenses	925	460	465	893	32
Provision for insurance losses	(35)	12	(47)	(1,006)	971
Insurance and other expenses	2	1	1	1	1
Total Expenses and Losses	$ 892	$ 473	$ 419	$ (112)	$ 1,004
Net Income	$ 3,237	$ 1,409	$ 1,828	$ 3,722	$ (485)
Unrealized gain (loss) on U.S. Treasury securities, net	1,067	1,450	(383)	1,115	(48)
Unrealized postretirement benefit gain (loss)	0	0	0	0	0
Comprehensive Income	$ 4,304	$ 2,859	$ 1,445	$ 4,837	$ (533)

Selected Financial Data	FSLIC Resolution Fund				
	Jun-20	Mar-20	Quarterly Change	Jun-19	Year-Over-Year Change
Cash and cash equivalents	$ 926	$ 926	$ 0	$ 912	$ 14
Accumulated deficit	(124,563)	(124,563)	0	(124,576)	13
Total resolution equity	907	926	(19)	913	(6)
Total revenue	3	3	0	11	(8)
Operating expenses	0	0	0	0	0
Recovery of tax benefits	0	0	0	0	0
Losses related to thrift resolutions	0	0	0	0	0
Net Income (Loss)	$ 3	$ 3	$ 0	$ 11	$ (8)

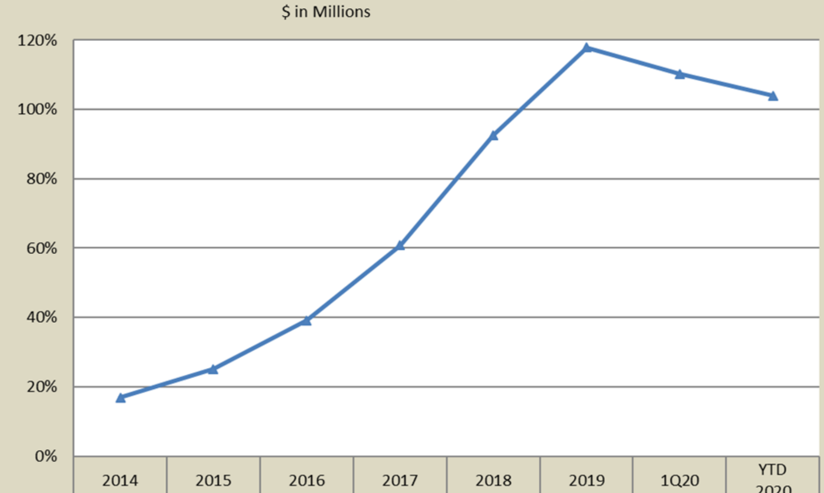
Receivership Selected Statistics June 2020 vs. June 2019

	DIF			FRF			ALL FUNDS		
($ in millions)	Jun-20	Jun-19	*Change*	Jun-20	Jun-19	*Change*	Jun-20	Jun-19	*Change*
Total Receiverships	244	263	(19)	0	0	0	244	263	(19)
Assets in Liquidation	$ 380	$ 1,039	$ (659)	$ 1	$ 2	$ (1)	$ 381	$ 1,041	$ (660)
YTD Collections	$ 285	$ 555	$ (270)	$ 1	$ 0	$ 1	$ 286	$ 555	$ (269)
YTD Dividend/Other Pmts -	$ 797	$ 859	$ (62)	$ 0	$ 0	$ 0	$ 797	$ 859	$ (62)

DIF Coverage Ratio

Interest on U.S. Treasury (UST) Securities as a percentage of Operating Expenses

$ in Millions



	2014	2015	2016	2017	2018	2019	1Q20	YTD 2020
Coverage Ratio	17%	25%	39%	61%	93%	118%	110%	104%
Interest on UST securities	282	423	671	1,057	1,633	2,117	507	961
Operating Expenses	1,664	1,687	1,715	1,739	1,765	1,796	460	925

The coverage ratio peaked in 2019 at 118%, after years of seeing a steady rise. Since 2014, the DIF balance has grown by over 80% and therefore has generated an increasing amount of interest income. Secondarily, Treasury yields remained below their historical averages, but did gradually rise from 2015 to 2018. However in 2019, yields dropped slowly, then in March 2020, the entire yield curve suffered extraordinary downward pressure as the FOMC slashed the overnight Fed Funds rate to nearly zero to support the economy.

While the investment portfolio balance should continue to grow at a slower pace, the maturing securities purchased at past higher yields can only be reinvested in significantly lower yields. Interest revenue in the coming quarters is expected to decrease as the Federal Funds Target Rate sits between 0bps and 25bps, and the 5-year tenor is yielding approximately 30.6bps.

Deposit Insurance Fund Portfolio Summary
(Dollar Values in Millions)

	6/30/20	12/31/19	Change
Par Value	$107,107	$104,429	$2,678
Amortized Cost	$108,501	$105,464	$3,038
Total Market Value (including accrued interest)	$111,474	$107,024	$4,450
Primary Reserve [1]	$111,474	$107,024	$4,450
Primary Reserve % of Total Portfolio	100.0%	100.0%	0.0%
Yield-to-Maturity	1.61%	1.98%	-0.37%
Weighted Average Maturity (in years)	1.03	1.18	-0.15
Effective Duration (in years)			
Total Portfolio	1.00	1.15	-0.15
Available-for-Sale Securities [2]	1.05	1.22	-0.17

[1] Primary Reserve is the total market value (including accrued interest) of overnight investments, all available-for-sale securities (AFS), and held-to-maturity securities maturing within three months.

[2] Excludes any overnight investments.

Summary of Other Corporate Investment Portfolios
(Dollar Values in Millions)

	6/30/20	12/31/19	Change
FRF-FSLIC			
Book Value [3]	$881	$878	$3
Yield-to-Maturity	0.11%	1.51%	-1.40%
Weighted Average Maturity	overnight	overnight	no change

[3] 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)

	6/30/20	12/31/19	Change
Book Value [4]	$1,974	$2,128	($154)
Effective Annual Yield	0.40%	1.76%	-1.35%
Weighted Average Maturity (in days)	15	32	(17)

[4] 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 2020
	Invest up to $18 billion (par value) in AFS securities with maturities between September 30, 2020 and December 31, 2024.
	Strategy Changes for the 3rd Quarter 2020
	Invest up to $32 billion (par value) in AFS securities with maturities between December 31, 2020 and July 1, 2025.
NATIONAL LIQUIDATION FUND	
	Strategy for the 2nd Quarter 2020
	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 2020
	Maintain an overnight deposit target floor balance within a range of $50 million to $200 million.

Executive Summary of 2020 Budget and Expenditures by Budget Component and Major Expense Category Through June 30, 2020 (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	$1,272,831	$643,699	$625,712	97%	($17,987)
Outside Services - Personnel	311,371	145,662	139,527	96%	(6,135)
Travel	78,194	39,287	17,806	45%	(21,481)
Buildings	99,034	48,826	49,799	102%	973
Equipment	106,650	58,140	48,303	83%	(9,837)
Outside Services - Other	15,917	8,309	8,160	98%	(149)
Other Expenses	15,443	8,185	4,822	59%	(3,363)
Total Ongoing Operations	**$1,899,440**	**$952,108**	**$894,129**	**94%**	**($57,979)**
Receivership Funding					
Salaries & Compensation	$765	$236	$850	360%	$614
Outside Services - Personnel	69,300	27,622	17,852	65%	(9,770)
Travel	1,030	535	389	73%	(146)
Buildings	2,227	1,112	1,063	96%	(49)
Equipment	8	3	(29)	-967%	(32)
Outside Services - Other	571	284	40	14%	(244)
Other Expenses	1,099	548	628	115%	80
Total Receivership Funding	**$75,000**	**$30,340**	**$20,793**	**69%**	**($9,547)**
Office of the Inspector General					
Salaries & Compensation	$37,033	$18,516	$17,280	93%	($1,236)
Outside Services - Personnel	2,400	1,200	1,041	87%	(159)
Travel	1,035	518	423	82%	(95)
Buildings	0	0	0		0
Equipment	1,888	944	658	70%	(286)
Outside Services - Other	0	0	4		4
Other Expenses	626	313	219	70%	(94)
Total Office of the Inspector General	**$42,982**	**$21,491**	**$19,625**	**91%**	**($1,866)**
Total FDIC Operating Budget	**$2,017,422**	**$1,003,939**	**$934,547**	**93%**	**($69,392)**

Executive Summary of 2020 Budget and Expenditures by Division/Office Through June 30, 2020 (Dollars in Thousands)					
Division/Office	Annual Budget	YTD Budget	YTD Expenditures	% of YTD Budget Used	YTD Variance
FDIC Operating Budget					
Risk Management Supervision	$546,948	$278,190	$260,416	94%	($17,774)
Information Technology	320,824	164,606	157,889	96%	(6,717)
Administration	273,690	134,407	130,440	97%	(3,967)
Depositor & Consumer Protection	185,003	94,154	85,425	91%	(8,729)
Legal	158,929	81,162	70,292	87%	(10,870)
Resolutions & Receiverships	147,249	73,621	70,237	95%	(3,384)
Complex Institution Supervision & Resolution	85,608	42,853	39,795	93%	(3,058)
Insurance & Research	59,499	29,994	28,757	96%	(1,237)
Inspector General	42,982	21,491	19,625	91%	(1,866)
Finance	42,939	21,326	19,774	93%	(1,552)
Chief Information Security Officer	40,120	22,855	19,556	86%	(3,299)
Executive Support [1]	29,433	14,481	10,635	73%	(3,846)
Corporate University - Corporate	23,604	10,616	10,172	96%	(444)
Executive Offices [2]	13,079	6,143	5,952	97%	(191)
Corporate University - CEP	11,394	8,040	5,582	69%	(2,458)
Corporate Unassigned	36,121	0	0		0
Total FDIC Operating Budget	**$2,017,422**	**$1,003,939**	**$934,547**	**93%**	**($69,392)**

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

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, Deputy to the Chairman for Policy, and Chief Information Officer.