



Federal Deposit Insurance Corporation

550 17th Street, N.W., Washington, D.C. 20429-9990

Deputy to the Chairman and CFO

November 11, 2019

MEMORANDUM TO: The Board of Directors

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

SUBJECT: Third Quarter 2019 CFO Report to the Board

The attached report highlights the FDIC's financial activities and results for the quarter ended September 30, 2019.

Executive Summary

- During the third quarter of 2019, the Deposit Insurance Fund (DIF) balance rose to \$108.9 billion, up \$1.5 billion from the June 30, 2019, balance of \$107.4 billion. The quarterly increase was primarily due to \$1.1 billion in assessment revenue, \$630 million in interest and unrealized gains on U.S. Treasury securities, and a \$192 million increase in negative provision for insurance losses, partially offset by \$443 million in operating expenses.
- The reserve ratio, which is the ratio of the DIF balance to estimated insured deposits, was 1.41 percent for the third quarter of 2019, compared to the second quarter 2019 reserve ratio of 1.40 percent.
- Through September 30, 2019, overall FDIC Operating Budget expenditures were below the year-to-date budget by nine percent (\$136 million). This variance was primarily the result of underspending in the Salaries and Compensation, Outside Services – Personnel, and Equipment expense categories in the Ongoing Operations budget component and the Outside Services – Personnel expense category in the Receivership Funding budget component.

I. Financial Results (See pages 7 – 8 for detailed data and charts.)

Deposit Insurance Fund

- For the nine months ending September 30, 2019, the DIF's comprehensive income totaled \$6.3 billion, compared to comprehensive income of \$7.5 billion for the same period last year. This decline was primarily the result of a \$4.5 billion decrease in assessment revenue, partially offset by an \$871 million increase in negative provision for insurance losses and a \$2.5 billion increase in interest and fair value adjustments on U.S. Treasury securities.
- Assessment revenue was \$3.7 billion for the first three quarters of 2019, compared to \$8.2 billion for the same period last year. The \$4.5 billion year-over-year decrease was primarily due to the cessation of the surcharge assessment on large institutions effective October 1, 2018, as a result of the reserve ratio exceeding the required minimum of 1.35 percent as of September 30, 2018.
- The provision for insurance losses was a negative \$1.2 billion for the first nine months of 2019, compared to a negative \$327 million for the same period last year. The negative provision for 2019 primarily resulted from a \$574 million reduction of receiverships' shared-loss liability estimates, \$443 million in unanticipated recoveries from litigation settlements and professional liability claims by receiverships, and a \$103 million reduction in future receivership expense estimates.

Assessments

- During September, the DIF recognized \$1.1 billion of assessment revenue for the estimate of third quarter 2019 insurance coverage. Gross assessment revenue of \$1.35 billion was reduced by \$237 million for expected small bank assessment credit usage. Additionally, the DIF recognized a \$3.8 million reduction in assessment revenue for the estimated versus actual 2nd quarter 2019 assessment collection.
- On September 30, 2019, the FDIC collected \$1.1 billion in DIF assessments for second quarter 2019 insurance coverage.

II. Investment Results (See pages 9 – 10 for detailed data and charts.)

DIF Investment Portfolio

- As of September 30, 2019, the total liquidity (also total market value) of the DIF investment portfolio stood at \$105.7 billion, up \$6.7 billion from its December 31, 2018, balance of \$99.0 billion. During the first three quarters of the year, interest revenue, receivership dividends, and deposit insurance assessment collections far exceeded resolution-related outlays and operating expenses.
- On September 30, 2019, the DIF investment portfolio's yield was 1.80 percent, down 25 basis points from its 2.05 percent yield on December 31, 2018.
- In accordance with the approved third quarter 2019 DIF portfolio investment strategy, staff purchased a total of 17 short-maturity conventional Treasury securities, all designated as available-for-sale. The 17 securities had a total par value of \$16.5 billion, a weighted average yield of 1.85 percent, and a weighted average maturity of 1.40 years.

III. **Budget Results** (See pages 11 – 12 for detailed data.)

Approved Budget Modifications

The 2019 Budget Resolution delegated to the Chief Financial Officer (CFO) and selected other officials the authority to make certain modifications to the 2019 FDIC Operating Budget. The following budget reallocations were approved during the third quarter in accordance with the authority delegated by the Board of Directors.

- In July, the CFO approved mid-year budget adjustments in the Ongoing Operations budget component that reallocated budget authority among several divisions and the Corporate Unassigned contingency reserve as well as among expense categories within division budgets. Budgets were reduced for three organizations and increased for four others.
 - The budget of the Office of the Chief Information Security Officer was decreased by a net of about \$278,000, with a reduction of about \$826,000 in the Outside Services – Personnel expense category related to delays in fully staffing several contracts and an increase of about \$548,000 in the Equipment expense category for additional expenses related to the Backup Data Center (BDC).
 - The budget of the Division of Insurance and Research was decreased in the Outside Services – Personnel expense category by \$200,000 due to lower-than-anticipated contract expenses for the visiting scholars program in the Center for Financial Research.
 - The budget of the Office of CIO Management Services (OCMS) was decreased in the Outside Services – Personnel expense category by about \$95,000 after reassessing its funding needs for the BDC and the Project Management Tools initiative.
 - The budget of the Legal Division was increased in the Outside Services – Personnel expense category by \$4.5 million due to a substantial increase in expenses related to ongoing litigation with a complex financial institution. Factors driving the increase include the extension of defendant litigation deadlines, fact and expert discovery, and FOIA-related issues.
 - The budget of the Division of Information Technology (DIT) was increased by \$4.4 million, primarily in the Equipment, Outside Services – Personnel, and Buildings expense categories to provide additional funding for the BDC and in the Equipment expense category to provide additional funding for laptop and iPhone replacements for examiners and others.
 - The CIO Council budget was increased by about \$920,000 to address new funding requirements. The increase included \$730,000 in the Equipment expense category for software licenses and about \$190,000 in the Outside Services – Personnel expense category for several development projects.
 - The budget for the Division of Risk Management Supervision (RMS) was increased in the Outside Services – Personnel expense category by \$550,000 to improve the analysis and sharing of cybersecurity threat information with financial institutions.
- In August, the CFO approved the establishment of an initial budget for the new Division of Complex Institution Supervision and Resolution (CISR) through budget reallocations totaling \$39.9 million across several expense categories from the budgets of the Office of Complex Financial Institutions (OCFI), RMS, and the Division of Resolutions and Receiverships (DRR). This reallocation also added \$2.5 million to the Corporate Unassigned contingency reserve.
- In August, the CFO approved budget increases or decreases in the Salaries and Compensation expense category for most divisions and offices. This realignment was based on an analysis by

the Division of Finance of 2019 Salaries and Compensation budgets using actual salaries and fringe benefits spending through July 31, 2019, and projections of spending required for the rest of 2019.

- In August, the CFO approved the reallocation of \$1.2 million in the Salaries and Compensation expense category from the Corporate Unassigned contingency reserve to OCFI and CISR to correct the timing of budget adjustments that were made to create CISR.

There were no changes to the Receivership Funding budgets for any organization.

Following these third quarter budget modifications, the balances in the Corporate Unassigned contingency reserves were \$10,349,114 in the Ongoing Operations budget component and \$19,313,320 in the Receivership Funding budget component.

Approved Staffing Modifications

The 2019 Budget Resolution delegated to the CFO the authority to modify approved 2019 staffing authorizations for divisions and offices, as long as those modifications did not increase the total approved 2019 FDIC Operating Budget.

- In July, the CFO approved an increase of nine authorized permanent positions in OCMS. These positions addressed needs for increased staffing for contract management, Information Security Managers, and IT risk governance and policy.
- In August, the CFO approved the establishment of an initial 2019 staffing authorization for CISR through the realignment of 275 authorized permanent positions from OCFI (all 83 positions), DRR (31 positions), and RMS (161 positions). This realignment was made effective as of July 21, 2019.
- In September, the CFO approved the transfer of six authorized permanent positions to staff the new Administrative Services Group reporting directly to the Chief Operating Officer. These positions were transferred from the Division of Administration (DOA), the Office of Minority and Women Inclusion, and Corporate University. These positions will be reported for administrative purposes as part of the DOA staffing authorization, similar to reporting for the Internal Ombudsman.
- In September, the CFO approved an increase of four permanent authorized positions in OCMS to improve acquisition planning and strategy for the Chief Information Officer organizations.

Spending Variances

Significant spending variances by major expense category and division/office are discussed below. Significant spending variances for the nine months ending September 30, 2019, are defined as those that either (1) exceed the YTD budget by more than \$1 million and represent more than two 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 \$7 million and represents more than seven percent of the major expense category or total division/office budget.

Significant Spending Variances by Major Expense Category

Ongoing Operations

There was a significant spending variance through the third quarter in one major expense category of the Ongoing Operations budget component.

Spending in the Equipment expense category was under the YTD budget by \$15.6 million, or 18 percent. This variance was attributable primarily to underspending by DIT of \$12.5 million, or 23 percent, of its YTD budget for Equipment. This included approximately \$10 million of underspending for hardware that was anticipated to be delivered by the end of September but was delayed. In addition, DOA underspent its YTD Equipment budget by about \$1.7 million due primarily to delays in the completion of nationwide electronic security system upgrades and network migration.

Receivership Funding

The Receivership Funding component of the 2019 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 and other expenses required to ensure readiness without regard to whether failures occur.

There was a significant spending variance through the third quarter in one major expense category of the Receivership Funding budget component. Outside Services – Personnel expenses through the end of the third quarter were \$52.6 million, or 51 percent, less than budgeted. This variance primarily reflected underspending by DRR (\$29.4 million, or 51 percent of its YTD budget) and the Legal Division (\$22.6 million, or 53 percent of its YTD budget). DRR underspending was attributable to the absence of insured institution failures for which funds had been budgeted. The variance for the Legal Division was attributable to lower-than-projected spending for outside counsel because cases were settled before going to trial; an increase in work performed by FDIC attorneys rather than outside counsel; and delays in the payment of almost \$10 million of invoices that are still pending review or have been rejected and must be resubmitted.

Office of Inspector General

There were no significant spending variances during the third quarter in any major expense category of the Office of Inspector General budget component.

Significant Spending Variances by Division/Office¹

Three organizations had significant spending variances through the end of the third quarter.

- DRR spent \$38.6 million, or 25 percent, less than budgeted, due to the absence of expenses for insured institution failures. The underspending was mostly in the Outside Services – Personnel expense category of the Receivership Funding budget component, but less-than-budgeted

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

spending in the Travel, Buildings, and Other expense categories of the Receivership Funding budget component also contributed to the variance.

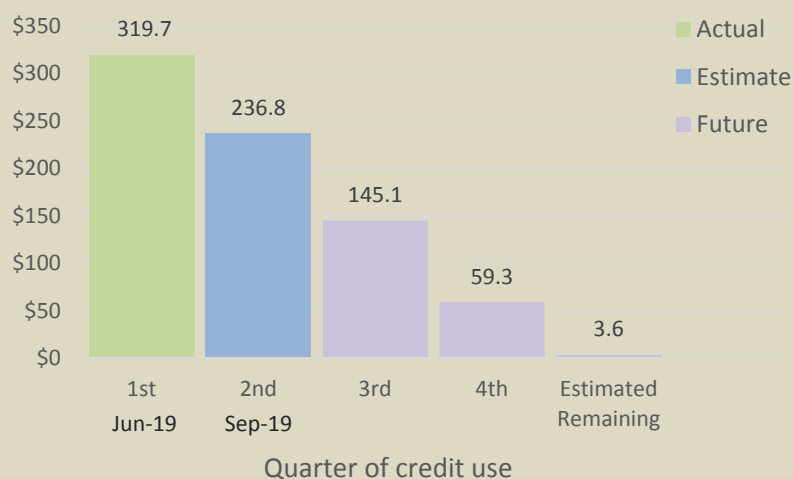
- The Legal Division spent \$29.6 million, or 20 percent, less than budgeted, mostly in the Outside Services – Personnel expense category of the Receivership Funding budget component due to lower-than-budgeted outside counsel expenses.
- DIT spent \$17.0 million, or 9 percent, less than budgeted due primarily to underspending in the Equipment expense category of its Ongoing Operations budget.

Fund Financial Results

(\$ in Millions)

Balance Sheet	Deposit Insurance Fund				
	Quarterly			Year-Over-Year	
	Sep-19	Jun-19	Change	Sep-18	Change
Cash and cash equivalents	\$ 4,268	\$ 8,795	\$ (4,527)	\$ 2,790	\$ 1,478
Investment in U.S. Treasury securities	100,873	94,524	6,349	92,211	8,662
Assessments receivable	1,115	1,060	55	2,702	(1,587)
Interest receivable on investments and other assets, net	582	694	(112)	539	43
Receivables from resolutions, net	2,801	3,204	(403)	2,897	(96)
Property and equipment, net	317	320	(3)	322	(5)
Total Assets	\$ 109,956	\$ 108,597	\$ 1,359	\$ 101,461	\$ 8,495
Accounts payable and other liabilities	212	241	(29)	204	8
Liabilities due to resolutions	427	530	(103)	654	(227)
Postretirement benefit liability	236	236	-	259	(23)
Contingent liability for anticipated failures	108	111	(3)	106	2
Contingent liability for guarantee payments and litigation losses	33	33	-	34	(1)
Total Liabilities	\$ 1,016	\$ 1,151	\$ (135)	\$ 1,257	\$ (241)
FYI: Unrealized gain (loss) on U.S. Treasury securities, net	586	500	86	(1,371)	1,957
FYI: Unrealized postretirement benefit (loss) gain	(14)	(14)	-	(46)	32
Fund Balance	\$ 108,940	\$ 107,446	\$ 1,494	\$ 100,204	\$ 8,736

Small Bank Assessment Credit Usage
(as of September 30, 2019; dollars in millions)



Pursuant to FDIC rulemaking in response to the Dodd-Frank Act increase of the minimum reserve ratio to 1.35 percent, small banks were awarded credits for the portion of their assessments that contributed to growth in the reserve ratio from 1.15 percent to 1.35 percent. The total amount of available credits is \$765 million. As of June 30, 2019, the reserve ratio exceeded 1.38 percent by reaching 1.40 percent, and small bank credits in the amount of \$320 million were applied. In addition, the 3rd quarter assessment revenue estimate was reduced by \$237 million for expected credit usage. The chart presents the actual and estimated credit usage by quarter; 73% of the credits are expected to be used in just two quarters of offset.

Fund Financial Results - continued

(\$ in Millions)

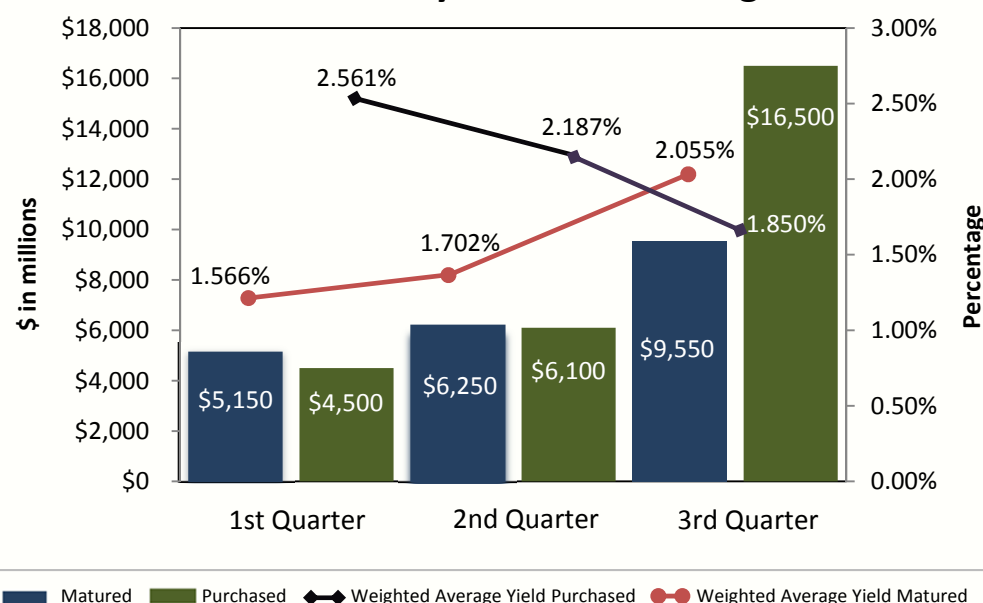
Income Statement (year-to-date)		Deposit Insurance Fund				
		Sep-19	Jun-19	Quarterly Change	Sep-18	Year-Over-Year Change
Assessments		\$ 3,667	\$ 2,556	\$ 1,111	\$ 8,176	\$ (4,509)
Interest on U.S. Treasury securities		1,586	1,042	544	1,152	434
Other revenue		17	12	5	8	9
Total Revenue		\$ 5,270	\$ 3,610	\$ 1,660	\$ 9,336	\$ (4,066)
Operating expenses		1,336	893	443	1,312	24
Provision for insurance losses		(1,198)	(1,006)	(192)	(327)	(871)
Insurance and other expenses		2	1	1	2	0
Total Expenses and Losses		\$ 140	\$ (112)	\$ 252	\$ 987	\$ (847)
Net Income		5,130	3,722	1,408	8,349	(3,219)
Unrealized gain (loss) on U.S. Treasury securities, net		1,201	1,115	86	(892)	2,093
Unrealized postretirement benefit gain (loss)		0	0	0	0	0
Comprehensive Income		\$ 6,331	\$ 4,837	\$ 1,494	\$ 7,457	\$ (1,126)

Selected Financial Data	FSLIC Resolution Fund				
	Sep-19	Jun-19	Quarterly Change	Sep-18	Year-Over-Year Change
Cash and cash equivalents	\$ 918	\$ 912	\$ 6	\$ 896	\$ 22
Accumulated deficit	(124,570)	(124,576)	6	(124,593)	23
Total resolution equity	919	913	6	897	22
Total revenue	17	11	6	11	6
Operating expenses	0	0	0	0	0
Losses related to thrift resolutions	0	0	0	0	0
Net Income (Loss)	\$ 17	11	6	\$ 11	\$ 6

Receivership Selected Statistics September 2019 vs. September 2018

	DIF			FRF			ALL FUNDS		
(\$ in millions)	Sep-19	Sep-18	Change	Sep-19	Sep-18	Change	Sep-19	Sep-18	Change
Total Receiverships	252	282	(30)	0	0	0	252	282	(30)
Assets in Liquidation	\$ 575	\$ 1,245	\$ (670)	\$ 2	\$ 2	\$ 0	\$ 577	\$ 1,247	\$ (670)
YTD Collections	\$ 1,113	\$ 1,333	\$ (220)	\$ 2	\$ 0	\$ 2	\$ 1,115	\$ 1,333	\$ (218)
YTD Dividend/Other Pmts -	\$ 1,374	\$ 3,185	\$ (1,811)	\$ 0	\$ 0	\$ 0	\$ 1,374	\$ 3,185	\$ (1,811)

U.S. Treasury Securities during 2019



For the first three quarters of 2019, the DIF portfolio has been impacted first by an inverted yield curve and then by two Federal Reserve rate cuts. As a result, the weighted average yield for purchases has gradually declined over each quarter. At the same time, the weighted average yield of maturities has risen over the year as higher-yielding securities have rolled off the portfolio. As a result, the overall yield of the DIF portfolio has fallen from 2.05% on December 30, 2018 to 1.80% on September 30. During 2019, 29 securities with a total par value of \$27.1 billion were purchased with a weighted average yield of 2.04%. At the same time, 41 securities with a par value of \$21.0 billion and weighted average yield of 1.83% have matured.

Deposit Insurance Fund Portfolio Summary (Dollar Values in Millions)

	9/30/19	12/31/18	Change
Par Value	\$104,015	\$99,339	\$4,676
Amortized Cost	\$104,552	\$99,063	\$5,489
Total Market Value (including accrued interest)	\$105,676	\$98,954	\$6,722
Primary Reserve ¹	\$105,676	\$98,954	\$6,722
Primary Reserve % of Total Portfolio	100.0%	100.0%	0.0%
Yield-to-Maturity ²	1.80%	2.05%	-0.25%
Weighted Average Maturity (in years)	1.31	1.75	-0.44
Effective Duration (in years)			
Total Portfolio	1.27	1.69	-0.42
Available-for-Sale Securities	1.33	1.79	-0.46
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, and held-to-maturity securities maturing within three months.

² The Yield-to-Maturity includes the potential yields of any 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)

	9/30/19	12/31/18	Change
<u>FRF-FSLIC</u>			
Book Value ⁴	\$872	\$857	\$15
Yield-to-Maturity	1.90%	2.42%	-0.52%
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)

	9/30/19	12/31/18	Change
Book Value ⁵	\$2,635	\$2,988	(\$353)
Effective Annual Yield	2.13%	2.46%	-0.33%
Weighted Average Maturity (in days)	36	51	(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 Changes for the 3rd Quarter 2019
	Invest up to \$22 billion (par value) in AFS securities with maturities between December 31, 2019 and December 31, 2023. Purchase no more than \$2 billion (adjusted par value) of TIPS. No "soft target" minimum investment for newly purchased Treasury securities in the 3- to 5-year maturity sector.
	Strategy Changes for the 4th Quarter 2019
	Invest up to \$19 billion (par value) in AFS securities with maturities between March 31, 2020 and December 31, 2024.
NATIONAL LIQUIDATION FUND	
	Strategy Changes for the 3rd Quarter 2019
	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 4th Quarter 2019
	No strategy changes for the fourth quarter of 2019.

Executive Summary of 2019 Budget and Expenditures
by Budget Component and Major Expense Category
Through September 30, 2019
(Dollars in Thousands)

Major Expense Category	Annual Budget	YTD Budget	YTD Expenditures	% of YTD Budget Used	YTD Variance
FDIC Operating Budget					
<i>Ongoing Operations</i>					
Salaries & Compensation	\$1,232,037	\$925,803	\$889,100	96%	(\$36,703)
Outside Services - Personnel	258,396	191,311	180,117	94%	(11,194)
Travel	85,236	63,584	59,404	93%	(4,180)
Buildings	106,187	79,103	76,624	97%	(2,479)
Equipment	114,399	85,694	70,123	82%	(15,571)
Outside Services - Other	16,091	12,250	11,710	96%	(540)
Other Expenses	13,118	9,950	8,442	85%	(1,508)
Total Ongoing Operations	\$1,825,464	\$1,367,695	\$1,295,520	95%	(72,175)
<i>Receivership Funding</i>					
Salaries & Compensation	\$3,761	\$3,176	\$2,097	66%	(\$1,079)
Outside Services - Personnel	156,753	102,974	50,349	49%	(52,625)
Travel	3,196	2,395	894	37%	(1,501)
Buildings	5,488	4,115	1,613	39%	(2,502)
Equipment	1,160	869	628	72%	(241)
Outside Services - Other	1,023	766	544	71%	(222)
Other Expenses	3,619	2,713	731	27%	(1,982)
Total Receivership Funding	\$175,000	\$117,008	\$56,856	49%	(\$60,152)
<i>Office of Inspector General</i>					
Salaries & Compensation	\$37,013	\$27,759	\$23,890	86%	(\$3,869)
Outside Services - Personnel	1,595	1,196	1,918	160%	722
Travel	1,218	914	1,282	140%	368
Buildings	0	0	0		0
Equipment	2,686	2,015	850	42%	(1,165)
Outside Services - Other	0	0	0		0
Other Expenses	470	353	367	104%	14
Total Office of Inspector General	\$42,982	\$32,237	\$28,307	88%	(\$3,930)
Total FDIC Operating Budget	\$2,043,446	\$1,516,940	\$1,380,683	91%	(\$136,257)

Executive Summary of 2019 Budget and Expenditures
by Division/Office
Through September 30, 2019
(Dollars in Thousands)

Division/Office	Annual Budget	YTD Budget	YTD Expenditures	% of YTD Budget Used	YTD Variance
FDIC Operating Budget					
Risk Management Supervision	\$551,291	\$424,015	\$410,057	97%	(\$13,958)
Administration ³	267,323	200,818	192,494	96%	(8,324)
Information Technology	240,504	181,027	164,034	91%	(16,993)
Resolutions & Receiverships	198,959	152,166	113,590	75%	(38,576)
Legal	191,093	144,913	115,314	80%	(29,599)
Depositor & Consumer Protection	179,507	135,782	130,188	96%	(5,594)
Insurance & Research	55,527	41,837	40,115	96%	(1,722)
CIO Council	51,890	39,227	39,131	100%	(96)
Chief Information Security Officer	48,096	35,483	30,884	87%	(4,599)
Inspector General	42,982	32,237	28,307	88%	(3,930)
Finance	40,740	31,379	28,853	92%	(2,526)
Complex Institution Supervision & Resolution	40,581	16,687	14,452	87%	(2,235)
Executive Support ¹	33,729	25,268	21,585	85%	(3,683)
Corporate University - Corporate	26,349	19,173	18,275	95%	(898)
Corporate University - CEP	20,939	15,361	13,502	88%	(1,859)
Executive Offices ²	13,548	10,938	9,691	89%	(1,247)
Complex Financial Institutions	10,726	10,629	10,211	96%	(418)
Corporate Unassigned	29,662	0	0		0
Total FDIC Operating Budget	\$2,043,446	\$1,516,940	\$1,380,683	91%	(\$136,257)

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

3) Budget and expenses for the Internal Ombudsman and the COO's Administrative Services Group are reported for administrative purposes with DOA.