FDIC

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

September 1, 2016

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 2016 CFO Report to the Board

The attached report highlights the Corporation's financial activities and results for the quarter ended June 30, 2016.

Executive Summary

- During the second quarter of 2016, the Deposit Insurance Fund (DIF) balance increased by $2.8 billion, from $75.1 billion to $77.9 billion. This quarterly increase was primarily due to $2.3 billion of assessment revenue, a $110 million unrealized gain on U.S. Treasury investments, $164 million of interest on U.S. Treasury obligations, and a $627 million decrease in provision for insurance losses, partially offset by $441 million in operating expenses.

- The DIF's reserve ratio, which is the DIF balance as a percent of estimated insured deposits, increased to 1.17 percent as of June 30 from 1.13 percent at the end of March. As a result, significant changes to assessments will occur now that the reserve ratio exceeds 1.15 percent. Regular risk-based assessment premium rates will decline, and a revised method for calculating risk-based assessment rates for banks with less than $10 billion in total assets will apply. In addition, the Dodd-Frank Act raises the minimum reserve ratio from 1.15 to 1.35 percent, requires that the reserve ratio reach 1.35 percent by September 30, 2020, and mandates that banks with total assets of $10 billion or more bear the cost of this increase. The FDIC will meet this requirement by imposing quarterly surcharges on large banks beginning third quarter 2016.

- During the second quarter of 2016, the FDIC was named receiver for two failed institutions. The combined assets at inception for these institutions totaled $116 million with an estimated loss of $18 million. The corporate cash outlay during the second quarter for these failures was approximately $31 million.

- Through June 30, 2016, overall FDIC Operating Budget expenditures were below budget by 8 percent ($81 million). Spending in the Ongoing Operations component was $34 million, or 4 percent, under budget, largely due to underspending for equipment, salaries and compensation, and contractual services. Spending in the Receivership Funding component was $47 million, or 25 percent, under budget, primarily due to lower-than-budgeted spending for contractual services related to failed financial institutions.

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

Deposit Insurance Fund

- For the six months ending June 30, 2016, the DIF's comprehensive income totaled $5.3 billion compared to comprehensive income of $4.8 billion for the same period last year. This $501 million increase was mostly due to a $139 million increase in assessment revenue, a $138 million increase in interest on U.S. Treasury obligations, and a $325 million increase in the unrealized gain on U.S. Treasury investments.

- The provision for insurance losses was a negative $670 million for the first half of 2016. The negative provision primarily resulted from a $718 million decrease in the estimated losses for institutions that failed in current and prior years, partially offset by a $71 million increase in the estimated losses for future failures.

Assessments

- During June, the DIF recognized a total of $2.328 billion in assessment revenue. Of this amount, $2.254 billion represented the estimate for second quarter 2016 insurance coverage. Additionally, the DIF recognized an adjustment of $75 million that increased assessment revenue. This adjustment consisted of a $77 million increase from prior period amendments (mainly due to risk rating changes) and a $2 million decrease to the estimate for first quarter 2016 insurance coverage recorded at March 31, 2016. The latter adjustment was primarily due to lower than estimated assessment rates.

- On June 30, 2016, the FDIC collected $2.3 billion in DIF assessments for first quarter 2016 insurance coverage.

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

DIF Investment Portfolio

- On June 30, 2016, the total liquidity (also total market value) of the DIF investment portfolio stood at $70.5 billion, up $6.7 billion from its December 31, 2015, balance of $63.7 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, 2016, the DIF investment portfolio's yield was 0.94 percent, unchanged from its December 31, 2015, yield. Although the new Treasury securities purchased during the first half of the year generally had higher yields than the maturing securities' yields, the portfolio had a larger balance of low yielding overnight investments at the end of the second quarter, thus temporarily bringing down the overall portfolio yield.

- In accordance with the approved second quarter 2016 DIF portfolio investment strategy, staff purchased a total of 17 short- to intermediate-maturity conventional Treasury securities, all designated as available-for-sale. The 17 securities purchased during the second quarter had a total par value of $7.8 billion, a weighted average yield of 0.71 percent, and a weighted average maturity of 1.25 years.

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

Approved Budget Modifications

The 2016 Budget Resolution delegated to the Chief Financial Officer (CFO) and selected other officials the authority to make certain modifications to the 2016 FDIC Operating Budget. The following budget reallocations were made during the second quarter in accordance with the authority delegated by the Board of Directors. None of these modifications changed the total 2016 FDIC Operating Budget as approved by the Board in December 2015.

- In May 2016, the CFO approved modifications to the Salaries and Compensation budgets of divisions and offices within the Ongoing Operations component based on an analysis of year-to-date spending for salaries, bonuses/lump-sum payments, and fringe benefits. That reallocation realigned existing budget authority among most divisions and offices, but resulted in no change to the total budget for either the Ongoing Operations or Receivership Funding budget components. The Corporate Unassigned contingency reserve in the Ongoing Operations budget component was increased by $4 million as a result of those reallocations.

- In June 2016, the CFO approved a reallocation within the Ongoing Operations and Receivership Funding components of the 2016 FDIC Operating Budget following a corporate-wide mid-year reassessment of actual and projected spending for the year. The budgets for all major expense categories and most divisions and offices were adjusted in the Ongoing Operations component.

    - The most significant increase in the Ongoing Operations component was a net increase of over $6 million to the budget of the Division of Administration (DOA) to provide for a number of security-related initiatives. The additional funds included increases of nearly $4 million for the completion of a nationwide upgrade of the facility access system to comply with Department of Homeland Security requirements; over $3 million for completion of the rollout of the FDIC's enhanced Access Control Program, which includes the introduction of the secure Personal Identification Verification card; nearly $2 million to cover the increased cost of U.S. OPM background investigations of FDIC employees and contractors; and $500,000 for additional security equipment in the Sensitive Compartmented Information Facility that provides secure video teleconference capabilities for the Corporation. DOA realigned $6 million of budgeted funds from other projects to partially offset these additional funding needs.

    - The mid-year budget reallocation reduced the Corporate Unassigned contingency reserve by nearly $6 million in the Ongoing Operations budget. The amounts remaining within the Corporate Unassigned contingency reserves for the Ongoing Operations and the Receivership Funding budget components as of June 30, 2016, were $16,604,545 and $27,636,513, respectively.

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, 2016, are defined as those that either (1) exceed the YTD budget by $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 $3 million and represents more than five 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 in three major expense categories during the second quarter in the Ongoing Operations component of the 2016 FDIC Operating Budget:

- Outside Services-Personnel expenditures were $6 million, or 5 percent, less-than-budgeted. DOA spent $3 million less-than-budgeted, largely due to the elimination of contractor records services support in the regions; lower-than-planned usage of various administrative and human resources contract services; and slower-than-budgeted spending on the Access Control and Electronic Security System projects. Elevated spending for these security-related projects during the second half of the year is expected to fully utilize DOA's current budget surplus in this major expense category as well as the additional funding approved for this purpose during the mid-year budget review. The Division of Resolutions and Receiverships (DRR) spent $1 million less-than-budgeted, primarily due to lower-than-planned spending for advisory services in support of Title II operational readiness in its Complex Financial Institutions Branch. The Division of Consumer Protection spent $1 million less- than-budgeted, primarily due to delays in MoneySmart projects, the Savings or Small Dollar Credit project, and the Household Survey, and due to lower-than-expected spending on the Economicinclusion.gov website maintenance.

- Travel expenditures were approximately $4 million, or 7 percent, less-than-budgeted. This was primarily attributable to the Division of Risk Management Supervision, which spent $3 million less-than-budgeted, primarily due to the improved condition of FDIC-supervised banks, and the exam frequency change for favorably-rated banks having assets less than $1 billion. Both of these factors result in fewer examinations, and less exam-related travel.

- Equipment expenditures were approximately $12 million, or 26 percent, less-than-budgeted. This was primarily attributable to the Division of Information Technology (DIT) which spent $11 million less-than-budgeted because of delays in its processing of hardware and software maintenance contracts and an ongoing evaluation of the possible use of shared services in lieu of acquiring FDIC-owned hardware.

Receivership Funding

The Receivership Funding component of the 2016 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 were significant spending variances in three of the seven major expense categories through the second quarter in the Receivership Funding component of the 2016 FDIC Operating Budget:

- Salaries and Compensation were $6 million, or 17 percent, less-than-budgeted. This variance was attributable to vacancies in budgeted non-permanent positions.

- Outside Services-Personnel expenditures were $34 million, or 26 percent, less-than-budgeted. DRR spent $33 million less-than-budgeted, primarily because there were only three bank failures in the first six months of the year. This resulted in lower-than-budgeted expenses for contracts supporting owned real estate, loan servicing, bank closings, securitizations, loss share agreement oversight, environmental services, and asset valuation.

- Other Expenses were $4 million, or 50 percent, less-than-budgeted. This variance was attributable to the transfer of banking operations and the disposition of failed banks' assets more quickly than expected.

Significant Spending Variances by Division/Office[1]

Three organizations had significant spending variances through the end of the second quarter:

- DRR spent $45 million, or 25 percent, less-than-budgeted, largely due to less-than-budgeted spending for resolution and receivership workload for the reasons described above.

- DIT spent $10 million, or 9 percent, less-than-budgeted. This variance was largely attributable to delays in spending its equipment budget, as explained above. This underspending was somewhat offset by higher-than-budgeted expenses in the Outside Services-Personnel category for ongoing infrastructure management services.

- The Legal Division spent $5 million, or 5 percent, less-than-budgeted. This variance was largely due to underspending of approximately $4 million in the Salaries and Compensation expense category ($3 million in Receivership Funding and $1 million in Ongoing Operations) due to vacancies in budgeted non-permanent positions and slower-than-projected hiring to fill those vacancies.

Other Matters

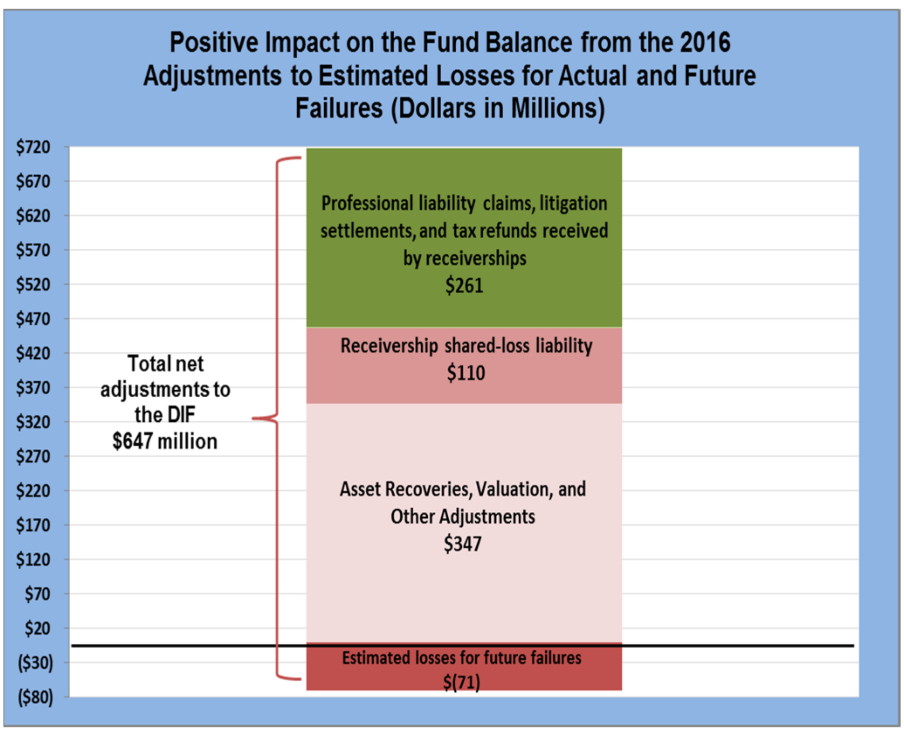
An analysis of 2016 funding requirements for employee pay and benefits was completed in May in accordance with the 2016 Budget Resolution. The analysis determined that those costs had been underestimated during the preparation of the 2016 FDIC Operating Budget by approximately $7 million in the Salaries and Compensation expense category, primarily due to an unbudgeted increase in the FDIC's contribution rate for most employees under the Federal Employees Retirement System that became effective in late 2015. The CFO elected not to exercise his delegated authority to adjust the 2016 FDIC Operating Budget to address this shortfall, since the net projected budget shortfall is not material relative to the total budget, and there is excess budget authority available to cover the shortfall in other accounts within the Salaries and Compensation expense category.

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

Fund Financial Results

($ in Millions)

Balance Sheet	Deposit Insurance Fund				
	Unaudited Jun-16	Unaudited Mar-16	Quarterly Change	Unaudited Jun-15	Year-Over-Year Change
Cash and cash equivalents	$ 5,510	$ 3,519	$ 1,991	$ 2,544	$ 2,966
Investment in U.S. Treasury obligations, net	64,690	63,833	857	55,850	8,840
Assessments receivable, net	2,254	2,238	16	2,177	77
Interest receivable on investments and other assets, net	309	474	(165)	590	(281)
Receivables from resolutions, net	9,477	9,638	(161)	14,862	(5,385)
Property and equipment, net	361	370	(9)	364	(3)
Total Assets	$ 82,601	$ 80,072	$ 2,529	$ 76,387	$ 6,214
Accounts payable and other liabilities	246	217	29	278	(32)
Liabilities due to resolutions	3,775	4,059	(284)	7,593	(3,818)
Postretirement benefit liability	233	233	-	243	(10)
Contingent liability for anticipated failures	437	443	(6)	684	(247)
Contingent liability for litigation losses	0	0	-	0	-
Total Liabilities	$ 4,691	$ 4,952	$ (261)	$ 8,798	$ (4,107)
FYI: Unrealized gain (loss) on U.S. Treasury investments, net	513	403	110	248	265
FYI: Unrealized postretirement benefit (loss) gain	(34)	(34)	-	(58)	24
Fund Balance	$ 77,910	$ 75,120	$ 2,790	$ 67,589	$ 10,321



The estimated recoveries from assets held by receiverships and estimated payments related to shared-loss covered assets are used to derive the loss allowance on the receivables from resolutions.

The $110 million net adjustment to the receiverships' shared-loss liability was due to unanticipated recoveries from shared-loss agreements where the non-single-family loss coverage has expired but the recovery period remains active. Also, numerous receiverships' shared-loss agreements terminated early during the period, which resulted in the lower than anticipated losses on the covered assets.

The $347 million net adjustment consists of a decrease in projected future receivership expenses, higher recovery rates, and better than estimated asset liquidation activity.

Fund Financial Results - continued

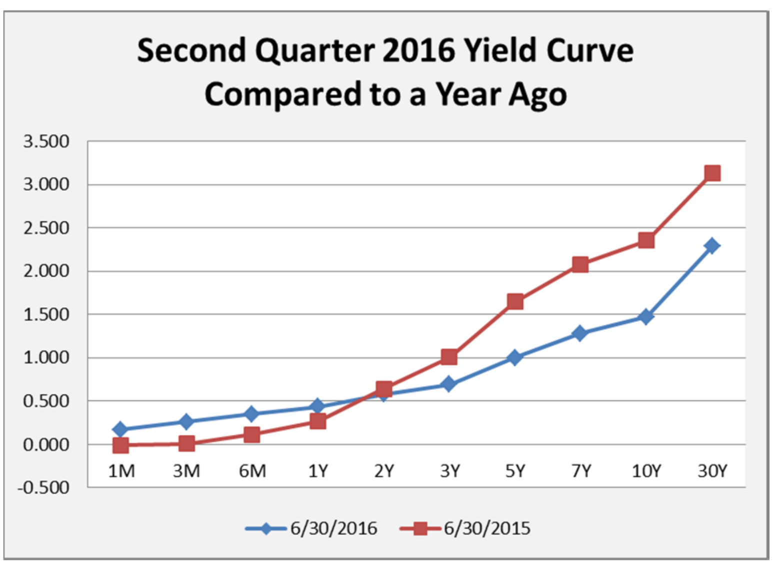
($ in Millions)

Income Statement (year-to-date)	Deposit Insurance Fund				
	Unaudited Jun-16	Unaudited Mar-16	Quarterly Change	Unaudited Jun-15	Year-Over-Year Change
Assessments	$ 4,656	$ 2,328	$ 2,328	$ 4,517	$ 139
Interest on U.S. Treasury obligations	311	147	164	173	138
Other revenue	9	5	4	10	(1)
Total Revenue	$ 4,976	$ 2,480	$ 2,496	$ 4,700	$ 276
Operating expenses	856	415	441	830	26
Provision for insurance losses	(670)	(43)	(627)	(743)	73
Insurance and other expenses	2	0	2	1	1
Total Expenses and Losses	$ 188	$ 372	$ (184)	$ 88	$ 100
Net Income	4,788	2,108	2,680	4,612	176
Unrealized gain (loss) on U.S. Treasury investments, net	522	412	110	197	325
Unrealized postretirement benefit gain (loss)	-	-	-	-	-
Comprehensive Income	$ 5,310	$ 2,520	$ 2,790	$ 4,809	$ 501

Selected Financial Data	FSLIC Resolution Fund				
	Unaudited Jun-16	Unaudited Mar-16	Quarterly Change	Unaudited Jun-15	Year-Over-Year Change
Cash and cash equivalents	$ 872	$ 872	$ -	$ 872	$ -
Accumulated deficit	(124,618)	(124,617)	(1)	(124,523)	(95)
Total resolution equity	872	872	-	872	-
Total revenue	1	1	-	2	(1)
Operating expenses	2	1	1	1	1
Provision for losses	(3)	(3)	-	-	(3)
Other expenses	2	2	-	1	1
Goodwill litigation expenses	-	-	-	63	(63)
Net Income (Loss)	$ -	$ 1	(1)	$ (63)	$ 63

Receivership Selected Statistics June 2016 vs. June 2015

$ in millions	DIF			FRF			ALL FUNDS		
	Jun-16	Jun-15	*Change*	Jun-16	Jun-15	*Change*	Jun-16	Jun-15	*Change*
Total Receiverships	422	480	(58)	-	-	-	422	480	(58)
Assets in Liquidation	$ 4,136	$ 6,337	$ (2,201)	$ 2	$ 5	$ (3)	$ 4,138	$ 6,342	$ (2,204)
YTD Collections	$ 837	$ 2,001	$ (1,164)	$ 2	$ 2	$ -	$ 839	$ 2,003	$ (1,164)
YTD Dividend/Other Pymts - Cash	$ 2,430	$ 4,708	$ (2,278)	$ -	$ -	$ -	$ 2,430	$ 4,708	$ (2,278)



The Treasury yield curve has flattened over the past year. Short-maturity yields have risen reflecting the Federal Reserve's December 2015 hike in the federal funds target rate, as well as expectations for possible additional hikes over the medium term. However, longer-maturity yields have declined, reflecting declining long-term inflation expectations and potentially weaker economic growth prospects.

Deposit Insurance Fund Portfolio Summary

(Dollar Values in Millions)

	6/30/16	12/31/15	Change
Par Value	$69,311	$62,973	$6,338
Amortized Cost	$69,673	$63,368	$6,305
Total Market Value (including accrued interest)	$70,457	$63,737	$6,720
Primary Reserve [1]	$70,457	$63,737	$6,720
Primary Reserve % of Total Portfolio	100.0%	100.0%	0.0%
Yield-to-Maturity [2]	0.94%	0.94%	0.00%
Weighted Average Maturity (in years)	1.30	1.65	-0.35
Effective Duration (in years)			
Total Portfolio	1.28	1.62	-0.34
Available-for-Sale Securities	1.38	1.64	-0.26
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 presently 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)

	6/30/16	12/31/15	Change
FRF-FSLIC			
Book Value [4]	$828	$828	$0
Yield-to-Maturity	0.18%	0.08%	0.10%
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)

	6/30/16	12/31/15	Change
Book Value [5]	$8,765	$10,508	($1,743)
Effective Annual Yield	0.46%	0.30%	0.16%
Weighted Average Maturity (in days)	80	90	(10)

[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 2016** Purchase up to $14 billion (par value) of Treasury securities with maturity dates between September 30, 2016, and September 30, 2021, subject to the following additional provisions: all newly purchased securities will be designated as available-for-sale; and no more than $2 billion (adjusted par value) of such securities shall consist of Treasury Inflation-Protected Securities.
	Strategy Changes for the 3rd Quarter 2016
	Purchase up to $14 billion (par value) of Treasury securities with maturity dates between December 31, 2016, and December 31, 2021, subject to the following additional provisions: all newly purchased securities will be designated as available-for-sale; and no more than $2 billion (adjusted par value) of such securities shall consist of Treasury Inflation-Protected Securities.
NATIONAL LIQUIDATION FUND	**Strategy for the 2nd Quarter 2016** 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 2016
	No strategy changes for the third quarter of 2016.

Executive Summary of 2016 Budget and Expenditures
by Major Expense Category
Through June 30, 2016
(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	$1,254,695	$611,839	$602,815	99%	($9,024)
Outside Services - Personnel	244,306	110,466	104,430	95%	(6,036)
Travel	98,897	48,372	44,865	93%	(3,507)
Buildings	96,799	47,403	46,005	97%	(1,398)
Equipment	85,419	44,961	33,309	74%	(11,652)
Outside Services - Other	15,716	9,295	7,355	79%	(1,940)
Other Expenses	14,869	6,943	6,211	89%	(732)
Total Ongoing Operations	**$1,810,701**	**$879,279**	**$844,990**	**96%**	**($34,289)**
Receivership Funding					
Salaries & Compensation	$61,080	$33,751	$28,085	83%	($5,666)
Outside Services - Personnel	296,955	134,302	99,816	74%	(34,485)
Travel	8,207	4,103	1,690	41%	(2,413)
Buildings	14,602	7,191	7,066	98%	(125)
Equipment	1,452	826	850	103%	24
Outside Services - Other	1,900	739	523	71%	(216)
Other Expenses	15,805	7,883	3,967	50%	(3,916)
Total Receivership Funding	**$400,000**	**$188,795**	**$141,997**	**75%**	**($46,797)**
Total FDIC Operating Budget	**$2,210,701**	**$1,068,074**	**$986,987**	**92%**	**($81,086)**

Executive Summary of 2016 Budget and Expenditures by Budget Component and Division/Office Through June 30, 2016 (Dollars in Thousands)					
Division/Office	Annual Budget	YTD Budget	YTD Expenditures	% of YTD Budget Used	YTD Variance
FDIC Operating Budget					
Risk Management Supervision	$593,295	$289,493	$281,304	97%	($8,189)
Resolutions & Receiverships	357,366	181,505	136,543	75%	(44,962)
Administration	274,243	131,491	126,361	96%	(5,130)
Legal	237,054	117,510	112,077	95%	(5,433)
Information Technology	216,586	113,307	103,605	91%	(9,703)
Depositor & Consumer Protection	178,813	87,741	85,521	97%	(2,220)
Insurance & Research	48,281	23,398	24,471	105%	1,073
CIO Council	51,791	22,382	20,669	92%	(1,713)
Finance	39,827	19,776	19,318	98%	(457)
Inspector General	34,153	17,077	16,074	94%	(1,003)
Information Security & Privacy Staff	33,788	16,281	15,952	98%	(329)
Corporate University - Corporate	24,662	12,261	12,303	100%	42
Executive Support [1]	26,174	12,546	11,521	92%	(1,025)
Complex Financial Institutions	20,976	9,505	8,961	94%	(544)
Corporate University - CEP	18,070	8,229	7,738	94%	(491)
Executive Offices [2]	11,381	5,572	4,570	82%	(1,002)
Corporate Unassigned	44,241	0	0	N/A	0
Total FDIC Operating Budget	**$2,210,701**	**$1,068,074**	**$986,987**	**92%**	**($81,086)**

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.