



December 14, 2017

**TO:** Board of Directors

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

**SUBJECT:** Proposed 2018 FDIC Operating Budget

### **Proposal**

This memorandum requests that the Board of Directors (Board) approve the proposed 2018 FDIC Operating Budget totaling \$2,092,132,587 including \$1,827,034,674 for ongoing operations, \$225,000,000 for receivership funding,<sup>1</sup> and \$40,097,913 for the Office of the Inspector General (OIG). The total proposed 2018 FDIC Operating Budget is \$65,690,177 (3.0 percent) lower than the 2017 FDIC Operating Budget, largely due to substantially reduced resource requirements for the receivership funding budget component. The proposed ongoing operations component of the budget is \$5,964,649 (0.3 percent) higher than 2017; while the proposed receivership funding component of the budget is \$75,000,000 (25.0 percent) lower than 2017. The 2018 OIG budget is \$3,345,174 (9.1 percent) higher than it was in 2017.

Approval is also requested for a total authorized 2018 staffing level of 6,076 full-time equivalent (FTE) positions (5,959 permanent, 117 non-permanent), down 287 positions (net) from the currently authorized 2017 staffing level of 6,363 positions.<sup>2</sup> This reflects a decrease from 2017 of 21 permanent positions and 266 non-permanent positions.

### **Background**

#### ***Structure of the FDIC Operating Budget***

The FDIC's proposed annual operating budget is composed of three separate and distinct components: ongoing operations, receivership funding, and the OIG. The separate display of the OIG budget is provided for informational purposes only, since the OIG budget is separately appropriated by the Congress and is not subject to Board approval.

<sup>1</sup>Certain factors that affect the Salaries and Compensation category of the proposed 2018 FDIC Operating Budget have not yet been determined (e.g., the FDIC's share of 2018 employee health insurance costs). When these factors are finally determined, they may require corresponding changes in estimated expenses for the Salaries and Compensation major expense category of the 2018 FDIC Operating Budget. As in prior years, the proposed 2018 Budget Resolution delegates authority to the Deputy to the Chairman and Chief Financial Officer to adjust the total Board-approved 2018 FDIC Operating Budget to account for such factors.

<sup>2</sup>The requested approval encompasses the proposed individual division and office staffing authorizations shown in Exhibit 6.

Funds approved by the Board for the ongoing operations, receivership funding, and OIG budget components cannot be reprogrammed to pay for expenditures incurred for the other components. The segregation of annual operating expenditures into these three components facilitates more effective cost management by isolating the FDIC's more stable ongoing operational expenses from the highly variable annual expenses associated with bank closings and subsequent receivership management activities and the separate appropriations process applicable to the OIG.

The receivership funding component provides funding for expenses incurred in connection with the failure or near failure of FDIC-insured institutions and the management of receiverships established in connection with these failures.<sup>3</sup> The separation of the receivership funding component is an acknowledgement that the number of failures and the expenses associated with these failures in any given year are to a large extent outside of the control of the FDIC and that the actual expenses incurred for resolutions and receivership management activities may, therefore, vary considerably from the estimates made during the annual planning and budget process. Over the past decade, annual receivership funding expenses have ranged from a low of \$20 million to a high of \$2.0 billion. The FDIC expects to fully recover all of its 2018 receivership funding expenditures through the billing of failed institution receiverships for services it provides.

### ***2018 Workload Analysis and Projections***

The proposed 2018 budget and staffing authorizations are based on an analysis of projected workload associated with the FDIC's major ongoing mission responsibilities. These include the FDIC's risk management and consumer protection supervision programs, its resolution and receivership management program, its large bank resolution planning responsibilities, and its deposit insurance and research programs.

The FDIC's supervision workload varies based upon the number and size of the institutions it supervises and the number of those institutions with composite CAMELS (risk management) ratings of 3, 4, and 5.<sup>4</sup> The number of risk management examinations is projected to decline by 6.1 percent, from 1,681 in 2017 to 1,579 in 2018, due primarily to continuing institutional consolidation. The reduction in workload resulting from the smaller number of examinations is partially offset by the additional work associated with the continuing growth in the average size and complexity of FDIC-supervised institutions, particularly those with more than \$10 billion in assets. Compliance and CRA examination workload is projected to decline by 2.4 percent, from 1,270 in 2017 to 1,239 in 2018. Although institutional consolidation is also gradually reducing the number of compliance and CRA exams to be conducted each year, the impact of

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<sup>3</sup>Salary and benefits expenses for the permanent in-house staff associated with the FDIC's Receivership Management business line (primarily in the Division of Resolutions and Receiverships and the Legal Division) are funded from the ongoing operations component of the budget, because the maintenance of this in-house staff would be necessary, regardless of whether any failures actually occurred.

<sup>4</sup>The projected number of compliance and Community Reinvestment Act (CRA) examinations to be conducted annually is based largely on the number of institutions supervised by the FDIC. Compliance and CRA ratings have only a limited impact on this workload.

consolidation is partially offset by variation in the number of exams that must be conducted from year to year under FDIC policy.

The primary drivers of the FDIC's resolutions and receivership management workload are the number and complexity of failures of FDIC-insured institutions, the number of active receiverships being managed by the FDIC, and the amount of post-failure workload remaining for those receiverships. Seven insured financial institutions have failed thus far in 2017, up slightly from five failures occurring in 2016. Receivership management workload is projected to remain somewhat elevated due to the continuing work associated with post-failure receiverships and loss share agreements being managed by the FDIC. The FDIC's inventory of assets in liquidation rose from approximately \$3.3 billion (book value) at the beginning of 2017 to \$5.0 billion (book value) as of September 30, 2017. As of that date, the FDIC was still managing 367 active receiverships emanating from insured institution failures, compared to 378 receiverships at the beginning of 2017. Historically, a high level of residual receivership management work typically continues for several years beyond an institution's failure date.

In carrying out its large bank resolution planning responsibilities, the FDIC monitors the risks in large, systemically important financial institutions (SIFIs), reviews the resolution plans submitted by large banks and bank holding companies, and prepares to undertake, if necessary, their orderly liquidation. The FDIC's resolution planning workload is projected to remain relatively constant in 2018.

The workload associated with the FDIC's deposit insurance and research programs is also expected to remain constant in 2018.

## **2018 Budget Highlights**

### ***Overview of the Proposed 2018 Budget by Component***

The proposed 2018 FDIC Operating Budget totals \$2,092,132,587 including \$1,827,034,674 for ongoing operations, \$225,000,000 for receivership funding, and \$40,097,913 for the OIG. As noted earlier, this represents an increase of \$5,964,649 (0.3 percent) in the ongoing operations budget component, a decrease of \$75,000,000 (25.0 percent) in the receivership funding budget component, and an increase of \$3,345,174 (9.1 percent) in the Inspector General's budget. Consistent with prior years, the ongoing operations component of the budget includes a \$25 million contingency reserve to be administered by the Deputy to the Chairman and Chief Financial Officer (CFO) to address funding requirements that emerge during the year. As discussed below, this reserve is expected to be used in 2018 in part for anticipated expenses to be incurred for the remediation of mission-critical systems to ensure that they can be recovered within prescribed timeframes and the migration of those systems to a new back-up data center. Detailed budget cost estimates are not yet available for that initiative.

The small increase in the ongoing operations budget component is primarily attributable to the increase in the cost of employee salary and benefits expenses. But, that increase is substantially offset by a continuing decline in the number of employees on non-permanent appointments, primarily in the supervision area.

The reduction in the receivership funding budget component reflects an expectation that the low level of new failure activity and the gradual reduction of residual workload from the financial crisis that has occurred in recent years will continue in 2018. Based on that expectation, the FDIC will need fewer temporary employees and contractors in the Division of Resolutions and Receiverships (DRR) and its supporting organizations next year.<sup>5</sup>

The separate OIG budget component is provided for informational purposes only, since the OIG budget is separately appropriated by the Congress and is not subject to Board approval. The increase in the OIG budget component primarily reflects the OIG's intention to (1) strengthen the office's capacity, through additional staffing as its appropriation status allows, to address risks associated with the Corporation's ongoing mission responsibilities as well as high-priority corporate initiatives; and (2) ensure that its Electronic Crimes Unit Lab is operating with proper capacity, security, and backup and recovery capabilities.

### ***Overview of Proposed 2018 Budget by Major Expense Category***

Exhibit 1 itemizes the proposed 2018 FDIC Operating Budget by major expense category. The proposed 2018 budget is lower than the 2017 budget in all expense categories except the Equipment category:

- The proposed 2018 Salaries and Compensation budget is \$1,290,828,544, which is \$26,906,481 (2.0 percent) lower than the 2017 Salaries and Compensation budget. The costs associated with an average annual salary increase of 4.0 percent for most FDIC employees in 2018 will be offset by the elimination of 287 authorized positions. The Salaries and Compensation expense category represents 61.7 percent of the proposed 2018 FDIC Operating Budget and 67.6 percent of the ongoing operations budget component, excluding the OIG.
- The proposed 2018 Outside Services-Personnel budget (for contractor-provided services) is \$457,508,502, which is \$27,261,745 (5.6 percent) lower than the 2017 budget. This decrease primarily reflects expectations for a continued low level of insured institution failures and a gradual reduction in post-failure receivership management workload in 2018, both of which will reduce contractor support requirements in the receivership funding budget component. The budget for contract services will increase by \$19,347,836 (7.6 percent) from 2017 to 2018 in the ongoing operations budget component, primarily due to funding for expenses associated with increased information technology (IT) security and modernization initiatives. The Outside Services-Personnel expense category represents about 21.9 percent of the proposed 2018 FDIC Operating

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<sup>5</sup>The FDIC cannot control the variable workload associated with the receivership funding component of the annual FDIC operating budget, nor can it project with certainty the specific number and type of failures that will occur in 2018 or the actual expenses that will be incurred in connection with those failures. The proposed 2018 receivership funding budget may not, therefore, prove to be a reliable estimate of 2018 expenses. The Board will be asked to approve additional funding if it is determined during the year that increased budget authority is needed for the receivership funding component.

Budget and 14.9 percent of the ongoing operations budget component, excluding the OIG.

- The proposed 2018 Travel budget is \$99,049,319, down \$1,168,334 (1.2 percent) from 2017, largely due to decreased travel related to examinations. The Travel expense category represents about 4.7 percent of the proposed 2018 FDIC Operating Budget and 5.1 percent of the ongoing operations budget component, excluding the OIG.
- The proposed 2018 Buildings and Leased Space budget is \$111,799,905, down \$8,954,714 (7.4 percent) from 2017, due to low levels of insured institution failures and the continued reduction in post-failure receivership management workload. The Buildings and Leased Space expense category represents about 5.3 percent of the proposed 2018 FDIC Operating Budget and 5.7 percent of the ongoing operations budget component, excluding the OIG.
- The proposed 2018 Equipment budget is \$95,264,269, up \$2,212,587 (2.4 percent) from 2017, due largely to funding needed to update and refresh IT equipment. The Equipment expense category represents about 4.6 percent of the proposed 2018 FDIC Operating Budget and 5.1 percent of the ongoing operations budget component, excluding the OIG.
- The proposed 2018 Outside Services-Other budget is \$17,838,384, down \$147,661 (0.8 percent) from 2017. The Outside Services-Other expense category represents about 0.9 percent of the proposed 2018 FDIC Operating Budget and 0.9 percent of the ongoing operations budget component, excluding the OIG.
- The proposed 2018 Other Expenses budget is \$19,843,664, down \$3,463,829 (14.9 percent) from 2017, due primarily to reduced receivership management activity. The Other Expenses category represents about 0.9 percent of the proposed 2018 FDIC Operating Budget and 0.7 percent of the ongoing operations budget component, excluding the OIG.

### **2018 Staffing Authorizations**

The proposed 2018 FDIC Operating Budget includes a total authorized staffing level of 6,076 FTE positions (5,959 permanent, 117 non-permanent), as shown in Exhibit 6.<sup>6</sup> This represents a net decrease of 287 positions, or 4.5 percent, from the current 2017 authorized staffing level. If approved by the Board, authorized 2018 permanent staffing will decrease in 2018 by 21 positions and authorized non-permanent staffing will decline by 266 positions from current 2017 authorized staffing levels.

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<sup>6</sup>In recent years, in conjunction with its approval of the annual FDIC operating budget, the Board has granted individual divisions and offices limited authority to temporarily exceed their annual staffing authorizations in order to provide them with flexibility in addressing succession management concerns. Because the FDIC will largely return to its core permanent staffing level by the end of next year, continuation of that authority is not being requested in 2018.

The proposed reductions in authorized permanent staffing reflect individual division and office assessments of their projected post-crisis workload. This reduction of 21 authorized permanent positions consists of a decrease of seven positions in the Division of Finance (DOF), four positions in the Office of Minority and Women Inclusion (OMWI), three positions each in the Division of Insurance and Research (DIR) and the Office of the Ombudsman (OO), and two positions each in the Division of Depositor and Consumer Protection (DCP) and the Executive Offices (EO).

Proposed 2018 non-permanent staffing authorizations reflect the elimination of 266 non-permanent positions, almost 70 percent of the current authorized non-permanent staffing level. This includes decreases of 127 positions in the Division of Resolutions and Receiverships, 81 positions in the Division of Risk Management Supervision (RMS), 33 positions in the Legal Division, 16 positions in the Division of Depositor and Consumer Protection (DCP), six positions in the Division of Administration, two positions in the Division of Information Technology (DIT), and one position in the Office of Financial Institution Adjudication. The proposed 2018 non-permanent staffing authorization is more than 3,100 positions below the peak number of non-permanent positions authorized in 2011. This reduction is consistent with the current post-crisis profile of the banking industry and reflects the completion of most of the FDIC's residual workload from the recent financial crisis. All authorized non-permanent positions associated with the crisis are expected to be eliminated by the end of 2019.

Authorized 2018 field examination staffing in RMS is proposed to decline to 1,549 positions (1,520 permanent, 29 non-permanent), a net reduction of 45 positions from 2017. This includes 1,271 positions (1,242 permanent, 29 non-permanent) to perform community bank supervision responsibilities, down 74 positions from 2017, and 278 large bank examination positions (all permanent) to perform large bank supervision responsibilities. These changes reflect continuing institutional consolidation among community banks and the increasing number of FDIC-supervised institutions with more than \$10 billion in assets.

Authorized 2018 field examination staffing in DCP is proposed to decline to 468 positions (all permanent), a reduction of two permanent positions and 20 non-permanent positions from 2017. This, too, reflects continued institutional consolidation within the U.S. banking industry.

### **Proposed 2018 Funding Increases for IT Security and Modernization**

The proposed budget continues the emphasis begun a year ago on increased funding for the Office of the Chief Information Security Officer (OCISO). The proposed 2018 OCISO budget is \$44,202,596, an increase of more than \$2.2 million (5.3 percent) from the 2017 budget and \$8.3 million (23.2 percent) from the 2016 budget. This increased funding will be used to enhance the protection of the FDIC's application systems and databases from breaches and intrusions, improve the quality and timeliness of the FDIC's responses to critical security incidents, and increase the resiliency of the FDIC's IT infrastructure.

Funding is also included for the first-year costs of a two-year Backup Data Center Migration Project to remediate designated application systems and databases that support mission-essential functions to ensure that they can be recovered within targeted timeframes and to migrate them

incrementally as they are remediated to a new and expanded backup data center.<sup>7</sup> The FDIC leases space for its current backup data center in Manassas, VA, under a contract awarded in 2012.<sup>8</sup> That contract has a remaining period of performance of more than four years. Through modifications to the current contract, the FDIC plans to relocate its backup capabilities over the next two years to a new and larger facility in Dallas, TX, and to acquire and install additional equipment and software at the new facility. The new backup data center will have approximately 25 percent more capacity than the current data center as well as an enhanced security infrastructure. The phased relocation of the current facility is intended, in part, to address the risk posed by the geographic proximity of the current backup data center to the FDIC's primary data center at its Virginia Square office complex.

Final project and spending plans are not expected to be completed for this initiative until the end of the first quarter of 2018. Based on initial estimates that are still being refined, the total two-year cost for this initiative is expected to be \$55-60 million, including \$35-40 million in 2018. Major cost components include project planning; application remediation; equipment and software acquisition, installation, and maintenance; security; telecommunications; and facility leasing. If the proposed 2018 FDIC Operating Budget is approved by the Board, DIT and the CIO Council would begin spending funds immediately from their proposed 2018 ongoing operations budgets to complete time sensitive tasks. These tasks include preliminary planning for the configuration of the new data center; the price negotiation for the space and other services to be provided at that facility; the acquisition of required equipment, software, and telecommunications capabilities; and the scoping and price negotiation for required application remediation activities. It is essential to commence work on these tasks immediately to prevent further delays in addressing the risks posed by the current backup data center. But, none of the additional \$20-25 million needed for this initiative in 2018, beyond the estimated \$15 million already included in the proposed DIT and CIO Council budgets, would be made available to DIT or the CIO Council until a detailed, two-year project schedule and spending plan are approved by the Board. The Board must approve a project plan that includes the schedule, deliverables, and detailed budget before any of the additional funds may be spent.

Because of the importance of this initiative, it is recommended that the Board assign responsibility for managing and overseeing its implementation (including schedule and funding) to the Capital Investment Review Committee (CIRC), which is chaired jointly by the FDIC's Chief Information Officer and Chief Financial Officer and is composed of the directors of all FDIC divisions. If the Board accepts this recommendation, the CIRC will by the end of the first

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<sup>7</sup>The FDIC's internal Operating Committee, which includes the Chief Operating Officer, Chief Financial Officer, Chief Information Officer, and all FDIC division and office directors, recently reviewed and confirmed the designation of 26 applications and databases as supporting mission essential functions. This designation establishes for each application or database a maximum tolerable downtime (MTD), a limited time period of 12 to 72 hours for restoring the full availability of the application or database. These designations and MTDs will be reviewed on at least an annual basis by FDIC senior management to determine whether changes should be made in the list of systems or databases designated as supporting mission-essential functions or their established MADs.

<sup>8</sup>The services provided under the current contract consist principally of space, electricity, air conditioning, and the ability to connect to telecommunication networks. The facility is operated and managed by FDIC personnel with contractual support through the FDIC Infrastructure Services Contract. The same basic approach will be maintained for the new backup data center.

quarter of 2018 submit to the Board for approval a detailed two-year project plan for the Backup Data Center Migration Project that includes the schedule, deliverables, and detailed budget. The project budget will identify the estimated expenses to be incurred in both 2018 and 2019 for each major cost component identified above. One-time and recurring costs will be separately identified. Total spending for this initiative may not exceed \$40 million for 2018 or \$60 million for the full two-year effort unless approved in advance by the Board. In addition to the detailed project budget, the project plan submitted to the Board will identify the objectives, priorities, key milestones, and target completion dates for the major tasks to be performed as part of this initiative. It will culminate in a full-scale, comprehensive test of the FDIC's ability to fail over to the backup data center all of the designated systems and databases that support mission-essential functions and then to restore the operation of those systems and databases to the FDIC's primary data center within target timeframes.

The CIRC will provide monthly briefings to the Board on the status of this initiative until the project and spending plan are approved and will continue to update the Board each quarter thereafter on the status of the project and any issues or concerns that arise. In approving the proposed 2018 FDIC Operating Budget, the Board is also affirming its approval of the plan outlined here for the two-year Backup Data Center Migration Project, including both the proposed conceptual approach to and governance framework for this initiative.

### **Projected 2018 Investment Budget Spending**

In December 2002, the Board established an Investment Budget that was separate and distinct from the annual operating budget. The Investment Budget provides funding on a multi-year basis for major investment projects (mostly IT systems development projects) that are individually approved by the Board. Funds may not be reallocated among projects, and any unused budget authority for a project expires when it is completed. The Capital Investment Review Committee (CIRC) monitors the progress of approved IT investment projects and reports on them quarterly to the Board.

The Investment Budget currently includes three active investment projects: the Structure Information Management System Redesign project, the Claims Administration System (CAS) Deposit Resolution Optimization Project, and the System of Uniform Reporting of Compliance and CRA Examinations (SOURCE) Modernization project.

### **Overview of Attached Exhibits**

Exhibit 1 displays the proposed 2018 FDIC Operating Budget by major expense category.

Exhibit 2 displays the proposed 2018 FDIC Operating Budget by division and office.

Exhibit 3 displays the proposed 2018 budgets by division and office for the ongoing operations and OIG budget components.

Exhibit 4 displays the proposed 2018 budgets by division and office for the receivership funding budget component.



Exhibit 5 displays the projected allocation of the proposed budget by major program.

Exhibit 6 displays the proposed 2018 staffing authorizations (permanent and non-permanent) for each division and office.

Also attached is the proposed 2018 Budget Resolution reflecting the recommendations outlined above.

**Contact Information**

If you have questions or need additional information, please contact Thomas E. Peddicord, Deputy Director, Division of Finance, at (703) 562-6252.

Attachments