FDIC
Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429 Deputy to the Chairman and Chief Financial Officer

November 28, 2007

TO: Board of Directors

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

SUBJECT: Proposed 2008 Corporate Operating Budget

Proposal

This memorandum requests that the Board of Directors approve a 2008 Corporate Operating Budget totaling $1,141,804,189, including $1,066,804,189 for ongoing operations and $75,000,000 for receivership funding.[1] The proposed budget is approximately $34 million (3.1 percent) higher than the approved 2007 Corporate Operating Budget. All of the proposed increase is in the ongoing operations component of the proposed 2008 budget. The budget for the receivership funding component of the proposed 2008 budget is unchanged from 2007. In addition, approval is requested for an authorized staffing level of 4,810 in 2008, up 94 positions from the currently-approved authorized staffing level of 4,716 for 2007.

Approval is also requested for a change in current corporate budgeting procedures related to the accounting for part-time positions in the management of approved staffing authorizations.

Overview

The proposed 2008 budget was developed based on an analysis of the projected 2008 workload for each of the Corporation's three major business lines—Insurance, Supervision, and Receivership Management—as well as projected workload and expenses for the Corporation's major program support functions. As part of the Corporation's annual strategic planning process, corporate workload assumptions and guidance on 2008 initiatives were established by the Chairman and FDIC senior management at the outset of the 2008 budget formulation process. Divisions and offices used those workload assumptions and planned initiatives to determine their 2008 budget requirements.

The number of FDIC-insured financial institutions is projected to continue to decline, from a projected 8,549 insured institutions at the end of 2007 to 8,399 insured institutions by the end of 2008. The total number of FDIC-supervised institutions is also projected to decline, from 5,208

[1]Certain factors that affect the Salaries and Compensation category of the proposed 2008 Corporate Operating Budget have not yet been finally determined. For example, the Corporation's costs for employee health insurance have not yet been finalized. When finally determined, these factors may require corresponding changes in estimated expenses for the Salaries and Compensation major expense category in the 2008 Corporate Operating Budget. As in prior years, the proposed 2008 Budget Resolution delegates authority to the Deputy to the Chairman and Chief Financial Officer to adjust the total Board-approved 2008 Corporate Operating Budget to account for such factors.

at the end of 2007 to 5,186 at the end of 2008,[2] which will result in a reduction in the number of risk management (safety and soundness) and CRA and compliance examinations conducted in 2008. The proposed 2008 budget includes the resources required to conduct an estimated 2,327 risk management examinations (approximately 100 fewer than projected for 2007) and 2,033 CRA and compliance examinations of FDIC-supervised institutions (approximately 200 fewer than projected for 2007). The reduced workload associated with fewer risk management examinations is expected to be more than offset, however, by an increase in the number of FDIC-supervised institutions with composite CAMELS ratings of 3, 4, and 5 (examinations of those institutions require substantially more time than examinations of 1- and 2-rated institutions).

Workload associated with the Corporation's resolutions and receivership management responsibilities is expected to increase in 2008. There have been three failures of FDIC-insured institutions to date in 2007, but the number of problem institutions has been increasing over the past several months as issues have emerged in the housing and credit markets. Nevertheless, the proposed staffing levels included in the 2008 Corporate Operating Budget for the Division of Resolutions and Receiverships (DRR) and the Division of Supervision and Consumer Protection (DSC), which assists DRR with pre- and post-closing activities for failures and near failures, are expected to be sufficient to handle most failure projection scenarios for 2008. The Corporation is establishing a contingency plan for responding to a larger number of failures and near failures, if necessary.

Nearly 98 percent of the funding for the 2008 Corporate Operating Budget is projected to come from the Deposit Insurance Fund (DIF), with the remainder paid from the FSLIC Resolution Fund (FRF). In addition, receiverships will be billed for services provided by the Corporation in accordance with established service billing procedures. The total spending authorized by the 2008 Corporate Operating Budget and estimated from previously-approved investment projects represents approximately 51 percent of the interest revenue and 25 percent of the combined interest and assessment revenue projected for the DIF in 2008.

2008 Budget Highlights

Overview of Proposed Budget by Major Expense Category

Attachment 1 itemizes the proposed 2008 Corporate Operating Budget by major expense category. In 2008, the largest component of the operating budget continues to be personnel-related expenditures. The proposed 2008 budget for the Salaries and Compensation expense category is about $696 million, which is $42 million (6.5 percent) higher than it is in the 2007 budget, due primarily to the cost of employee pay increases and a projected increase in the number of authorized and on-board staff. The Salaries and Compensation expense category represents about 61 percent of the proposed 2008 Corporate Operating Budget, slightly higher than in 2007. The second largest component of the proposed 2008 Corporate Operating Budget

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[2]The changes in the projected number of FDIC-insured and FDIC-supervised institutions reflect the net effect of projections of the number of institutions that will be acquired by other institutions or will otherwise no longer be in business and projections of the number of *de novo* institutions that will be established during 2008.

is the $246 million budget for Outside Services-Personnel (contractor-provided services), which is about $6 million (2.3 percent) higher than the 2007 budget. The Outside Services-Personnel expense category represents 22 percent of the proposed 2008 budget, about the same as in 2007. The remainder of the proposed 2008 Corporate Operating Budget consists of Travel expenses ($65 million), up $2.7 million (4.4 percent) from 2007, due largely to the increased number of examiners on board and inflation in travel costs; Buildings and Leased Space expenses ($57 million), down about $13.5 million (19.3 percent) from 2007, due primarily to substantial one-time lease costs savings to be realized in 2008; Equipment expenses ($49 million), down about $1.1 million (2.1 percent) from 2007; Outside Services-Other expenses ($14.5 million), down about $1.7 million (10.8 percent) from 2007; and Other Expenses ($14 million), about the same as in 2007.

Increased Supervisory Resources

The proposed 2008 Corporate Operating Budget provides for a significant increase in examiner staffing in order to ensure that the FDIC maintains a strong supervisory posture in light of the significant risk management and consumer protection issues currently confronting the banking industry. Authorized examiner staffing is proposed to increase from 1,724 in 2007 to 1,808 in 2008 (1,423 risk management examiners, 385 compliance examiners), an increase of 84 examiner positions (4.9 percent). This includes an additional 60 risk management examiners and 24 compliance examiners.[3] If approved, 72 of the new examiner positions (60 risk management, 12 compliance) would be authorized temporarily for a period of at least two years and would be filled through the re-employment of retired commissioned examiners. This would permit DSC to improve the balance in the current examiner workforce between experienced examiners and trainees. This strategy has been adopted in order to add seasoned resources to the workforce to help identify and address the potential safety and soundness concerns that are emerging at many institutions and to mentor and coach the large and growing number of examiner trainees.[4] DSC also plans to recruit new examiners at the mid-career level in addition to continuing entry level hiring through the Corporate Employee Program (CEP).

Funding for Other Corporate Priorities

Augmented resources are also provided for three other major corporate priorities in the proposed 2008 Corporate Operating Budget: (a) large/complex bank risk assessment and failure preparedness; (b) consumer protection/economic inclusion; and (c) workforce transition and succession management.

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[3]The proposed staffing authorization for DSC also includes an additional 12 compliance examiners in 2009. If approved, that would bring total authorized compliance examiner staffing to 397 and increase total authorized examiner staffing to 1,820 in 2009. That would complete the phased, three-year addition of 71 permanent compliance examiners to the workforce, consistent with the plan presented to the Board in conjunction with its consideration of the 2007 Corporate Operating Budget.

[4]At the end of 2007, the examiner workforce will have approximately 400 employees who do not have commissions and have less than five years of experience as examiners, including about 170 trainees in the first-year Corporate Employee Program who are assigned to Corporate University. This number is expected to grow to more than 500, or about 28 percent of the examiner workforce, by the end of 2008.

In the large/complex bank area, funding is provided for contractor support to conduct a skills survey and skill gap analysis and complete development of a new training program to provide employees with the skills needed to better understand the complex risk measurement and management approaches (such as complex risk models) now used in the wholesale and retail credit business lines and capital market activities in which the largest insured financial institutions are engaged. This includes corporate and commercial real estate lending, securitization activities, and complex structured products. Such training is needed to maintain and enhance the FDIC's ability to assess the risks in individual institutions and across the industry and their potential impact on the DIF; develop appropriate risk-based insurance assessment rates; and, if necessary, handle the failure of a large/complex insured institution. Funding is also provided to conduct multiple large/complex bank failure simulations during 2008 to ensure that the Corporation is prepared for such a failure.[5]

Funds are also included in the proposed 2008 Corporate Operating Budget for contractual support for numerous consumer protection/economic inclusion initiatives:

- Continued support for and promotion of the new Alliance for Economic Inclusion
- Foreclosure counseling and outreach
- Completion and publication of a study of bank overdraft protection programs (begun in 2007)
- Analysis and publication of data from surveys on the "unbanked"
- Conduct of an identity theft media campaign
- Continued provision of *My Money* Tool Kits through the Financial Literacy Hotline
- Promotion of financial literacy through the FDIC's award-winning *Money Smart* financial education curriculum and its military base outreach program
- Development of public school and computer-based instructional versions of the *Money Smart* curriculum

Finally, the proposed 2008 Corporate Operating Budget provides funding for multiple initiatives that are intended to facilitate a smooth transition of the workforce to a new generation of employees as "baby boomers" retire over the next several years. Enhanced training and development for new employees is a key element of the Corporation's workforce transition/ succession management strategy. The proposed budget includes increased staffing and contractual support for Corporate University for the multi-year development and roll-out of new commissioning programs for resolutions and receivership management employees and the development and implementation of a new Bank Operations Simulation Laboratory in Dallas. In addition, the proposed budget provides funding for "temporary overhire" initiatives in DRR and the Legal Division.

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[5]In addition to the inclusion of funding for these initiatives in the proposed 2008 Corporate Operating Budget, the Board has previously approved an investment project budget to develop and implement a new Claims Administration System (currently projected to be implemented by the end of 2009). That system, in combination with planned new rulemaking by the Board, should facilitate future deposit insurance determinations in the event of a large/complex bank failure.

"Temporary Overhire" Initiatives

The proposal for "temporary overhire" authority in DRR and the Legal Division reflects the fact that both divisions have substantially higher projected vulnerability to retirements than other FDIC divisions over the next five years. Using estimates of probable retirement (not retirement eligibility), DRR is projected to lose 26-35 percent and the Legal Division 20-36 percent of their current workforces to retirement by year-end 2012 (by comparison, DSC is projected to lose only 7-15 percent of its current workforce to retirement during that period). These estimates do not include attrition due to factors other than retirement. Legal, for example, has lost attorneys to private law firms as well as to other regulators this year. Attorneys with specialized skills that are in high demand by private law firms might find retirement particularly attractive because they could begin to draw Federal retirement pay and benefits while earning a second salary. Both the DRR Director and the General Counsel have requested the authority to hire in excess of their authorized staffing levels (223 and 426, respectively) in 2008 to address this situation.

In both divisions, the "temporary overhire" authority would be used to accomplish two separate and distinct objectives:

- To fill on a "double-encumbered" basis selected positions held by key subject matter experts approaching retirement who have critical skills. This would facilitate an orderly knowledge transfer from those employees to replacement employees.

- To add new skills, augment existing skills in critical specialty areas, and realign staffing and skill sets to accommodate changing corporate priorities. Each division would be able to begin addressing such skill needs immediately, without having to seek an increase in authorized staffing or wait for vacancies to occur over time, by re-programming some currently-encumbered positions to other purposes before they actually became vacant.

If approved, caps on the number of "temporary overhires" would be established for both divisions to facilitate a return to authorized staffing levels by year-end 2010, assuming the Corporation's retirement projections prove to be accurate.[6] Even if the projected retirements do not materialize as soon as projected, there would be little risk that either division would exceed

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[6]These caps were determined by the Division of Finance (DOF), in consultation with each division, and were based on the most recent corporate retirement projections prepared by DOF. If this proposal is accepted by the Board in conjunction with its approval of the proposed 2008 Corporate Operating Budget, DRR and the Legal Division will be permitted to hire additional employees up to the number of actual vacancies each had on June 30, 2007, plus the number of vacancies projected by DOF to occur as a result of retirements through year-end 2010. Under this methodology, DRR will be permitted to hire up to 19 employees and the Legal Division up to 32 employees in excess of their authorized staffing levels of 223 and 426, respectively. All accessions in each organization after June 30, 2007, will be counted against this limit. Once this additional hiring is completed, no further hiring, other than continuation of regular planned new entry-level hiring (through CEP for DRR and the Honors Attorney program in the Legal Division), would be permitted in either division until it fell below its Board-authorized staffing level. DOF will monitor compliance with these caps.

its authorized staffing level on a long-term basis, since both have a very large number of projected retirements in both 2011 and 2012.

Receivership Funding

In 2003, the Board adopted the concept of an annual corporate operating budget with two components: Ongoing Operations and Receivership Funding. Funds approved by the Board for one component cannot be reprogrammed to pay for expenditures incurred for the other component. The Receivership Funding component provides funding for expenditures that are incurred in connection with the failure (or near failure) of FDIC-insured institutions and the management of receiverships established in connection with those failures. The segregation of annual operating expenditures into these two components has facilitated more effective cost management by isolating the more stable, ongoing operational expenses from the variable annual expenses associated with bank closings and subsequent asset liquidation and litigation activities.

The approved 2007 Corporate Operating Budget included $75 million for Receivership Funding, the same level budgeted for this purpose every year since the separate Receivership Funding component was instituted in 2003. There have been only three failures to date in 2007, and there is little work remaining from previous failures. As a result, 2007 Receivership Funding expenditures are projected to total only about $25 million. (Receivership Funding expenditures have ranged from about $11 million to $40 million annually from 2003 through 2006.)

At present, there is considerable turmoil in the banking industry due to the emerging problems in the housing and credit markets. As a result it is difficult to project with any accuracy the number of failures and near failures that might occur next year or their size or complexity. Due to this uncertainty, the proposed 2008 Corporate Operating Budget includes level funding of $75 million for Receivership Funding activities, but this estimate is presented with a reminder that the FDIC cannot control the variable workload associated with this component of the annual corporate operating budget. Additional funding may, therefore, be sought from the Board of Directors during 2008 if it appears that actual Receivership Funding expenses will exceed the approved budget.

Projected Investment Budget Spending

In December 2002, the Board established an Investment Budget that was separate and distinct from the annual corporate operating budget. The Investment Budget consists of individual investment project budgets that are separately approved by the Board (prior to 2003, funding for such projects was included in the Corporation's annual corporate operating budgets). These projects are funded on a multi-year basis, and the funds approved by the Board cannot be reprogrammed among projects or for any other purpose. The Capital Investment Review Committee (CIRC) monitors the progress of approved investment projects and reports on them quarterly to the Board.

The Investment Budget currently includes only four active information technology (IT) projects, and two of them (the FFIEC Central Data Repository and the Legal Information Management System) are already operational and have been largely completed. Neither of those projects is expected to incur significant expenses in 2008. Investment Budget spending has declined from a high of about $108 million in 2004 (when there were 10 approved investment projects underway) to an estimated $14.5 million in 2007. Investment Budget spending is projected to be approximately $15.5 million in 2008.

Proposed Change in Accounting for Part-Time Employees

In conjunction with its consideration of the proposed 2008 Corporate Operating Budget, the Board is also requested to approve a change in the FDIC's current procedures for accounting and reporting for part-time staff. At present, employees with full-time and part-time work schedules count equally against each organization's Board-approved staffing authorization. As a result, managers may in some cases be reluctant to approve part-time schedules, because such schedules result in a reduction in the staff time available to accomplish assigned work. This probably has a disproportionate impact on women employees, who often seek part-time schedules when they have children, in order to be able to maintain a reasonable work-life balance.

An *ad hoc* task group assigned earlier this year to study the retention of women in the examiner workforce specifically identified the current method of accounting for part-time employees as a barrier to retention of women examiners. The group felt that a change in the current methodology would make supervisors in DSC and elsewhere more willing to approve "meaningful part-time schedules" for their employees and that those schedules would allow female examiners, in particular, to continue their careers with the FDIC and ultimately return to full-time schedules when their family-related responsibilities diminished. If successful, the FDIC would be able to retain the skills and experience of these employees in the workforce on a long-term basis and to avoid the significant costs now being incurred to train replacement examiners. FDIC senior management has endorsed the task group's recommendation.

Accordingly, the Board is asked to approve a new methodology for reporting on-board FDIC employment, effective January 1, 2008. If approved, FDIC employment will be reported to the Board and in the Annual Report after that date on a full-time on-board equivalent basis, based upon employees' official work schedules as recorded in the Corporation's official personnel records.[7] This will not affect total authorized staffing levels for divisions and offices; only reporting of on-board staffing against those authorized staffing levels will change. There is a small cost associated with this recommendation, since divisions and offices will be able to

[7]The proposed new reporting method does not conform exactly to "full time equivalent" (FTE) reporting requirements, as defined by the U.S. Office of Management and Budget (OMB) and the U.S. Office of Personnel Management (OPM), which take into account overtime, leave, and related factors. For purposes of implementing this change within the FDIC, full-time on-board equivalent staffing counts will be determined based upon employees' official work schedules, as recorded in the Corporate Human Resources Information System (CHRIS) at specific points in time. Overtime work as well as temporary or unofficial part-time schedules not recorded in CHRIS will not be taken into account. Required reporting by the FDIC to OMB and OPM will continue to adhere to "FTE" reporting definitions promulgated by those agencies, consistent with current practice.

increase their hiring to "recover" staff time now being lost to current part-time schedules.[8] Some one-time costs will also be incurred to make changes in current reporting systems. But, these additional costs are expected to be minimal and can be fully absorbed within the proposed 2008 Corporate Operating Budget.

Overview of Attached Exhibits

Attachment 1 displays the proposed 2008 Corporate Operating Budget by major expense category. Attachments 2 and 3 display the proposed budget by division/office (with and without the receivership funding component). Attachment 4 shows the projected allocation of the proposed budget by major program and fund. Attachment 5 shows proposed year-end 2007 and 2008 authorized staffing levels for each division/office.

Also attached is the proposed 2008 Budget Resolution.

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

[8]Currently-approved part-time schedules would permit the "recovery" of up to 48 FTEs on a corporate-wide basis, although it is not likely to be practical to fully "recover" such time in many organizations because the "recovered" staff time will not add up to a full position (the maximum potential cost of additional hiring resulting from "recovered" FTEs would be approximately $4.2 million if all 48 FTEs were "recovered" by the affected divisions/offices). If this recommendation is approved, DSC will "recover" on a one-time basis approximately 28 examiner positions from currently-approved part-time schedules. Over time, the number of part-time examiners will increase if the change has the desired effect of making supervisors more willing to approve such schedules.