FHLBank
San Francisco

Dean Schultz
President and
Chief Executive Officer

September 20, 2006

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 Seventeenth Street, N.W.
Washington, D.C. 29429

Attention: Comments

Re: Deposit Insurance Assessments and Federal Home Loan Bank Advances
Federal Deposit Insurance Corporation (FDIC) RIN 3064-AD09

Dear Mr. Feldman:

The Federal Home Loan Bank of San Francisco appreciates the opportunity to comment on the notice of proposed rulemaking on deposit insurance assessments published by the Federal Deposit Insurance Corporation on July 24, 2006 (71 FR 41910). Our comments specifically address the FDIC's request for comment on whether Federal Home Loan Bank (FHLBank) advances should be included in the definition of volatile liabilities or, alternatively, whether higher assessment rates should be charged to institutions that have significant amounts of secured liabilities. For the reasons stated below, the Federal Home Loan Bank of San Francisco strongly opposes the suggested notion that mere use of FHLBank advances warrants higher assessment rates.

Advances are not volatile liabilities for FHLBank members. FHLBank advances have pre-defined, well understood, and predictable terms. Unlike deposits, funds from advances are not subject to unexpected fluctuations due to circumstances outside the control of an FHLBank member. Experience has shown that deposits may be lost due to disintermediation arising from a variety of factors, e.g., special, short-term promotions in a particular market or the existence of higher returns to depositors on alternative assets. While some institutions can look to Wall Street for replacement liabilities, the money and capital markets have not functioned well as long-term, stable providers of wholesale funds to the community banks that comprise the bulk of the membership of the FHLBank System.

As set by Congress, a key purpose of the FHLBank System is to provide a source of long-term liquidity for FHLBank members. Throughout their 75-year history, the FHLBanks have performed this mission successfully. The FHLBanks are a stable, reliable source of funds for member institutions, and the availability of such credit serves a valuable role in members' liquidity and interest rate risk management plans. Given the value of such a stable source of funding, it is not surprising that more than 8,200 financial institutions are members of the FHLBank System. Treating FHLBank advances the same as uninsured deposits by including them in the definition of volatile liabilities would be irrational given the stability of the FHLBanks, the reliable availability of advances as a source of predictable and manageable wholesale funding, and the beneficial effect of such funding on members' business plans. We urge the FDIC not to include FHLBank advances in the definition of volatile liabilities.

An institution's use of advances is not per se indicative of additional risk to the insurance fund. Deposit insurance premiums should be based on an institution's actual risk profile, taking into account an institution's supervisory rating and capital ratios. Financial institutions that are engaged in excessively risky activities should pay a higher premium, regardless of whether those activities are financed by insured deposits, FHLBank advances, or alternative wholesale funding sources. As noted in a research paper published by the FDIC Center for Financial Research in 2005, recent failures of high-risk banks generally did not involve, nor were they related to, advances use. Empirical evidence supports the conclusion that advances neither cause, nor are they even a relevant estimator of, future problem resolution issues or CAMELS downgrades. The FDIC examination staff is better suited to determining a bank's risk profile than an inflexible formula imposed on all insured institutions, regardless of circumstance.

Discouraging borrowing from the FHLBanks would be counterproductive to reducing the risk of failure of FDIC-insured institutions. In fact, discouraging the use of FHLBank advances could lead to the perverse effect of increasing risks to FHLBank members. Borrowers frequently use FHLBank advances for liquidity purposes and to manage interest rate risk, as well as to fund loan growth. In many markets, the supply of deposit funds is inadequate to meet loan demand and prudent financial management needs. Curtailing the use of FHLBank advances would force institutions to look to alternative, often more costly wholesale funding sources that are demonstrably more volatile, thereby reducing affordable credit availability and increasing liquidity risk.

Penalizing the use of advances through the imposition of insurance premiums also would conflict with the intent of Congress in establishing the FHLBanks, in opening membership in FHLBanks to commercial banks in FIRREA, and, more recently, in adopting the Gramm-Leach-Bliley Act, which expanded small banks' access to advances. The FHLBanks' mission is to provide financial institutions with access to low-cost funding so they may adequately meet communities' credit needs to support homeownership and community development. Charging higher assessments to financial institutions that use advances to serve those credit needs would disadvantage the communities and frustrate the FHLBanks' mission as established and repeatedly reaffirmed by the Congress.

Over the past several years, Congressional Committees and principal sponsors of FDIC reform have expressed specific concerns that the FDIC, in developing a risk-based insurance assessment proposal, not adversely affect FHLBank advances. The Congressional intent has been expressed in both the House and Senate on a bi-partisan basis. Both the House Budget Committee report on reconciliation (November 7, 2005) and the House Financial Services Committee report on deposit insurance reform (April 29, 2005) contained such expressions of concern. In addition, Senator Tim Johnson (D-SD), in a Senate Floor statement on November 3, 2005, stated that FDIC reform legislation was not intended to result in increased insurance premiums simply because an institution holds FHLBank advances. Congressman Spencer Bachus (R-AL) gave a similar statement on the House Floor on December 19, 2005. Congressman Richard Baker (R-LA) also made statements on the House Floor on April 7, 2003, and June 5, 2002, opposing a potential FDIC proposal to classify institutions with certain amounts or percentages of advances as more risky and,

therefore, charge them higher premiums. Congressman Baker said that such actions would contradict Congress' clear intent to broaden access to advances under the Gramm-Leach-Bliley Act. In brief, the legislative history indicates that the FDIC should not charge premiums based on an institution's use of advances.

Finally, a regulatory and legal structure is already in place to ensure collaboration between the FDIC and the FHLBanks. If an FDIC-insured institution is experiencing financial difficulties, the FDIC and the relevant FHLBank are required by regulation to engage in a dialogue to ensure the institution has adequate liquidity while minimizing other risks, including losses to the FDIC. In addition, the FHLBanks are provided the legal authority for confidential access to exam reports to assist with this analysis.

The cooperative relationship between the FHLBanks and member financial institutions has worked exceedingly well for nearly 75 years. FHLBank advances serve as a critical source of credit for housing and community development purposes, support sound financial management practices, and allow member financial institutions throughout the nation to remain competitive. FHLBank membership has long been viewed as protection for deposit insurance funds because FHLBank members have access to liquidity when needs arise. Penalizing financial institutions for their cooperative relationship with the FHLBanks would make them less competitive, limit credit availability in the communities they serve, and limit their use of a valuable liquidity source, all for no justifiable economic or public policy reason. We urge the FDIC not to include FHLBank advances in the definition of volatile liabilities and not to charge higher assessment rates to institutions simply because they hold FHLBank advances among their secured liabilities.

Thank you for consideration of our comments.

Sincerely,

Dean Schultz
President and Chief Executive Officer