FHLBank
San Francisco

December 17, 2008

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments, Federal
Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

VIA E-Mail (Comments@FDIC.gov) & Overnight Mail

Re: Notice of Proposed Rulemaking and Request for Comment – RIN 3064-AD35
Federal Deposit Insurance Corporation Revision of Deposit Insurance Assessment Rates

Dear Mr. Feldman:

The Federal Home Loan Bank of San Francisco ("Bank") has reviewed the notice of proposed rulemaking published by the Federal Deposit Insurance Corporation ("FDIC") on October 16, 2008, revising, among other things, the FDIC's deposit insurance assessment rates ("Proposed Rule"). We appreciate the opportunity to comment on the Proposed Rule.

The Bank has significant concerns about certain aspects of the Proposed Rule, in particular, the FDIC proposal to charge an assessment premium if a depository institution's ratio of secured liabilities to domestic deposits exceeds 15%, with "secured liabilities" defined to include Federal Home Loan Bank ("FHLBank") advances. For the reasons stated below, we do not support this aspect of the Proposed Rule.

I. Including FHLBank advances in the term "secured liabilities" will increase the cost of FHLBank advances to member institutions, directly affecting their cost of liquidity and indirectly affecting the cost of loans to the communities that they serve.

A. *Impact on liquidity*

In light of the current liquidity constraints in the credit markets and ongoing issues associated with the mortgage securitization market, the Bank is concerned that including FHLBank advances in the term "secured liabilities" will constrain liquidity further and cause depository institutions to turn to more volatile, less reliable funding sources. As established by Congress, a key purpose of the FHLBank System is to provide a source of long-term liquidity for FHLBank members. Throughout their 76-year history, the FHLBanks have achieved this mission successfully, and in doing so, have served as a valuable liquidity risk management tool for members. In this regard, FHLBank membership can be viewed as helping to protect deposit insurance funds by providing liquidity to FHLBank members when needs arise. 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 management plans.[1] The significant increase in FHLBank members' use of advances as a liquidity management tool during the current credit crisis strongly supports this view.

By including FHLBank advances in the term "secured liabilities" and increasing FDIC assessments based on an institution's percentage of secured liabilities to domestic deposits, the Proposed Rule will have the effect of increasing the cost of FHLBank advances to member institutions, directly resulting in an increased cost of liquidity for the many institutions that rely on FHLBank advances to manage their liquidity needs. Curtailing the use of FHLBank advances in this way would force institutions to look to alternative, often more costly wholesale funding sources that are more volatile and less reliable, thereby reducing affordable credit availability, increasing liquidity risk, and potentially leading to further overall weakening of financial institutions. In short, discouraging borrowing from the FHLBanks by essentially limiting the volume of advances a member institution may obtain from its FHLBank would be counterproductive to reducing the risk of a liquidity failure of FDIC-insured member institutions.

B. *Impact on loans to communities*

Penalizing the use of advances through the imposition of insurance premiums conflicts with the intent of Congress in initially establishing the FHLBanks, and then in opening membership in FHLBanks to commercial banks through the Financial Institutions Reform, Recovery and Enforcement Act of 1989, and in expanding small banks' access to FHLBank advances through the Gramm-Leach-Bliley Act. The FHLBanks' mission is to provide member institutions with access to low-cost funding so they may adequately meet communities' credit needs to support homeownership and community investment. Charging higher assessments to member institutions that use advances to serve those credit needs will disadvantage the communities they serve and frustrate the FHLBanks' mission as established and repeatedly reaffirmed by Congress.

More specifically, many FHLBank members depend on access to low-cost liquidity from the FHLBanks so that they may provide credit in their communities for loans that do not meet conforming loan underwriting standards (e.g., loan size above the conforming limit, which is due to decrease on January 1, 2009). Because the non-agency securities market is presently not an option for such loans, raising the cost of FHLBank advances would have a detrimental impact on the mortgage market, and housing market, of some of the most severely impacted regions of the country, furthering a downward economic spiral.

In essence, the Proposed Rule penalizes financial institutions for their cooperative relationship with the FHLBanks and could have the result of making FHLBank members less effective in serving the credit needs of the communities they serve.

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[1] Unlike deposits, funds from advances are not subject to unexpected fluctuations due to circumstances outside the control of an FHLBank member. The current credit crisis has shown that deposits may be lost due to disintermediation arising from a variety of factors, both expected (e.g., term promotions in a particular market or the existence of higher returns to depositors on alternative assets) and non-expected (e.g., perceptions that an institution is close to failure or FDIC take-over). The credit crisis also has shown that the money and capital markets have not functioned well as long-term, stable providers of wholesale funds, even for those institutions that can normally look to Wall Street for replacement liabilities.

II. Including FHLBank advances in the term "secured liabilities" will likely increase interest rate risk for members that rely on FHLBank advances to help manage this type of risk.

In addition to liquidity management, members frequently use FHLBank advances to manage interest rate risk. FHLBank advances are an attractive asset liability management tool because they are simple, precise, and transparent on-balance sheet transactions that help FHLBank members more easily match the term and interest rate features of their assets and liabilities. FHLBank advances have consistently proven to be a safe and reliable funding source for purposes of prudent interest rate risk management. As the current credit crisis has shown, there has been a significant decline in the availability of other financial tools normally used to manage interest rate risk. For example, competition for core deposits has increased among financial institutions, making longer-term deposits scarcer; the repurchase market has frozen. Many smaller Bank members have avoided the use of derivatives because of the related accounting complexities. By increasing the cost of FHLBank advances, the Proposed Rule effectively discourages FHLBank members from taking advantage of an effective tool to manage interest rate risk precisely at a time when making stable and reliable access to long-term funding is even more vital for interest rate risk management. Given the instability of the financial markets, it is more imperative than ever that financial institutions have the ability to manage interest rate risk adequately and in a cost-effective manner.

In addition, because FHLBank advances are available at longer terms than those readily available for deposits financial institutions can use FHLBank advances to actually reduce their risk of failure and to maintain their safety and soundness. Institutions that use FHLBank advances in this constructive manner should not be punished by having to pay an increased assessment, as anticipated by the Proposed Rule. Penalizing institutions that are reducing their risk of failure seems counter to the FDIC's own goal of preserving the insurance fund.

III. The FDIC offers no evidence to support its basic premise that all secured liabilities, including advances, are equally risky.

We agree that 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. However, we do not believe that an institution's use of advances is per se indicative of additional risk to the deposit insurance fund, and the FDIC has not demonstrated that depository institutions are using secured FHLBank advances to increase their risk profile.

As noted in a research paper published by the FDIC Center for Financial Research in 2005, failures of high-risk banks generally did not involve, nor were they related to, FHLBank advances use. Empirical evidence supports the conclusion that FHLBank advances neither cause, nor are they even a relevant estimator of, future problem resolution issues or CAMELS downgrades. The FDIC offers no empirical evidence to dispute this conclusion or to support its premise that greater advance use in general, or use of advances above the threshold specified in the Proposed Rule in particular, increases the risk of failure and consequential loss to the FDIC. The example described by the FDIC in the preamble makes an unwarranted assumption that each depository institution faces the same risk of failure, which is inherently untrue.

With respect to a depository institution's liquidity risk alone, deposits present inherently more risk to the institution than an FHLBank advance. Any depositor can demand early repayment of his or her deposit for any reason, or no reason, at any time for a financial penalty upon early withdrawal. An FHLBank can only call a standard noncallable advance upon a borrower's default, and thus these FHLBank advances clearly present less liquidity risk to an institution than deposits. When asset-backed commercial paper issuance and term reverse-repurchase agreement markets essentially collapsed in 2007, the relative reliability of FHLBank advances became even more apparent.

IV. Subjecting FHLBank advances to increased assessment rates is contrary to public policy.

Given the significant concerns previously expressed by members of both the United States House of Representatives and Senate when limits on FHLBank advances were initially raised by the FDIC, we do not believe that the FDIC should be imposing an explicit disincentive or effective cap on the volume of advances an insured depository institution may obtain from its FHLBank. On a bi-partisan basis, both the United States House of Representatives and Senate expressed strong concerns that the FDIC's development and implementation of a risk-based insurance assessment system would negatively impact the cost of homeownership or community credit by charging higher premiums for the use of FHLBank advances. (See the House Budget Committee report on the Deficit Reduction Act of 2005 (November 7, 2005) and the House Financial Services Committee report on deposit insurance reform (April 29, 2005).) Such concern was also expressed in separate Congressional Record statements by principal sponsors of FDIC reform. The Proposed Rule, by including advances in "secured liabilities," appears to directly contradict policymakers' positions with respect to the FHLBank System.

V. The Proposed Rule did not contemplate the current financial crisis and may be inconsistent with recent governmental actions taken to specifically address the crisis.

In response to the current credit crisis, the FDIC and Congress have taken a variety actions to increase depository institutions' access to liquidity through deposits, including temporarily raising deposit insurance limits from $100,000 to $250,000 (through the Emergency Economic Stabilization Act) and temporarily extending insurance and guarantees for certain deposits and unsecured debt of particular institutions (through the Temporary Liquidity Guarantee Program). It would be inconsistent with the policy objectives of these programs to now impose an additional constraint on liquidity for FHLBank members by creating a costly disincentive to use FHLBank advances, a legitimate and stable source of liquidity. At a minimum, it would be prudent to delay implementation of any secured liabilities assessment adjustments until after the credit crisis subsides, and Congress and other policymakers can consider changes in deposit insurance premiums within the context of a comprehensive review of deposit insurance.

VI. Recommendations

For the reasons noted above, we recommend the following with respect to the Proposed Rule:

1. We urge the FDIC not to include FHLBank advances in the definition of "secured liabilities" and not to charge higher assessment rates to financial institutions simply because they hold a certain amount of FHLBank advances among their secured liabilities. If the Proposed Rule is adopted as currently proposed, we believe the impact on the use of FHLBank advances could result in undesirable and unintended outcomes for all financial institutions and the communities they serve. Given the significant challenges already facing the banking industry and the economy at this time, increasing the cost of liquidity and unnecessarily constraining access to funding sources would hinder recent efforts by Congress to

encourage the healthy flow of capital in the economy and to address the credit crisis, which could result in a further weakening of the general economic environment.

2. If the FDIC does proceed with an upward rate adjustment tied to secured liabilities that include FHLBank advances, we recommend that the FDIC consider treating FHLBank advances more favorably than other forms of secured liabilities. The FHLBanks are unique providers of secured funding, chartered specifically by Congress to serve the needs of their financial institution members. The FHLBanks have long been a reliable funding source and an effective asset-liability risk management tool for their members. Since August 2007, the FHLBanks have played a critical role in stabilizing the economy, providing liquidity when most other sources were unable to do so. The number of financial institution failures during this turbulent period would most likely have been higher (and costlier to the deposit insurance fund) if FHLBank advances had been subject to the proposed assessment rates.

3. If the FDIC proceeds with the proposed secured liabilities assessment, we urge the FDIC to postpone the effective date of the proposed secured liabilities assessment until at least the end of 2009, when the impact of several Congressional and federal measures will be better understood. This will avoid changes that would conflict with the efforts of Congress and other policymakers to deal with the immediate credit crisis.

Thank you for considering our comments.

Sincerely,

Dean Schultz
President and Chief Executive Officer