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June 12, 2008

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 Seventeenth Street, N.W.
Washington, D.C. 20429

RE: Interim Final Policy Statement on Covered Bonds – Request for Comments

Dear Mr. Feldman:

On April 15, 2008, the Federal Deposit Insurance Corporation adopted an interim final policy statement titled "Covered Bond Policy Statement" (Policy Statement) and solicited public comment on various issues relating to the FDIC's treatment of covered bonds in a receivership and conservatorship context. In addition, the FDIC solicited public comments on other issues, including the FDIC's treatment of secured liabilities for assessment and other purposes. In particular, the FDIC asked "whether an institution's percentage of secured liabilities to total liabilities should be factored into an institution's insurance assessment rate or whether the total secured liabilities should be included in the assessment base." In addition, the FDIC requested comments on "whether ... there should also be an overall cap for secured liabilities."

The First State Bank of Norton, Plainville, Hill City, and Hoxie, Kansas appreciates the opportunity to address the important issues raised by this request for comments.
While the Policy Statement did not specifically refer to Federal Home Loan Bank (FHLBank) advances, we are concerned that the term "secured liabilities" encompasses such loans. We believe that penalizing the use of FHLBank advances, or placing an arbitrary cap on their use, is not consistent with sound public policy, especially in light of the current demand for enhanced liquidity in the credit markets, and is not consistent with Congressional intent.

FHLBank advances serve as a consistent, reliable source of liquidity for our bank and other FHLBank members. The availability of FHLBank advances as a means of wholesale funding is especially important to our bank and to the other community banks that represent a large majority of the FHLBank System's 8,100 plus members. We do not have reliable access to other sources of cost-effective wholesale funding and rely on the availability of FHLBank advances as a critical tool for managing our balance sheets and implementing our business plans. In fact, in 2007 FHLBank advances increased 36.6 percent to $875 billion, and increased further to $913 billion by the end of the first quarter 2008 - indicating that the FHLBanks are playing a vital role in alleviating the current shortage of liquidity in the mortgage markets. Limiting or penalizing the use of the FHLBank funding is inimical to the current efforts by the Administration, Congress, and the Federal Reserve to restore liquidity and bolster confidence in the mortgage sector.

A policy that discourages borrowing from the FHLBanks would be counterproductive to reducing the risk of failure of FDIC-insured institutions and could, in fact, increase risks to FHLBank members. FHLBank advances are commonly used for liquidity purposes, and help FHLBank members manage interest-rate risk and fund loan growth, especially in markets in which the supply of deposit funds is inadequate to meet loan demand and prudent financial management needs. If the use of FHLBank advances is discouraged, our bank and other FHLBank members would be forced to seek alternative, often more costly and volatile sources of wholesale funding, thereby reducing profitability and increasing liquidity risk.

We think the FDIC should consider the potential unintended consequences of its actions if it were to cap the amount of secured liabilities of insured depository institutions. To the extent that an institution were close to the cap, and it suffered a liquidity issue, such a cap would prevent an FHLBank from performing its historic role of supplying a ready source of liquidity to institutions with adequate collateral. Thus, we believe that the imposition of a cap could actually increase the likelihood that the institution would default and, instead of decreasing the costs to the FDIC, could increase the costs to the FDIC.

Furthermore, recent events show that insured depository institutions that were involved in securitization of home mortgage loans relied extensively upon FHLBank advances to fund holding jumbo mortgages in portfolio when the non-agency securitization market essentially shut down due to investor panic. It is our view that an FDIC rule capping the level of an insured depository institution's secured borrowing would increase the current cost of jumbo mortgages to the American public by decreasing the ability of such institutions to obtain ready liquidity by pledging mortgages to an FHLBank.

A policy that discourages the use of FHLBank advances by imposing higher deposit insurance premiums on institutions based on their use of FHLBank advances, or that limits the amount of advances that they can use, would be contrary to the intent of Congress in establishing the FHLBanks, in opening FHLBank membership to commercial banks as part of 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. An FDIC policy that discourages the use of FHLBank advances would undermine the mission of the FHLBanks as established and repeatedly reaffirmed by Congress.

When the FDIC initiated its risk-based deposit insurance assessment rulemaking, a similar question arose as to the treatment of FHLBank advances. On a bi-partisan basis, both the House and Senate strongly expressed concern 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 FDIC received 569 comments on the issue and all but one argued that the FDIC should not address FHLBank advances. There is no reason to believe that the views of Congress or the commenters on this matter have changed now that the vehicle is covered bonds rather than deposit insurance reform.

For seventy-five years, the FHLBanks, their member financial institutions, and the communities they serve nationwide have benefited from FHLBank advances. FHLBank advances function as a critical source of credit for housing and community development purposes, sustain prudent financial management practices, and enable small community member banks throughout the nation to remain competitive. FHLBank membership has long been viewed as protection for deposit insurance funds because FHLBank members have access to a reliable source of liquidity. In considering a final Policy Statement on covered bonds, or in taking any other administrative action, we strongly urge the FDIC not to penalize our bank and other institutions based on their use of FHLBank advances, or to limit the amount of such liabilities that we can use for our funding needs.

Sincerely,

John P. Engelbert
President