



October 28, 2009

By e-mail to Comments@FDIC.gov

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

Attention: Comments/RIN 3064-AD49

Re: Proposed Rulemaking on Prepaid Assessments

Dear Mr. Feldman:

The Federal Home Loan Bank of Topeka (FHLBank Topeka) appreciates the opportunity to comment on the Notice of Proposed Rulemaking (proposed rule) published by the Federal Deposit Insurance Corporation (FDIC) in the *Federal Register* on October 2, 2009 proposing to amend the FDIC's assessment regulations to require insured depository institutions to prepay, on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012.

The Federal Deposit Insurance Act (FDI Act) gives the FDIC the authority to borrow from one or more Federal Home Loan Banks (FHLBanks) for the use of the Deposit Insurance Fund (DIF). FHLBank Topeka encourages the FDIC to revisit the option of borrowing from one or more FHLBanks to partially address the DIF's anticipated liquidity needs. FHLBank Topeka believes that prepaying assessments disproportionately affects small insured depository institutions and provides only a small portion of the total to be collected. Since the FDIC has the legal right to differentiate how it collects assessments from small and large insured depository institutions, we believe that by borrowing from one or more FHLBanks, the FDIC would be able to eliminate the need for small insured depository institutions, which we propose be defined as less than \$1 billion in assets, to prepay assessments.

FHLBank Topeka is a privately owned, federally-chartered corporation that helps member financial institutions, including small FDIC-insured depository institutions that make up the vast

majority of its membership, expand the availability of mortgage credit, compete more effectively in their markets and foster strong and vibrant communities. FHLBank Topeka's relationship with those small insured depository institutions in its district influenced our decision to request the FDIC consider additional options besides requiring all insured depository institutions to prepay their assessments.

Authority to Borrow from FHLBanks

The FDI Act specifically authorizes the FDIC to borrow from the FHLBanks. The FDI Act provides "The Corporation may borrow from the Federal Home Loan Banks, with the concurrence of the Federal Housing Finance [Agency], such funds as the Corporation considers necessary for the use of the Deposit Insurance Fund." 12 U.S.C. §1824(e)(1).

The FHLBank Act similarly gives the FHLBanks the authority to make loans to the FDIC. It provides that "the Federal Home Loan Banks may, upon the request of the Federal Deposit Insurance Corporation, make loans to such Corporation for the use of the Deposit Insurance Fund." 12 U.S.C. §1431(k). Therefore, the FDIC has the authority to borrow money from the FHLBanks for the use of the DIF, and the FHLBanks have the authority to lend money to the FDIC for the use of the DIF.

The FDI Act and the FHLBank Act provide substantially similar provisions as to the requirements of a loan from an FHLBank to the FDIC. The FDI Act provides "any loan from any Federal Home Loan Bank...to the Deposit Insurance Fund shall-

- (A) bear a rate of interest of not less than the current marginal cost of funds to that bank, taking into account the maturities involved;
- (B) be adequately secured, as determined by the Federal Housing Finance [Agency];
- (C) be a direct liability of the Deposit Insurance Fund; and
- (D) be subject to the limitations of section 1825(c) of this title."

12 U.S.C. §1824(e)(2).

Given that the statute requires the loan be adequately secured, FHLBank Topeka believes the FDIC's obligation to repay the loan would be secured by the full faith and credit of the United States. 12 U.S.C. §1825(d) provides that "the full faith and credit of the United States is pledged to the payment of any obligation issued...by the Corporation, with respect to both principal and interest..." An obligation guaranteed by the full faith and credit of the United States is equivalent to a security guaranteed by the United States which is eligible collateral to an FHLBank under 12 U.S.C. §1430(a)(3)(B). An FHLBank would also be limited to charging a

minimum interest rate and the FDIC would be limited in the amount it may borrow under §1825(c)¹.

Consequently, FHLBank Topeka believes there is clear authority for the FDIC to borrow from one or more FHLBanks and encourages the FDIC to revisit this as a means to eliminate the need for prepayment of assessments for small insured depository institutions.

Authority to Differentiate Between Small and Large Insured Depository Institutions

The FDIC has the authority to differentiate between large and small institutions. 12 U.S.C. §1817(b)(1)(D) provides that “The Board of Directors may establish separate risk-based assessment systems for large and small members of the Deposit Insurance Fund.” The broad authority in the FDI Act therefore would allow the FDIC to differentiate between large and small members for the purposes of requiring institutions to prepay assessments by establishing separate assessment systems for those institutions. The FDIC has established definitions for “Small Institution” and “Large Institution” in its assessment regulations. The FDIC defines “Small Institution” as “An insured depository institution with assets of less than \$10 billion...” 12 C.F.R. §327.8(g). Accordingly, a “Large Institution” is defined as “...an insured depository institution with assets of \$10 billion or more...” 12 C.F.R. §327.8(h). However, the FDIC has provided an exception in the definition of “Large Institution” which allows for institutions in Risk Category I with assets of between \$5 billion and \$10 billion to request treatment as a large institution in determining the institution’s initial base assessment rate. 12 C.F.R. §327.9(d)(8)(i). Since the FDIC has broad authority to define “small” and “large” institutions, FHLBank Topeka suggests the FDIC, for the purposes of this regulation, define “Small Institution” as an institution with assets of less than \$1 billion and “Large Institution” as an institution with assets of \$1 billion or more. Such a determination would allow community banks to continue to pay assessments under the current assessment system. While large institutions would still be required to prepay assessments, it is the large institutions that are most capable of shouldering the burden created by requiring prepayment.

Benefits of Borrowing from FHLBanks

FHLBank Topeka believes that it is in the best interest of the banking industry, particularly the community banking industry that comprises the vast majority of the FHLBanks’ customer base, for the FDIC to consider borrowing from the FHLBanks as a means to eliminate the need for prepayment of assessments from small insured depository institutions. As of October 28, 2009,

¹ 12 U.S.C. §1825(c)(5) limits the amount of outstanding obligations the FDIC may incur by providing that “...the Corporation may not issue or incur any obligation, if, after issuing or incurring the obligation, the aggregate amount of obligations of the Deposit Insurance Fund, outstanding would exceed the sum of – (A) the amount of cash or the equivalent of cash held by the Deposit Insurance Fund; (B) the amount which is equal to 90 percent of the Corporation’s estimate of the fair market value of the assets held by the Deposit Insurance Fund, other than assets described in subparagraph (A); and (C) the total of the amounts authorized to be borrowed from the Secretary of the Treasury....”

106 institutions have failed. While this understandably places a significant strain on the DIF, requiring institutions to prepay more than three years of assessments further harms community banking institutions that are struggling to survive in this difficult economic environment.

The proposed rule cites difficulties in borrowing from the Treasury Department, the Federal Financing Bank (FFB) and insured depository institutions. For example, borrowing from the Treasury would require the concurrence of the FDIC's Board, the Federal Reserve Board and the Secretary of the Treasury in consultation with the President, and would also require a schedule for the repayment of the borrowing be agreed to by the Secretary after consultation with the Financial Services Committee of the House of Representatives and the Committee on Banking, Housing and Urban Affairs of the Senate. Limitations are also in place which would not make borrowing from the FFB a practical alternative. Furthermore, borrowing from insured depository institutions "would be voluntary and would not ensure that the DIF collects enough cash to fund future failures." 74 F.R. 51065 n. 15. However, there are no such limitations on borrowing from an FHLBank.

We agree with the FDIC's observation that "additional or higher special assessments could severely reduce industry earnings and capital when the industry is under stress." 74 F.R. 51066. However, prepaid assessments would have the same present impact as "additional" assessments, adding an illiquid and noninterest-bearing asset to the balance sheet that institutions will not fully recover until the end of 2012.

The preamble to the proposed rule states "the FDIC believes that most of the prepaid assessment would be drawn from available cash and excess reserves, which should not significantly affect depository institutions' current lending activities." 74 F.R. 51066. However, as reflected by the number of institutions that have failed in 2009, liquidity is already significantly constrained and placing further stress on the liquidity of small institutions could result in more failures, possibly resulting in additional strain to the DIF.

The Regulatory Flexibility Act analysis undertaken by the FDIC is beneficial to understanding the proposed rule's impact on community banking institutions. The analysis states that "the proposal has no significant effect on capital and earnings, although there could be a small loss of interest earned by some small institutions." 74 F.R. 51067. FHLBank Topeka believes the FDIC is underestimating the loss of interest that could be earned were an institution not required to prepay its assessments and did not adequately consider the full opportunity costs of the prepayments.

The analysis also states that the proposal could affect the liquidity of small institutions, but states that "for 95.8 percent of small institutions, the prepayment would be less than 25 percent of their

cash and cash equivalent assets.” 74 F.R. 51067. Notwithstanding the approximately 190² small institutions³ that would have to make a prepayment of 25 percent or more of their cash and cash equivalent assets, an institution that is required to prepay assessments representing less than 25 percent of its cash and cash equivalent assets could be significantly harmed by this proposal by decreasing liquidity as well as hampering an institution’s capital and earnings ability.

Furthermore, although the proposed rule provides for an exemption for institutions that cannot prepay their assessments and an option allowing an institution to transfer its prepaid assessments, these options do not significantly mitigate the risk discussed in the preamble that “additional or higher special assessments could severely reduce industry earnings and capital when the industry is under stress.” 74 F.R. 51066. A prepayment of more than three years worth of assessments could create the same harmful effects the FDIC wishes to avoid by not raising assessment rates or requiring payment of special assessments.

Borrowing from one or more FHLBanks presents a better alternative than requiring small insured depository institutions to prepay assessments. Institutions would be able to retain much needed liquidity and would not have to experience the negative effects on capital or earnings were they required to prepay more than three years of assessments, and the FDIC would be able to increase the reserve of the DIF. Because of the status of FHLBanks as government-sponsored enterprises (GSEs), an FHLBank can obtain funds for significantly lower cost than insured depository institutions can obtain funds, particularly small insured depository institutions. While the proposed rule states there would be no interest costs by collecting prepaid assessments, there would still likely be interest costs to the institutions that will be required to borrow funds to prepay the FDIC assessments. *See* 74 F.R. 51066. Therefore, FHLBank Topeka believes that the FDIC can borrow funds from one or more FHLBanks for lower cost than the industry as a whole will be required to borrow to meet the prepayment mandate. This is especially true for small insured depository institutions which have less funding options than do larger institutions.

FHLBank Topeka estimates that small insured depository institutions (under \$1 billion in assets) will only provide a small portion of the total prepaid assessments. Institutions with under \$1 billion in assets number approximately 7,500, with another approximately 700 institutions having assets over \$1 billion. Based on second quarter 2009 numbers, FHLBank Topeka estimates that those 7,500 institutions would provide approximately \$6 billion in prepaid assessments of the \$45 billion the FDIC estimates it will receive, or less than 14 percent of the total.

² Calculated by taking 4.2% of the 4591 small insured depository institutions (defined as under \$175 million in assets for purposes of the Regulatory Flexibility Act) identified in the proposed rule.

³ As used in the proposed rule analyzing the proposed rule’s effects under the Regulatory Flexibility Act.

A loan from one or more FHLBanks in lieu of prepaid assessments would allow small insured depository institutions to stabilize and build capital while minimizing the additional financial burdens on those institutions. If the current assessment system remains in place for small institutions and the FDIC requires prepayment from large institutions, the DIF reserve ratio will increase as failure rates decrease. Because of the ability of an FHLBank to be flexible in its loan terms, the DIF could return to its statutorily mandated reserve ratio by paying down FHLBank loans as the reserve ratio increases under the current assessment regulations.

The cost to the FDIC to borrow from one or more FHLBanks would be minimal. In addition, the term of the borrowings can be structured to meet the maturity needs of the FDIC. For example, the FHLBanks could provide a guaranteed line of credit such that the FDIC would have the ability to draw on the line of credit when funds are actually needed. The guaranteed line could provide that the FHLBank would charge a fixed, small markup in its costs of funds such that the FHLBank would not be disadvantaged in redirecting liquidity from other highly rated investments to the FDIC. For example, lending overnight to the FDIC could be done today at an annualized rate of 15 to 20 basis points. Once funds are drawn, the cost to borrow would be low and depend on the type of funding needed. Loans could be structured to best suit the needs of the FDIC. Even if the FDIC draws the full \$6 billion, the annual cost at 15 basis points would only be \$9 million.

The proposed rule also expresses a preference that the deposit insurance system remains directly industry funded. While not consisting solely of institutions insured by the FDIC, the unique cooperative ownership structure of FHLBank Topeka would allow for industry funding. Since FHLBank Topeka is a cooperative owned primarily by FDIC-insured institutions, any FHLBank Topeka loans to the FDIC would essentially be funded by the industry. Furthermore, since FHLBanks are owned by their member institutions, borrowing from an FHLBank would not increase the public debt limit as it would if the FDIC were to borrow from the Treasury Department or the FFB.

Finally, the proposed rule states that "prepaying assessments would be simpler than borrowing from [the FHLBanks] because the assessment system already exists and requires only minor modifications to accommodate prepayment of assessments." 74 F.R. 51065 n. 15. FHLBank Topeka does not believe that the simpler solution is necessarily the best solution. While no lending agreement is in place between the FHLBanks and the FDIC, FHLBank Topeka believes such an agreement would be more beneficial to the FDIC and banking institutions than would requiring prepayment of more than three years of assessments for small insured depository institutions. Furthermore, while requiring institutions to prepay assessments may be a simple way to rebuild the DIF from the FDIC's perspective, institutions may struggle to comply with the requirements of the proposed rule. Institutions may be required to locate, apply for, and receive funding to prepay assessments, analyze and revise their balance sheets to ensure they remain in

compliance, undertake administrative burdens to track prepayment amounts, and possibly apply for an exemption or find an institution that is willing to enter into an agreement to transfer the prepaid assessments. Such requirements can represent significant burdens for small institutions.

Based on the foregoing, we believe that the FDIC should reconsider the benefits derived from borrowing from one or more FHLBanks. Such borrowing would be beneficial to small insured depository institutions, as they would be relieved of some of the burden of being required to prepay more than three years of assessments, and would ultimately be positive for the industry as a whole.

We appreciate the opportunity to provide our comments on this important proposed rule.

Sincerely,



Ronald K. Wente
Chairman of the Board



Andrew J. Jetter
President and CEO

Cc: Edward J. DeMarco
Stephen M. Cross