FHLBank
Topeka
Building Communities Together

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September 18, 2006

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

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 Topeka (FHLBank Topeka) is pleased to provide its response to the FDIC's notice of proposed rulemaking and request for comment regarding deposit insurance assessments. Our response is limited to 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. As a Federal Home Loan Bank with over 70 years of experience lending to depository institutions and with over 800 members actively using our advance products, we believe we are particularly well positioned to address the FDIC's request for comment on this subject.

We do not believe it would be appropriate to directly link the use of advances by an insured depository institution and the deposit insurance assessment rate applicable to that institution. Specifically, we believe that the use of advances by insured depository institutions reduces the overall level of risk exhibited by an insured depository institution and therefore reduces the risk of loss to the deposit insurance fund. In addition, we believe that a direct link between advance usage and deposit insurance premiums would be inconsistent with public policy as expressed by the United States Congress.

Risk of Loss to the Fund

The ultimate rationale for any attempt to link the use of advances with insurance assessments is the belief that the use of advances increases the likelihood of loss to the deposit insurance fund. While arguments can be constructed to suggest this is the case, our experience confirms the opposite: the use of advances by an institution tends to decrease the overall level of risk exhibited by that institution.

It is helpful to compare the risks associated with using deposit funding and advance funding. The use of deposits to fund a depository institution carries with it certain risks. Depository institutions compete for deposits in the open market. That market is generally highly competitive and an institution can not be assured what level of deposits it will be able to attract at any specific term and rate. Deposit structures are generally dictated by the terms sought by depositors, not the terms specifically needed by the institution. Existing deposits can easily be lost to other institutions willing to pay higher rates. Even deposits with longer terms are subject to withdrawal as a depositor essentially has the right to put the deposit back to the institution in exchange for paying an early withdrawal penalty. This stands in stark contrast to advances. A depository institution knows the terms and rates that are available and has the option to select the advance type best tailored to the institution's funding needs. Advances are available for longer terms at fixed rates, allowing an institution to lock in funding costs with certainty. While FHLBanks have certain rights as a creditor, experience has shown time and time again that FHLBanks work cooperatively with troubled institutions to help them address problems and regain financial health.

We are familiar with some of the research conducted on this issue. However, that research seems to be based on the assumption that advances usage increases risk and research methodology is constructed to test that conclusion. We believe it would lead to more meaningful results to test whether access to and use of advances actually lowers an institution's overall risk profile. Why would advances lower an institution's risk profile? There are several reasons. Advances come in a broad mix of available terms and risk characteristics. They provide an institution the ability to better manage its asset-liability mix, both at a micro level by matching the terms of an advance to a specific loan made by the institution and at a macro level by addressing overall mismatches in the institution's funding mix. Historically, a primary risk factor for depository institutions has been the level of liquidity exhibited. Access to FHLBank advances significantly increases an institution's available liquidity.

Some have asserted a "moral hazard" associated with advance usage (as is unquestionably the case with deposits), claiming that FHLBanks do not take into account the risk profile of an institution in making lending decisions. This is simply not the case. FHLBank Topeka expends significant effort in monitoring the financial condition of its borrowing members. Institutions which exhibit higher levels of risk are identified and contacted to ensure that concerns are being addressed. FHLBank Topeka works closely with such members to ensure that the institution focuses on improving its financial situation. An institution's unwillingness to appropriately address its financial condition can lead to credit actions such as delivery of collateral and limitations on the terms of advances. FHLBank Topeka has always worked cooperatively with an institution's primary regulator to assist when difficulties arise and to play a constructive role in helping the institution return to financial health or work towards an alternative resolution preferred by the regulator.

Pubic Policy

The FHLBank System was established by Congress to provide a reliable source of liquidity for depository institutions. FHLBank Topeka is a stable, reliable source of funds for its nearly 900 member institutions, and the availability of such credit has a predictable, beneficial effect on members' business plans. Penalizing the use of advances through the imposition of insurance premiums would be in direct conflict with that Congressional intent. Our mission and mandate 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 those institutions utilizing advances would, in effect, use the regulatory process to vitiate the FHLBanks' mission as established and repeatedly reaffirmed by Congress.

Congressional intent and public policy have been expressed in numerous Congressional reports and statements of Members of Congress. On a bi-partisan basis, both the House and Senate have strongly expressed concern that the FDIC's development and implementation of a risk-based insurance assessment system not negatively impact the cost of homeownership or community credit by charging higher premiums for the use of FHLBank advances. This can be found in both the House Budget Committee report on the Deficit Reduction Act of 2005 (House Rept. 109-276, Section-by-Section Analysis, Sec. 4004; November 7, 2005) and the House Financial Services Committee report on the Federal Deposit Insurance Reform Act of 2005 (House Rept. 109-067, Section-by-Section Analysis, Sec. 4; April 29, 2005). 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 advances. Congressman Spencer Bachus (R-AL) made 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, expressing strong concern that the FDIC might 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. Accordingly, it is the clear intent of Congress that the FDIC should not charge higher premiums based on an institution's use of FHLBank 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 capital deficient, its FHLBank must honor a request from the member's appropriate federal banking agency or insurer not to lend to such member, and may renew outstanding advances to a member without positive tangible capital for a term greater than 30 days only at the written request of the member's appropriate federal banking agency or insurer.

In conclusion, the cooperative relationship between the FHLBanks and member financial institutions has worked remarkably well for 75 years. FHLBank advances serve as a critical source of credit for housing and community development purposes, support sound financial management practices, and allow community banks throughout the nation to remain competitive. FHLBank membership has long been viewed as protection for deposit insurance funds because FHLBank members have reliable access to liquidity. Penalizing financial institutions for their cooperative relationship with the FHLBanks would result in community banks being less competitive, would limit credit availability in the communities they serve, and would limit their use of a valuable liquidity source, all for no justifiable economic or public policy reason.

Therefore, we urge the FDIC not to include FHLBank advances in the definition of volatile liabilities or to charge higher assessment rates to institutions that have significant amounts of secured liabilities.

Sincerely,

Andrew J. Jetter
President and CEO