FEDERAL HOME LOAN BANK OF CINCINNATI

September 19, 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 (RIN 3064-AD09)

Dear Mr. Feldman:

We appreciate the opportunity to respond to your request for comment regarding the Federal Deposit Insurance Corporation's (FDIC) proposed rule on deposit insurance assessments – specifically, 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. Given that the use of FHLBank advances is not included in the definition of volatile liabilities as the regulation is currently proposed, we are in agreement with the FDIC on this position. With respect to the application of higher assessment rates to institutions that have significant amounts of secured liabilities, we would once again agree with the initial position of the FDIC on this issue and would support an institution not being penalized for FHLBank advance usage. Specific support for these conclusions is provided below for your consideration.

FHLBank advances are not volatile liabilities.

FHLBank advances have pre-defined, understood and predictable terms, and in many ways are less volatile than deposits. Small banks in particular are finding the competition for deposits currently to be difficult, and many rely on FHLBank advances as a stable source of funding for mortgages and community investment. Advances are available to our members on a fixed or variable rate basis in maturities ranging from one day to 30 years. Longer-term fixed rate advances are especially valuable as both a funding source and as an interest rate risk management tool, particularly since deposits of equivalent terms are extremely difficult to attract. In addition, the dependability of FHLBank advances adds a large measure of stability to the business plans of community banks. We agree with the current position of the FDIC not to include FHLBank advances in the definition of volatile liabilities.

221 E. 4th Street • Suite 1000 • Cincinnati, Ohio 45202 • 513-852-7500 • 513-852-7655
Mailing Address: P.O. Box 598 • Cincinnati, Ohio 45201-0598

Penalizing FHLBank advances may encourage risky behavior by FDIC-insured institutions.

Our smaller members depend, to a significant extent, on the FHLBank as a source of low-cost funding. Any move by the FDIC to penalize financial institutions for holding FHLBank advances would raise the cost of these advances and disproportionately hurt the smaller institutions. In our district of Kentucky, Ohio and Tennessee, these small community banks – those with assets less than $1 billion – hold advances-to-assets of a weighted average 7.40 percent vs. their larger counterparts at 6.48 percent. In addition, our smaller members have fewer alternatives for sources of liquidity than their medium-to-large counterparts. Curtailing the use of FHLBank advances would force institutions to look to alternatives, which are often more costly and volatile, and would reduce profitability while increasing liquidity risk.

FHLBanks take a financial institution's overall financial health into account when making advances.

While FHLBanks often do not charge higher interest rates on advances to higher-risk borrowers, FHLBanks do increase the overall cost of borrowing for higher risk institutions as determined by their overall financial condition and risk profiles. A member's FHLBank borrowing capacity and access to long-term funding is based on the combination of the financial risk rating and collateral position. Higher-risk borrowers are required to put up more and/or higher-quality collateral, to access advances.

The FHLBanks are restricted in lending to capital-deficient members.

The FHLBanks are subject to applicable Federal Housing Finance Board regulation that restricts advance activity to a capital-deficient member. As a result, an FHLBank "shall not make a new advance to a member without positive tangible capital unless the member's *appropriate federal banking agency or insurer* requests in writing that the Bank make such advance." (Emphasis added.) In addition, an FHLBank may not renew or make a new advance to a capital-deficient-yet-solvent member if it has received written notice from the appropriate federal banking agency or insurer that the member's use of FHLBank advances is prohibited. In effect, the FDIC has the ability to limit additional FHLBank advance activity in certain high-risk situations if the respective FHLBank has not already done so.

The FHLBank takes great pride in the fact that we stand ready to support our member's liquidity requirements as mandated by Congress, which means at times we may be the lender of last resort for a financially distressed institution. However, in our experience, prudent credit underwriting – along with risk-based collateral requirements – have proven to be a strong deterrent to high-risk borrowers taking on unnecessary advances. Historically, FHLBank advances to troubled institutions have been restricted to short-term liquidity needs that are often used to support a declining deposit base. This measured approach to member liquidity funding has enabled various institutions the time and funds necessary to work their way back to a healthy status and avoid the need for

> FDIC intervention. Ultimately, by regulation, the FDIC has the ability to encourage or discourage an FHLBank from funding a troubled institution. As such, we believe that the existing "cooperative system" protects both the FHLBank and the FDIC.

We believe our services and standards promote sound management of our member institutions, which benefits their communities, protects our investment, and ultimately helps to protect the FDIC from losses. Penalizing financial institutions for their cooperative relationship with the FHLBanks could result in their being less competitive, limit credit availability in the communities they serve, and limit their use of a valuable liquidity source. We support the proposed regulation, as written, without inclusion of Federal Home Loan Bank advances in the definition of volatile liabilities. We also support the FDIC's position in maintaining the current policy of not assessing additional deposit insurance premiums for FDIC-insured institutions with significant amounts of secured liabilities, such as FHLBank advances.

Sincerely,

David H. Hehman
President