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August 24, 2006

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 Seventeenth Street, N.W.
Washington, D.C. 29429

Re: Request for Comments – Deposit Insurance Assessments on FHLBank Advances – RIN 3064-AD09

Dear Mr. Feldman:

Please be advised that with respect to the FDIC's proposed notice of rulemaking and comment, we do not believe that Federal Home Loan Bank (FHLBank) advances should be included in the definition of volatile liabilities, or that higher assessment rates should be charged to institutions that have significant amounts of secured FHLBank liabilities.

River Valley Financial Bank is a $330 million bank headquartered in Madison, Indiana that extends mortgage loans to customers across southeastern Indiana and north central Kentucky; In carrying out our housing finance mission, we routinely and reliably borrow from the Federal Home Loan Bank of Indianapolis (FHLBI) in order to meet our liquidity needs in all market conditions, and we use the FHLBI to fund our housing and community development lending. Currently, we have over $75 million in advances from the FHLBI. Because of a number of factors, communities we serve do not necessarily have the financial resources (in the form of deposits) to sustain the housing needs that as a community bank we are asked to fund. The FHLBI allows us to fulfill that need.

Based on my track record of using the FHLBI, advances are not volatile liabilities for FHLBank members. FHLBank advances have pre-defined, understood, and predictable terms. Experience has shown that deposits may be lost due to disintermediation arising from a variety of factors, such as special, short-term promotions in a particular market or the existence of higher returns to depositors on alternative assets. Conversely, advances do not evaporate due to circumstances outside the control of an FHLBank member and the FDIC from a safety-soundness perspective. While some institutions can look to Wall Street for replacement liabilities, the capital markets have not functioned well as long-term, stable providers of wholesale funds to the community banks that comprise the bulk of the FHLBank membership. Since smaller institutions may on a proportionate basis rely more on FHLBank borrowings than those institutions having direct access to Wall Street and the capital markets, we do not want to disadvantage the small and mid-size banks with higher FDIC premiums simply because they lack capital market access.

The stability of FHLBank advances is illustrated by the fact that members are cooperative owners of the FHLBank, and as a government-sponsored enterprise, the FHLBank operates under specific congressional mandates to support liquidity and housing finance, and is closely regulated by the Federal Housing Finance Board. Under this regulatory regime, a prospective member is required to purchase FHLBank stock as a prerequisite to membership. This transaction establishes an ongoing relationship between the FHLBank and the member in which each party's compliance with the terms of the advance ensures the continued vitality of the other.

As set by Congress, the primary purpose of the FHLBank System is to provide a source of long-term liquidity for FHLBank members. Throughout their 75-year history, the FHLBanks have been a stable, reliable source of funds for member institutions, and the availability of such credit has a predictable, beneficial effect on members' business plans. Currently, the FHLBank System provides funding for more than 8,200 member financial institutions. It would be illogical to include FHLBank advances in the definition of volatile liabilities given the stability of the FHLBanks, the reliable availability of advances as a source of wholesale funding, and the beneficial and predictable effects of such funding for the members.

Deposit insurance premiums should be based on an institution's actual risk profile, taking into account an institution's supervisory rating and capital ratios. Banks that are engaged in excessively risky activities should pay a higher premium, regardless of whether those activities are financed by insured deposits or stable FHLBank advances. It may be appropriate to risk-adjust other wholesale funding sources, which are unstable, volatile, and outside of the community banks' regular deposit gathering market – all attributes that are not found with FHLBank borrowings. The professional and capable FDIC examination staff is better suited to determine a bank's risk profile than an inflexible formula imposed on all insured institutions, regardless of circumstance.

Discouraging the use of FHLBank advances would be counterproductive and could perversely increase risks to FHLBank members and the FDIC. In many markets, the supply of deposit funds is inadequate to meet loan demand and prudent financial management needs. Member institutions frequently use FHLBank advances for liquidity purposes as a lower cost alternative to deposits to fund loan growth. Additionally, the use of advances by a member institution may actually reduce the risk of failure because advances enable an institution to better manage its interest rate risk. FHLBanks monitor closely the financial strength of member institutions and take appropriate actions based on the members' performance.

If the FDIC were to charge a premium on FHLBank advances used to fund home loans, we fail to see that any benefit accrues back to the homebuyer as borrower from the FDIC institution. The premiums appear to be nothing more than a hidden tax on the homeowner. A depositor clearly benefits by having his or her funds protected by FDIC insurance. Assessing insurance premiums on the basis of an FHLBank provides no benefits to the homeowner, the institution, or the FHLBank. Thus, it is inappropriate and inequitable that the borrowing homeowner incurs this additional charge. Curtailing the use of FHLBank advances would force institutions to look to alternative, and often more costly, wholesale funding sources that are demonstrably more volatile, thereby reducing profitability and increasing liquidity risk.

Penalizing the use of advances through the imposition of insurance premiums conflicts with the intent of Congress in establishing the FHLBanks, in opening membership in the FHLBanks to commercial banks under the 1989 FIRREA legislation, and with the Gramm-Leach-Bliley Act of 1999, which expanded community 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. Charging higher assessments to those banks utilizing advances would, in effect, use the regulatory process to undermine the FHLBanks' mission as established and repeatedly upheld by the Congress. Moreover, the legislative history discussing the new FDIC premium legislation cautions that the risk-based insurance premium assessment model to be developed by the FDIC should not adversely affect the use of FHLBank advances.

To address the risk of FHLBank advances to the FDIC insurance fund, a regulatory and legal structure already exists to ensure collaboration between the FDIC and the FHLBanks. If an FDIC-insured institution experiences financial difficulties, the FDIC and the relevant FHLBank are required by regulation to ensure the institution has adequate liquidity and minimizes other risks, including losses to the FDIC. In addition, the FHLBanks possess the legal authority to obtain confidential access to exam reports to assist with this analysis.

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 member banks throughout the nation to remain competitive. FHLBank membership has long been viewed as protection for deposit insurance funds by providing FHLBank members alternative access to low-cost liquidity during all economic cycles. Penalizing financial institutions for their cooperative relationship with the FHLBanks would result in the institutions being less competitive, limit credit availability in the communities they serve, and limit their use of a valuable liquidity source – all for no justifiable economic or public policy reason. We urge the FDIC not to include Federal Home Loan Bank advances in the definition of volatile liabilities.

We thank the FDIC for the opportunity to submit comments on this important issue.

Sincerely,

Matthew P. Forrester
President, CEO