FIRST AMERICAN
STATE BANK

September 13, 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:

First American State Bank appreciates the opportunity to comment on the FDIC's notice of proposed rulemaking and request for comment regarding deposit insurance assessments. We are particularly concerned about 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.

First, advances are not volatile liabilities for FHLBank members. Advances offer pre-defined, understood, and predictable terms. Unlike customer deposits, advances do not evaporate due to circumstances beyond our control. Experience has shown that deposits may be lost due to disintermediation arising from a variety of factors such as special promotions in a particular market or the existence of higher returns to depositors on alternative assets. While some larger members of FHLBank Topeka can look to Wall Street for replacement liabilities, the capital markets are not a realistic option for the majority of the community banks that comprise the bulk of FHLBank Topeka's membership.

Second, as established by Congress, the primary purpose of the FHLBank System is to provide a source of long-term liquidity for FHLBank members. We have found that FHLBank Topeka is a stable, reliable source of funds, and the availability of such credit has a predictable, beneficial effect on our business plan. 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 effect of such funding on members' business plans. Therefore,

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we urge the FDIC not to include Federal Home Loan Bank advances in the definition of volatile liabilities.

We are aware of concerns that, since FHLBanks are collateral-based lenders, institutions with adequate collateral could undertake risky activities without jeopardizing their access to FHLBank funding. However, all types of protected funding (including most types of insurance) raise such "moral hazard" issues. In banking, the classic instruments for combating such moral hazards are strict supervisory oversight and capital requirements. These tools are far superior to an assessment that discourages the use of FHLBank advances. Another useful tool would be deposit insurance premiums that are based on an institution's actual risk profile, taking into account an institution's supervisory rating and capital ratios. Banks engaged in excessively risky activities certainly should pay a higher premium, regardless of whether those activities are financed by insured deposits, FHLBank advances, or alternative wholesale funding sources. FDIC examinations will more accurately determine a bank's risk profile than an inflexible assessment formula imposed on all insured institutions.

Measures that would discourage borrowing from the FHLBanks would impede rather than assist in achieving the goal of reducing the risk of failure of FDIC-insured institutions. In fact, discouraging the use of FHLBank advances could lead to the unintended consequence of *increasing* risk to our bank. We use FHLBank advances for liquidity purposes and to manage interest rate risk, as well as to fund loan growth. At times the supply of deposit funds is inadequate to meet loan demand and prudent financial management needs. Curtailing the use of FHLBank advances would force our institution to look to alternative wholesale funding sources that are demonstrably more volatile and often more costly, thereby reducing profitability and increasing liquidity risk.

Moreover, surveys undertaken in recent years by the FDIC indicate that banks which pose more than normal risks to the FDIC generally are not heavy users of FHLBank advances. In addition, a Federal Reserve Bank of Richmond 2005 working paper found that the impact of FHLBank advances on bank risk is modest, and is small compared with measures of credit risk.

Penalizing the use of advances through the imposition of insurance premiums also would conflict with the intent of Congress in establishing the FHLBanks, in extending membership in the System to commercial banks under FIRREA, and in adopting the Gramm-Leach-Bliley Act, which expanded small banks' access to advances. The FHLBanks' primary 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 banks utilizing advances would, in effect, use the regulatory process to vitiate the FHLBanks' mission as established and repeatedly reaffirmed by Congress.

Consequently, 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. 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) included such strong expressions of concern. In addition, 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,

John R. Davidson
Chairman and Chief Executive Officer