



8500 Freeport Parkway South  
Suite 100  
Irving, Texas  
75063-2547

P.O. Box 619026  
Dallas, Texas  
75261-9026

**214.441.8500**  
fax 214.441.8552  
www.fhfb.com

August 24, 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

Dear Mr. Feldman:

Thank you for the opportunity to comment on the Federal Deposit Insurance Corporation notice of proposed rulemaking on deposit insurance assessments. Specifically, I write to address 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. FHLBank advances are appropriately excluded from the definition of volatile liabilities in the published proposed rulemaking for the following reasons:

- FHLBank advances are a dependable and reliable source of funding for our member institutions.
- FHLBank advances are an important risk management tool for our member institutions.
- Raising the deposit premiums for member institutions that use FHLBank advances would create a barrier that would be contrary to Congressional intent.

Let me elaborate on each of the above points.

Advances are not volatile liabilities for FHLBank members. FHLBank advances have pre-defined, understood, and predictable terms. Advances are available to member institutions when other funding sources may not be available due to circumstances outside of the control of an FHLBank member. For example, retail deposits may be lost due to disintermediation arising from a variety of factors: special, short-term promotions in a particular market by a new market entrant or the existence of higher returns to depositors on alternative assets. While some member institutions can look to Wall Street for replacement liabilities, the money and capital markets have not functioned well as long-term, stable providers of wholesale funds to the community banks that comprise the bulk of the membership of the FHLBank System. Due to our unique cooperative structure, our member institutions are also the owners of the FHLBanks. Therefore, FHLBanks are fully and permanently committed to serving their members/owners in all market environments.

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 performed this mission successfully. The FHLBanks are a stable, reliable source of funds for member institutions, and the availability of such credit has a predictable, beneficial effect on members' businesses. Given the value of such a stable source of funding, it is not surprising that more than 8,200 financial institutions are members of the FHLBank System. 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' businesses. I urge the FDIC not to include Federal Home Loan Bank advances in the definition of volatile liabilities.

Deposit insurance premiums should be based on an institution's 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, FHLBank advances, or alternative wholesale funding sources. The oversight provided by the professional and capable FDIC examination staff is a better determinant of a bank's risk profile than an inflexible formula imposed on all insured institutions, regardless of circumstance.

Discouraging borrowing from the FHLBanks would be counterproductive to reducing the risk of failure of FDIC-insured institutions. In fact, discouraging the use of FHLBank advances could lead to the perverse effect of increasing risks to FHLBank members. Borrowers frequently use FHLBank advances for liquidity purposes and to manage interest-rate risk, as well as to fund loan growth. In many markets, the supply of deposit funds is inadequate to meet loan demand and prudent financial management needs. Curtailing the use of FHLBank advances would force institutions to look to alternative, often more costly wholesale funding sources that are demonstrably more volatile, thereby reducing profitability and increasing liquidity and interest rate risk.

Including FHLBank advances in the definition of volatile liabilities would raise the cost of advances, thereby creating a barrier to their usage. Such an outcome would conflict with the intent of Congress in establishing the FHLBanks, in opening membership in FHLBanks to commercial banks in FIRREA, and, more recently, in adopting the Gramm-Leach-Bliley Act, which expanded small 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 with respect to homeownership and community development. Charging higher assessments to those banks utilizing advances would, in effect, use the regulatory process to weaken the FHLBanks' mission as established and repeatedly reaffirmed by Congress.

During the pendency of FDIC reform legislation in the past several years, Congressional Committees and principal sponsors of FDIC reform expressed specific concerns that the FDIC, in developing a risk-based insurance assessment proposal, not adversely affect advances. The Congressional intent has been expressed in both the House and Senate on a bi-partisan basis. Both the House Budget Committee report on reconciliation (November 7, 2005) and the House Financial Services Committee report on deposit insurance reform (April 29, 2005) contained such 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) gave 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. In brief, the legislative history indicates that the FDIC should not charge premiums based on an institution's use of 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 experiencing financial difficulties, the FDIC and the relevant FHLBank are required by regulation to engage in a dialogue to ensure the institution has adequate liquidity while minimizing other risks, including losses to the FDIC. In addition, the FHLBanks are provided the legal authority for 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 because FHLBank members have access to guaranteed liquidity. Penalizing financial institutions for their cooperative relationship with the FHLBanks would result in their 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. I urge the FDIC not to include Federal Home Loan Bank advances in the definition of volatile liabilities.

Sincerely,

A handwritten signature in black ink, appearing to read "Terry Smith", written in a cursive style.

Terry Smith  
President

