



FHLBI Insider

FHLBI variable rate funding is a cheaper, more convenient, and more reliable alternative to fed funds.

“There are three faithful friends: an old wife, an old dog, and ready money.”

— *Benjamin Franklin*
(1706-1790)

During the economic expansion of the past nine years, financial institutions have been experiencing robust loan growth and anemic deposit growth. As a result, traditional asset-based liquidity ratios have been dropping nationwide. For this reason, having ready-access to borrowings to manage liquidity shortfalls has become increasingly important.

Historically, most financial institutions have used fed funds lines as their primary source of backup liquidity. For many years, fed funds lines were generally reliable and relatively inexpensive. But the merger

This *Insider* was written by James B. Eibel, CFA, vice president and marketing representative. Back issues of the *Insider* are available on the Bank's website.

wave of the mid-1990's drastically reduced both the number of correspondent banks and the level of competition. For many community banks, the result has been higher costs and less favorable terms for fed funds lines. As a result, such banks have sought out alternative funding sources for liquidity management. One such option is variable rate borrowing from the FHLBI.

Variable rate advances are one of the most popular FHLBI products. As of June 30, 2000, the Bank had \$2.6 billion outstanding to 134 financial institutions. Variable rate borrowings have been popular with both large and small institutions alike, and for good reason. FHLBI variable rate advances are cheaper, more convenient, and more reliable than most fed funds lines.

Cost

Obviously price is a major factor in choosing where to borrow for liquidity. While fed fund pricing varies widely, most community banks pay their correspondent banks 25 basis points or more above the fed funds effective rate. This fairly consistent spread can be attributed to

the benchmark rate that the Federal Reserve sets for its seasonal borrowing program, which is a flat 25 basis points over the fed effective rate. (Note that the seasonal borrowing program itself is not used by many as a source of liquidity because it requires borrowers to commit to using it only in certain months, limiting its usefulness.)

In comparison to correspondent bank pricing, the FHLBI variable rate advance is very attractive. While it has not precisely tracked the fed effective, the variable rate has been consistently lower than the 25 basis point premium generally added to the fed effective by most correspondent banks (see graph on page 2). Rather than using a specific formula to peg the variable rate advance to the fed effective, the FHLBI simply funds its overnight obligations as cheaply and effectively as it can, and then passes the results on to its members. This has historically produced excellent results for borrowers. During the first nine months of 2000, the variable rate advance price was only 12 basis points over the fed effective on an annualized average.



Convenience

The growth in variable rate lending by the FHLB has had a great deal to do with convenience. In addition to being less expensive, variable rate FHLBI borrowings are more convenient than most fed funds lines. Variable rate advances can be accessed quickly and require little or no administration. In order to access funding in a given day, members only need to call the FHLBI before noon Indianapolis time. Similarly, members can pay off their variable rate borrowings by calling the Bank before noon.

The size or amount of a variable rate advance is limited only by the member and its ability to post collateral. Also, the member can maintain the variable advance for any period of time without making daily settlements or having to manage periodic clean-ups. In addition, the borrowed position can be expanded or contracted as desired by a simple phone call. What could be easier?

What if a member could manage its borrowed position without ever picking up a telephone? Member Link, the FHLBI's secure Internet site, now enables members to both initiate and prepay variable rate borrowings online. In order to get same-day execution for an advance or prepayment, a member simply needs to

point and click before noon Indianapolis time.

The combination of quick and easy access, the option to pre-pay, and no periodic clean-ups makes the variable rate advance an ideal core short-term funding source. These conveniences also make the variable rate advance perfect for funding both floating rate assets and warehousing loans.

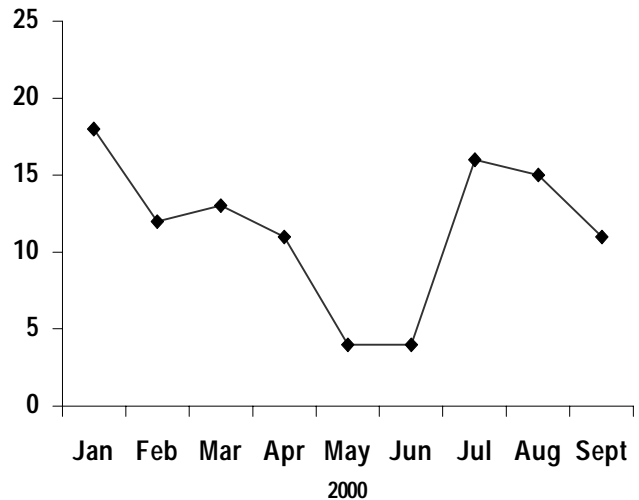
Reliability

"We have found the variable rate advance program to be another valuable alternative in meeting our periodic short-term funding needs," according to Ray Tooker of Macatawa Bank. "This past spring when our agricultural lending portfolio reached its seasonal high, we maxed out on our correspondent banks' fed funds lines. Additional fed funds borrowings would have required additional fees. We avoided the fees by using an FHLBI variable rate ad-

vance. It was convenient, flexible, easy to put in place, and cost effective."

Mr. Tooker's experience is typical. Unlike correspondent banks, the FHLBI is owned by its member institutions and is, therefore, sensitive to their needs. During its 68 years, the FHLBI has established itself as a reliable source of funding. All the FHLBanks have helped their members through difficult times, from the Great Depression to the Y2K scare. The FHLBI's long track record for reliability should place it at the top of any liquidity plan.

Variable rate vs. fed effective rate
Annualized rate differential



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Send comments to Financial Communications, Federal Home Loan Bank, PO Box 60, Indianapolis, IN 46206.

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