



Insider

New Fed Funds Floater Advance Reduces Funding Costs

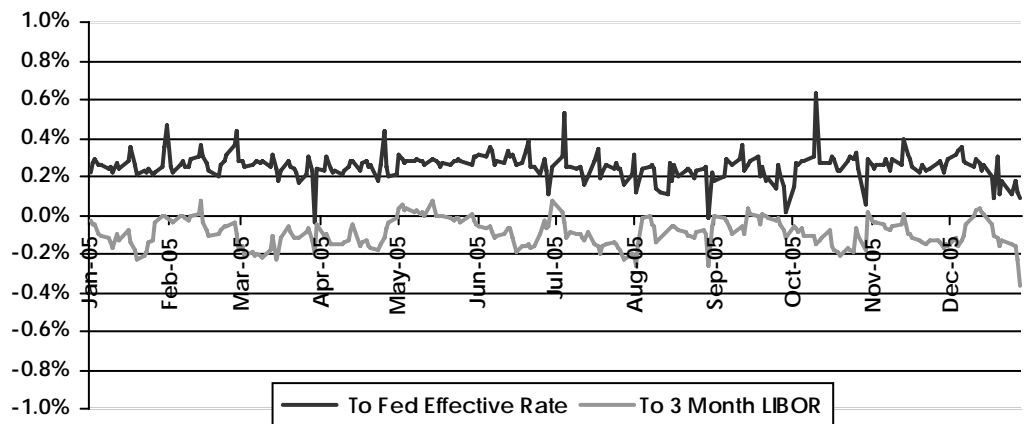
It is a good thing to have options, especially when managing a liquidity position. In recognition of this, the FHLBI is offering a new floating rate advance priced off the fed funds effective index. The fed funds floater advance has a maximum term of 90 days and can be tailored to individual prepayment needs. As such, the product could be a tool to manage basis and option risks while also reducing funding costs.

Unlike the popular variable rate advance, the fed funds floater is pegged to an observable money market index (the federal funds effective rate). Indexing provides borrowers with pricing certainty. While variable rate advance pricing has

been highly correlated to fed effective and 3 month LIBOR indices (99% daily pricing correlation existed during 2005), some deviations have occurred.

below the index, the spread was relatively stable. Volatility between variable rate advance pricing and the fed effective is related to month-end settlement activity

Chart 1. Variable Rate Advance Spread to Money Market Indices for 2005



	Fed Funds Effective	3 Month LIBOR
Average difference	0.25%	-0.09%
Maximum difference	0.63%	0.08%
Minimum difference	-0.04%	-0.36%

This *Insider* was written by James B. Eibel, CFA, vice president and marketing representative. Back issues of the *Insider* are available at www.fhlbi.com.

As displayed in Chart 1, the variable rate advance priced an average of 25 basis points over the fed effective during 2005. While deviations ranged from a high of 63 basis points above to 4 basis points

and the timing of FHLBI variable rate pricing (2 PM Indianapolis time).

In the case of 3 month LIBOR, the variable rate advance priced an average of 9 basis points below



the index over the past year. During the period, spreads ranged from a high of 8 basis points above to 36 basis points below the index. Volatility between the variable rate advance and 3 month LIBOR is also impacted by month-end ac-

The fed funds floater allows institutions to specify whether they desire prepayment daily, every 30 days, every 60 days, or every 90 days. Reduced prepayability is rewarded with a tighter pricing to the fed effective. As of January

tions. If you would like more information, contact Jon Griffin at (317) 465-0503.

Insider Bids Farewell

Mergers and acquisitions are part of the financial services industry. The *Insider* is not immune to this reality. After 13 years and 38 issues, the *Insider* will be merged into a new FHLBI magazine that will be published each spring and fall. The initial issue will be published in spring 2006 and will contain an article on deposit pricing strategies written by Doreen Koning, a member of the financial strategies team. Back issues of the *Insider* are available on the FHLBI's website at www.fhlbi.com, and the new magazine will be posted there as well.

Chart 2. Fed Funds Floater Pricing

January 2006	
Prepayment Option	Spread Over Fed Effective
Daily	0.26%
30 day	0.21%
60 day	0.16%
90 day	0.11%

tivity and timing differences in rate setting. It should be noted that term structure differences (overnight vs. three months) also add to volatility.

While pegging the fed funds floater to an index provides pricing certainty, the primary benefit is a reduced funding cost in exchange for reduced prepayment flexibility. Prepayment flexibility, while nice, comes at a cost in capital markets transactions. The variable rate advance is priced to assume daily prepayability whether an institution needs it or not. For institutions with core short-term funding positions, the optionality embedded in variable rate advances may be unnecessary and costly.

2006, a 15 basis point differential existed across the various fed funds floater prepayment options (See Chart 2).

Institutions with relatively predictable or core short-term funding positions can use fed funds floaters to minimize cost while maintaining adequate prepayment flexibility. In particular, a liquidity position can be optimized by laddering the various prepayment options and advance maturities.

FHLBI Introduces Bullet Advances Up to 20 Years

In response to member requests, the FHLBI will now be offering bullet advances between 10 and 20 years. These maturities will be available subject to market condi-

This article has been presented for educational purposes only. The FHLBI is not a financial or investment advisor. It is solely the reader's responsibility to evaluate the risks and merits of any funding strategy or business proposal before its implementation and to monitor its performance over time. If you need information for use in evaluation of a funding strategy, please contact our financial strategies staff.

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