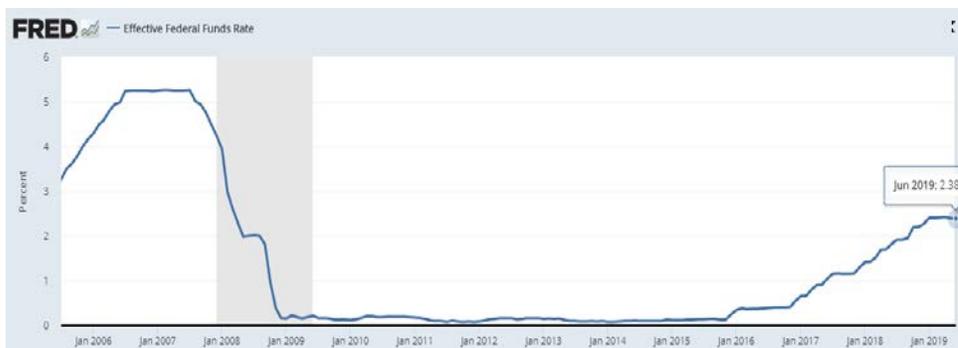


## Going Down

### Funding Issues and Strategies for a Down Rate Environment

Going up? Going down? Today's interest rate environment feels like we are in an elevator in which all the buttons have been pushed and not sure which direction it will take you next. With today's decrease of the Fed Funds Target Rate by 25 bps by the Federal Open Market Committee (FOMC), we now know that the down button has been pushed.

Since December 2015, the FOMC has increased the Fed Funds Target Rate 9 out of the past 29 meetings and consumers and the market were starting to wake up to the prospect of higher rates. The banking industry started to see aggressive deposit pricing and asset composition strategies beginning to change. Now the down button is being pushed and institutions have to think about whether their strategies may have to be adjusted.

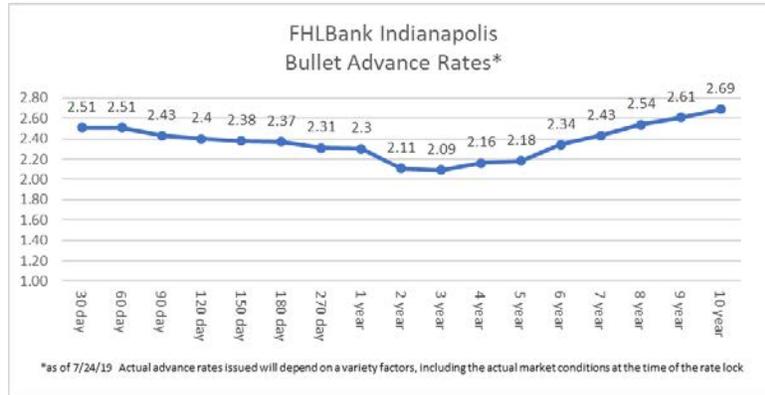


If rates are going down, here are some funding issues to consider:

- Should deposit rates be decreased? Over the past couple years, depositors have been starting to wake up from the long dry spell of no change. Institutions have been putting a lot of effort into attracting, and maintaining, deposits with higher rates. Lowering rates could cause some deposits to leave and/or decrease the ability to attract new deposits. As part of the ALCO discussion, this cost should be weighed against the cost of having above market rates. To help with this, FHLBank Indianapolis members can utilize the Marginal Cost Tool on Member Link to help estimate the cost of lowering rates.
- Historically, decreases in deposit rates have lagged compared to changes in the market. The FHLBank advance rates are market driven. Because of this they should always be considered in a decreasing rate environment when funds are needed to make sure the most optimal decision is being made.
- Will it be even harder to obtain CD or term deposits? Over the past year many institutions have seen an increase in CD holdings from aggressive CD promotions. Depositors may feel uncertainty regarding future rates and opt to park funds in liquid

accounts or seek out alternative investments. If so, should your institution consider adding fixed-term wholesale funding to the mix?

- Short term market rates have decreased, but the current shape of the curve provides a “sweet spot” at the three year point, which is currently the lowest FHLBank Indianapolis bullet advance rate. Perhaps this is an opportunity for your institution to economically add 3 year funding?



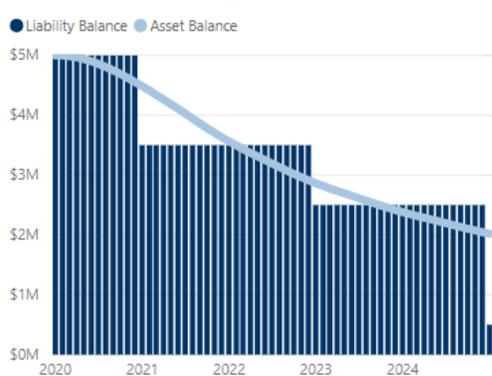
- Prepayment risk for loans and securities is magnified in a falling rate environment and can cause margin compression. Unlike most deposit products, FHLBank advances, such as the callable advance, can be structured to be prepayable to mitigate the impact of falling rates. The rates below are for a ordinary five year bullet advance and a five year advance with a call option embedded after the third year:

Rate indication as of 7/24/2019<sup>1</sup>

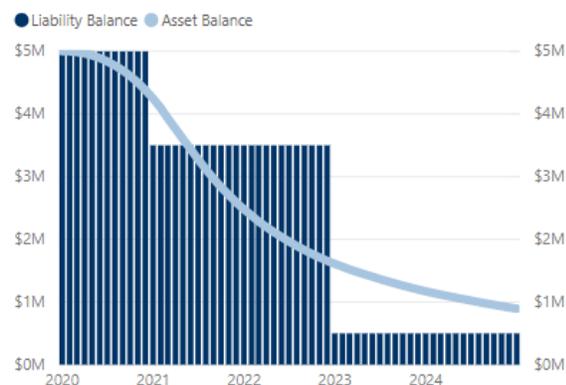
5 Yr. Bullet Advance 2.18% 5 Yr. NC 3 Yr. Bermudan Advance 2.32%

Below illustrates the balance over time of a rate sensitive mortgage with a lifetime CPR of 12.7% and effective duration of 4.97 yrs. that is funded with laddered bullet advances, as well as a 5NC3 advance<sup>2</sup>. In the down 50 bps rate shock, prepayments accelerate but the funding is able to be called at year 3 to adjust to the changing needs.

Assets vs. Funding - Base Case



Assets vs. Funding - Dwn 50 Shock



<sup>1</sup> Actual rate issued will depend on a variety of factors, including the actual market conditions at the time of the rate lock. Callable advances require \$5 million in requests to execute trade.

<sup>2</sup> Results based on ramped rate shock over 1 yr., first 12 mo. CPR is 10.2% in base case and 16.7% in dwn 50 bps (24.7% lifetime CPR).

As a member of the FHLBank Indianapolis, you have access to funding options to help with changing interest rate environments. Funding can be structured to meet your institution's ALM needs and to provide protection and reliable funding whichever way the interest rate elevator moves. Your account manager and the Member Research & Strategies group are available to discuss with your board, management, or ALCO liquidity and economic issues affecting your institution and help develop funding strategies.

**For additional assistance in analyzing funding strategies, contact FHLBank Indianapolis Member Services 800.442.2568 or [memberservices@fhlbi.com](mailto:memberservices@fhlbi.com)**

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Written July 31, 2019. This article has been presented for educational purposes only and is not a commitment to lend. FHLBank Indianapolis is not a financial or investment advisor. It is solely the reader's responsibility to evaluate the risk and merits of any funding strategy or business proposal prior to entering into a transaction. The decision to obtain advances and/or credit products from the Federal Home Loan Bank of Indianapolis, and the analysis of how they may fit into a member's financial or business strategy, remain the member's sole responsibility. Additional terms and conditions are set forth in the FHLBank Indianapolis Credit Policy and your Advances, Pledge and Security Agreement.

*The results shown are highly dependent on the assumptions made to produce the results. Actual results may vary based on changes in loan prepayment speeds, changes in interest rates, and the shape of the yield curve. Other economic and financial market factors may also have a significant material impact on the results.*