FHLB - Not Only For Advances

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Liquidity, liquidity, liquidity; it's one of the central themes of 2018. As loan growth continues to expand, liquidity has returned to the spotlight. Securing diversified sources though a well-defined liquidity plan is at the forefront of discussion. Instead of cannibalizing their local markets to raise funding, financial institutions look to institutional/wholesale sources and the FHLB for advances. However, an often overlooked opportunity is utilizing the FHLB to issue Letters of Credit (LOC) for the securitization of political subdivision deposits.

Political subdivisions, or public entities, can be a consistent and stable source of deposits. They are funded through sales and property taxes, user fees and state and federal sources. Their funding cycles are consistent and repeated annually, regardless of the economic cycle. However, due to state statues and individual investment policies, balances in excess of the FDIC insured limits must be secured in order for a financial institution to participate in deposit opportunities.

As an alternative to pledged securities, FHLB Letters of Credit can provide an efficient and acceptable form of collateralization for public unit deposits. An FHLB LOC provides many benefits over the use of pledged securities. A financial institution can expand its acceptable forms to include LOC's, and furthermore, it frees up their security portfolio to be utilized for other liquidity needs.

As a securitization method, FHLB LOCs are highly customizable; furthering their appeal to financial institutions and political subdivisions. The LOC can be issued on an individual basis or pooled. As a pooled source, the LOC is issued to a money manager/agent who, in turn, monitors the LOC's usage and underlying deposits. The Letter of Credit amount can be issued as a fixed or a fluctuating balance. Also, to provide further flexibility, the terms on the LOCs can be written to a specific maturity date or incorporate evergreen language. As a form of collateralization, LOCs provide more flexibility and convenience than pledged securities. Perhaps the greatest advantage is the lack of need to monitor market values as the LOC is a direct obligation of the FHLB, and therefore is not subject to market fluctuations.

Although there are many benefits to using an FHLB LOC, it is important to also examine concerns. Perhaps the largest drawback from utilizing an LOC is that it limits your ability to borrow from the FHLB. Also, LOCs are limited to certain types of depositors, but can be a great tool in seeking out political subdivision depositors.

Letters of Credit are a highly customizable tool used to streamline and attract public unit depositors. By reducing the need to encumber securities, financial institutions can free up liquid assets to improve their liquidity ratios and mitigate the need to monitor market value fluctuations. As a securitization method, LOCs are a great option and can provide diversification from FHLB advances in your funding mix.

About D. James Lutter

D. James (Jim) Lutter is the Senior Vice President of Trading and Operations at PMA Financial Network, Inc. and PMA Securities, Inc. where he oversees PMA Funding., a service of both companies that provides over 1,000 financial institutions with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities, Inc. and Investment Advisor Representative with Prudent Man Advisors, Inc. Mr. Lutter has the following FINRA licenses with PMA Securities, Inc.: Series 7, 24, 50, 53, 63, 65 and 99.

About Todd A. Terrazas

Todd joined PMA Financial Network, Inc. in 2014 as a Financial Analyst for the firm's Credit Risk Management team. He now serves as Business Development & Product Manager for PMA Funding, where he is responsible for developing financial institution partner relationships and managing funding product solutions and association affiliations. Mr. Terrazas also engages in strategic planning and identifying market trends through extensive market research. Prior to joining the firm, he was a Market Research Analyst at Common Goal Systems, Inc. Mr. Terrazas earned his Bachelor of Arts in Finance from Calvin College.

Additional information is available upon request. For more information visit www.pmanetwork.com and www.pmafunding.com.