



# LETTERS OF CREDIT

**Flexible and Easy-to-use**

Derek Layton | Lending Officer

Michael Young | Senior Marketing & Member Solutions Officer

March 9<sup>th</sup> | 2:00 P.M. CT

To maximize your ability to hear the webinar, we're muting all participants. Please keep your line muted.

# ABOUT THE PRESENTERS



## **DEREK LAYTON | Lending Officer**

Derek began his banking career in 2014 at a community bank. He joined FHLBank in 2018 as a Lending Analyst and was promoted to Lending Officer in January 2020. He assists members with product education and current and prudent funding strategies to make intelligent borrowing decisions.



## **MICHAEL YOUNG | Sr. Marketing & Member Solutions Officer**

Michael joined FHLBank in 2012. He has held various positions with the bank in several areas, including Accounting, Enterprise Risk Management, and Lending. Michael was promoted to his current role in 2023 and continues to assist members with viable strategies and product education to maximize the value of their membership.



# FHLBANK TOPEKA'S MISSION



FHLBank Topeka makes a difference by providing reliable liquidity and funding to help our members build strong communities.

# Letter of Credit Types

- **Simple Standby Letter of Credit**
  - Generally Public Unit Deposits (PUDs)
- **Confirming Letter of Credit**
  - “wrap” or used in conjunction with a member’s letter of credit

# What are Public Unit Deposits?

- **Deposits from Municipalities or Political Subdivisions**
  - Examples: School Districts, State or County Treasurers, Hospitals, Rural Water Districts, etc.
- **Beneficiary Considerations**
  - Creditworthiness, safety and soundness of the depository
  - As a result, depositories are required to collateralize PUDs
    - In excess of FDIC \$250,000 limit
- **Per the FDIC, “Collateralization provides an avenue of recovery in the unlikely event of the failure of an insured depository.”\***

\*FDIC 12 C.F.R. 330.15



# Forms of PUD Collateralization

- **Two Main Forms of Collateralization:**
  - Pledging Securities
    - Historically been most widely used method
  - Letters of Credit
    - Beneficiaries starting to prefer this method over pledging securities
    - Becoming more and more popular due to downfalls of pledging securities

# Downfalls of Pledging Securities

- **Why is pledging securities becoming a less popular option for collateralizing PUDs?**
  - Encumbers highly liquid assets, decreasing liquidity ratios
  - Requires frequent monitoring of market values by depository and beneficiary
  - Constrains balance sheet – reducing flexibility
  - Securities are often called or prepaid
  - Specific security types, often lower-yielding, are required to be eligible for securing deposits

# What is a Letter of Credit?

- **Financial instrument offered to collateralize PUDs**
  - Use FHLBank Aaa/AA+ rating to secure funds for the depositor
  - Highest short-term credit rating ensures safety and security of funds, and makes the Letter of Credit widely accepted
  - If the depository fails, the public unit could immediately draw upon the letter of credit
- **Used to assist with:**
  - Facilitating residential housing finance
  - Facilitating community lending
  - Asset/liability management





# Why use Letters of Credit?

- **Convenient - Fast - Efficient:**
  - Online Submission through Members Only. Trade securities for loans – if demand allows
- **Reduce safekeeping costs - No more monitoring market values and worrying about pledging and releasing securities**
- **The forgotten call - No more scrambling to purchase a new, low-yielding security**
- **Unpledged securities and improve liquidity**
  - Collateralize PUDs with illiquid loans, effectively monetizing the loan portfolio

# Why use Letters of Credit?

- **Boost earnings:**
  - Revise your security investment strategy, putting higher-yielding assets on balance sheet
  - Supplement securities for loans – if demand allows

# LETTER OF CREDIT UTILIZATION STRATEGIES

## Example Bank

Somewhere, FHLBank Topeka District

February 6, 2023

Current Credit Obligation & Collateral Position Summary (\$ actual)				
FHLBank Outstanding Credit Obligations			FHLBank Collateral Summary	
Credit Obligation Type	Amount	Number		
Regular Advances	\$ 113,373,800	73	Total Lending Value of Collateral	\$ 346,851,771
Overnight Line of Credit	82,864,100		Total Collateral Required	196,237,900
Letters of Credit (LTC)	-	-	Unused Collateral	150,613,871
MPF CE Exposure	-		Collateral Coverage Ratio	176.8%
Swap Exposure	-		Loans Lending Value	\$ 346,851,772
Total	\$ 196,237,900		Securities Lending Value	-
Funded Credit Obligations	\$ 196,237,900			

Utilize Excess Collateral

Utilizing Letters of Credit to Improve Liquidity Position

(\$ in thousands)

	Current Position	Replaced Pledged Securities w/LTC	Liquidity Ratio Improvement
<b>\$ Increase in FHLBank Ltrs of Credit</b>			
\$ 45,000			
<b>Liquidity Ratio</b>	4.64%	8.88%	424 bps
<b>On-Hand Liquidity Ratio</b>	4.35%	8.59%	424 bps
<b>Pledged Securities / Securities</b>	64.61%	21.43%	4,318 bps
Pledged Securities	\$ 67,341	\$ 22,341	
Securities	104,231		
FHLBank Letters of Credit [Current]	-	45,000	
Unused Collateral	150,614	105,614	
Transaction - PUDs	\$ 21,058		
Nontransaction PUDs	67,959		
Total PUDs	89,017		
% of Deposits	10.07%		
Total Uninsured PUDs (MRY)	\$ -		

Improve Liquidity Position

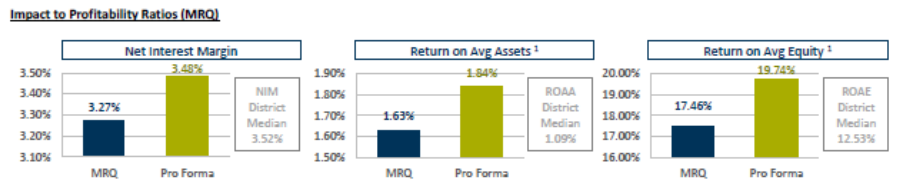
Utilizing Letters of Credit to Maximize Earnings

(\$ in thousands)

	Current Position	Replace & Reinvest Pledged Securities	Change
<b>\$ Increase in FHLBank Ltrs of Credit:</b>	\$ 45,000		
<b>Balances</b>			
FHLBank Letters of Credit	\$ -	\$ 45,000	\$ 45,000
Pledged Securities	67,341	22,341	(45,000)
Reinvestment in Higher Yielding Loans		45,000	45,000
Total Securities	104,231	59,231	(45,000)
<b>Incremental Impact to Net Interest Income</b>			
Annual Income on Pledged Securities [MRQ Yield: 1.87%]	\$ 1,261	\$ 418	\$ (843)
Annual Income on Loans [Yield: 7.50%]		3,375	3,375
Letter of Credit Cost (0.125% - minimum fee of \$125)		(56)	(56)
<b>Net Additional Annual Income Earned</b>			<b>\$ 2,476</b>

Assumes full LTC amount is reinvested in loans, resulting in no impact to liquidity & on-hand liquidity ratios

Boost Earnings



Member FHLBank position as of 9/30/2022; collateral position as of 1/20/2023  
 Liquidity Ratio = Total Liquid Assets (Cash & Balances Due + Securities + Fed Funds Sold & Reverse Repos + Trading Account Assets - Pledged Securities) / Liabilities  
 On-Hand Liquidity = (Interest-bearing Balances + Securities + Fed Funds Sold & Reverse Repos - Fed Funds Purchased & Repos - Pledged Securities) / Liabilities  
 (1) S-corps tax adjusted for comparative purposes in district median calculations.

# Utilizing Excess Collateral

## Current Credit Obligation & Collateral Position Summary (\$ actual)

FHLBank Outstanding Credit Obligations			FHLBank Collateral Summary	
<u>Credit Obligation Type</u>	<u>Amount</u>	<u>Number</u>	Total Lending Value of Collateral	\$ 346,851,771
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MPF CE Exposure	-		Loans Lending Value	\$ 346,851,772
Swap Exposure	-		Securities Lending Value	-
Total	<u>\$ 196,237,900</u>			
Funded Credit Obligations	<u>\$ 196,237,900</u>			



# Liquidity Enhancement Strategy

## Utilizing Letters of Credit to Improve Liquidity Position

(\$ in thousands)

	<u>Current Position</u>	<u>Replaced Pledged Securities w/LTC</u>	<u>Liquidity Ratio Improvement</u>
<b>\$ Increase in FHLBank Ltrs of Credit</b>			
\$ 45,000			
Liquidity Ratio	4.64%	8.88%	424 bps
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Total Uninsured PUDs (MRY)	\$ -		



# BOOST EARNINGS

## Utilizing Letters of Credit to Maximize Earnings

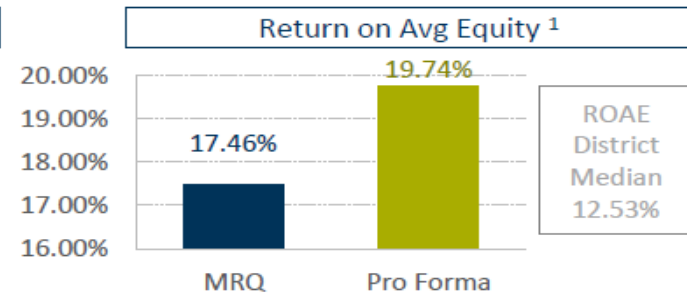
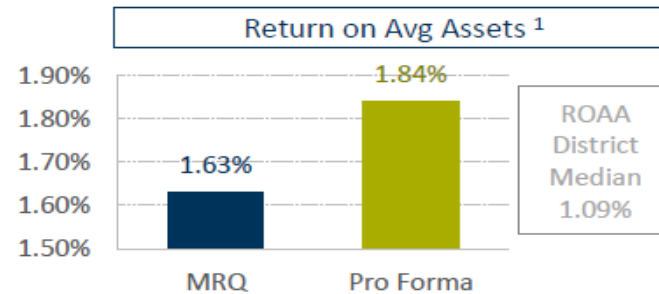
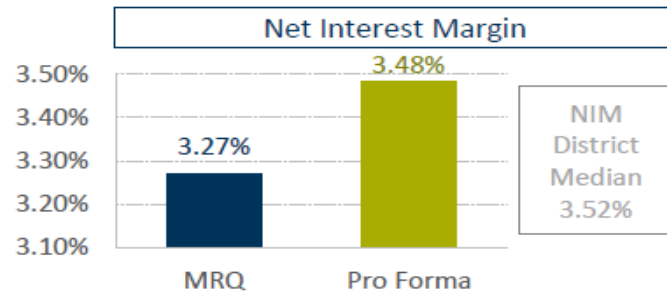
(\$ in thousands)

**\$ Increase in FHLBank Ltrs of Credit: \$ 45,000**

<u>Balances</u>	<u>Current Position</u>	<u>Replace &amp; Reinvest Pledged Securities</u>	<u>Change</u>
FHLBank Letters of Credit	\$ -	\$ 45,000	\$ 45,000
Pledged Securities	67,341	22,341	(45,000)
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<b>Net Additional Annual Income Earned</b>			<b>\$ 2,476</b>

Assumes full LTC amount is reinvested in loans, resulting in no impact to liquidity & on-hand liquidity ratios

### Impact to Profitability Ratios (MRQ)



# Cost and Flexibility of Letters of Credit

- **Simple Letter of Credit Fee**
  - 1/8% per annum or 12.5 basis points (minimum of \$125)
- **Confirming Letter of Credit Fee**
  - 1/4% per annum or 25 basis points (minimum of \$500)
- **Fees charged on the date the letter of credit is issued**
  - May elect to have the fee charged quarterly for letters of credit issued in an amount  $\geq$  \$5 million
- **Letter of Credit Cancellation**
  - Can cancel a Letter of Credit at anytime
  - Will be refunded a proration of the fee charged
    - Subject to the minimum fee



# Stock Dividend Impact

The table below illustrates the incremental benefit you received from the Class B Stock dividend for the fourth quarter 2022 as you use each of our three main products.

Member Value Analysis				
	Advances	MPF	Ltr of Cr	
Class B Dividend Rate	8.50%	8.50%	8.50%	
Avg Interest on Reserve Balances (IORB)	-3.71%	-3.71%	-3.71%	
Marginal Spread	4.79%	4.79%	4.79%	A
Class B Activity Requirement	4.50%	3.00%	0.25%	B
<b>Incremental Benefit of Dividend</b>	<b>0.22%</b>	<b>0.14%</b>	<b>0.01%</b>	A x B = C

Avg IORB represents the daily average rate on reserve balances in fourth quarter 2022.

- From 09/30/2022 - 11/02/2022: 3.15%
- From 11/03/2022 - 12/14/2022: 3.90%
- Estimate from 12/15/2022 - 12/30/2022: 4.40%





# Tools Essential to Using Letters of Credit

## ➤ **Required Documents**

- Letter of Credit Agreement (one time)
- Standby Irrevocable Letter of Credit Application (Per letter)

## ➤ **Essentials to Issuing & Maintaining Letters**

- Members Only Log In
  - Letters & fee tickets for issued letters
  - Download existing Letter of Credit
  - Obtain forms under Required Docs



# LETTERS OF CREDIT SYSTEM

- **FHLBank Topeka's Letter of Credit Process**
  - Benefits to you
    - Issue letters online or email our easy fill application
    - Secured email confirmation to you and your depositor
    - Access via Members Only
      - Letter of Credit
      - Fee Ticket



# Initiating a Letter of Credit

- Application Process
  - Issuing a letter online

The screenshot displays the FHLBank Topeka Members Only portal. At the top, there is a navigation bar with links for Contact, FHLBank Public Site, AHP, HSP, and Logout. Below this is the FHLBank Topeka logo and the text 'Members Only'. A secondary navigation bar lists various services: ADVANCES, LETTERS OF CREDIT, WIRES, COLLATERAL, SAFEKEEPING, CAPITAL STOCK, DEPOSITS, RATES, REPORTS, and RESOURCES. The 'REPORTS' section is expanded, showing a dropdown menu with options: Application (highlighted with a red arrow), Documents, Fees, Forms, Manage Letters, and Reports. Below the dropdown, there is a date selector set to 03/03/2021 and a list of reports: Advance Payments Due (PDF), General Activity Report (PDF), and Summary of Current. The 'Overnight Line of Credit' section shows the 'Daily Overnight Line of Credit Rate' as of 03/03/2021 2:30:30 PM at 0.36%. A note states: 'The overnight line of credit rate reprices daily based on FHLBank's cost of funds.' At the bottom of the page, there are buttons for 'More Reports', 'Draw', 'Paydown', and 'More Documents'.



# Initiating a Letter of Credit

## ➤ Application Process

### ➤ Issuing a letter online

Upon submitting your application, you will receive a message indicating its status. **Applications may only be submitted between 9:00 a.m. and 3:30 p.m. CT.** Please contact the Lending department at 800.809.2733 with questions.

Beneficiary:\*

-- Select --

Issue Date:\*

03/03/2021

Expiration Date:\*

MM/DD/YYYY

Amount:\*

\$ 0

Multiple Draws:\*

Permitted

By clicking Submit, you agree as an authorized representative of the Institution and certify the Institution to be in full compliance and will maintain full compliance with the Agreements and Policies, including any revisions and changes to the same, while the letter of credit is outstanding.

Submit



# Initiating a Letter of Credit

## ➤ PDF Application Process

- Sending in the FHLBank application
  - Email to [fhlb.lending@fhlbtopeka.com](mailto:fhlb.lending@fhlbtopeka.com)
  - Issued same day if application received by 3:30pm CT.
  - Renewing an existing letter a new application must be sent





SERVING COLORADO | KANSAS | NEBRASKA | OKLAHOMA

**Standby Irrevocable Letter of Credit Application**

**Institution:** \_\_\_\_\_  
**Address:** \_\_\_\_\_

Pursuant to, and subject to, the terms of its Letter of Credit Agreement and its Advance, Pledge and Security Agreement with the Federal Home Loan Bank of Topeka (FHLBank), the undersigned Institution hereby applies for a standby irrevocable letter of credit for the Institution's account in the amount of \$\_\_\_\_\_.

In accordance with FHLBank policy governing fees for letters of credit, the FHLBank is hereby authorized to charge the Institution's demand deposit account number \_\_\_\_\_ for the fees associated with this letter of credit (subject to minimum fees as identified in FHLBank's Member Products and Services Guide). If the letter of credit to be issued hereunder is for a term greater than one year, the FHLBank is further authorized to charge the Institution's demand account for the required fees on each anniversary date.

You are instructed to issue the letter as follows:

1. Date letter of credit is to be issued: \_\_\_\_\_
2. In favor of: \_\_\_\_\_  
Beneficiary's full name: \_\_\_\_\_  
Beneficiary's full physical address: \_\_\_\_\_  
Beneficiary's contact name: \_\_\_\_\_  
Beneficiary's phone number: \_\_\_\_\_  
Beneficiary's email: \_\_\_\_\_

3. Available: (check one)

- without conditions  
 with conditions (specify conditions below)

Conditions will be stated in the Drawing Certificate used by the Beneficiary when making draws under the letter. The FHLBank, however, has no duty or obligation to investigate whether the conditions stated in the Drawing Certificate are true.

Conditions permitting a draw and/or other special instructions:

\_\_\_\_\_

4. Expiration date of the letter of credit: \_\_\_\_\_ (Must be a valid business day.)

5. Multiple draws are to be: (check one)

- permitted  
 prohibited

(If permitted, the unused balance of the letter of credit will remain available until the stated expiration date.)

Certification:

Please indicate the purpose for which the letter of credit will be used: (check one)

- Public unit deposit collateralization  
 Facilitating residential housing finance  
 Facilitating community lending (CICA approval required)  
 Asset/liability management (please describe below)

- Liquidity or other funding (please describe below)

(The Institution hereby certifies that it is in compliance with all laws and regulations in regarding the collateralization of deposits.)

The undersigned is an authorized representative of the Institution and has read and understands the Member Products and Services Guide of the FHLBank and certifies the Institution to be in full compliance. Furthermore, the Institution agrees to maintain full compliance with the Member Products and Services Guide, including any revisions and changes to same, while the letter of credit is outstanding.

**By:** \_\_\_\_\_  
**Authorized Signature**

**Typed Name and Title**

**Date:** \_\_\_\_\_

# For More Information

## ➤ Members

- [www.fhlbtopeka.com/letters](http://www.fhlbtopeka.com/letters)
- Email us – [fhlb.lending@fhlbtopeka.com](mailto:fhlb.lending@fhlbtopeka.com)
- Call us – 800.809.2733

## ➤ Guides for you and your beneficiaries

- [Kansas](#)
- [Nebraska](#)
- [Oklahoma](#)
- [Colorado](#)



# FHLBANK CONTACTS

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