



LETTERS OF CREDIT

Flexible and Easy-to-use

Derek Layton | Lending Officer

Michael Young | Senior Marketing & Member Solutions Officer

March 9th | 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

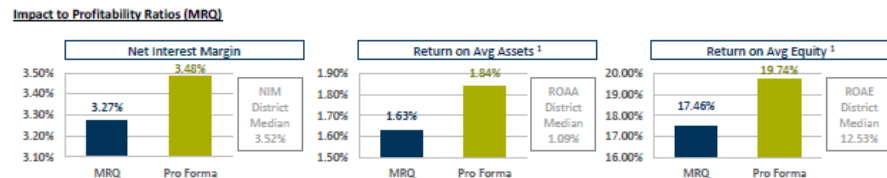
Utilizing Letters of Credit to Improve Liquidity Position				
(\$ in thousands)				
		Current Position	Replaced Pledged Securities w/LTC	Liquidity Ratio Improvement
\$ Increase in FHLBank Ltrs of Credit				
\$ 45,000				
Liquidity Ratio		4.64%	8.88%	424 bps
On-Hand Liquidity Ratio		4.35%	8.59%	424 bps
Pledged Securities / Securities		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)				
\$ Increase in FHLBank Ltrs of Credit:	\$ 45,000			
Balances		Current Position	Replace & Reinvest Pledged Securities	Change
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)
Incremental Impact to Net Interest Income				
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)	
Net Additional Annual Income Earned			\$ 2,476	

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)

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Liquidity Enhancement Strategy

Utilizing Letters of Credit to Improve Liquidity Position

(\$ in thousands)

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BOOST EARNINGS

Utilizing Letters of Credit to Maximize Earnings

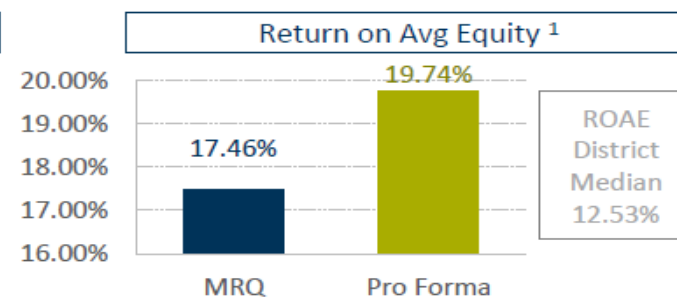
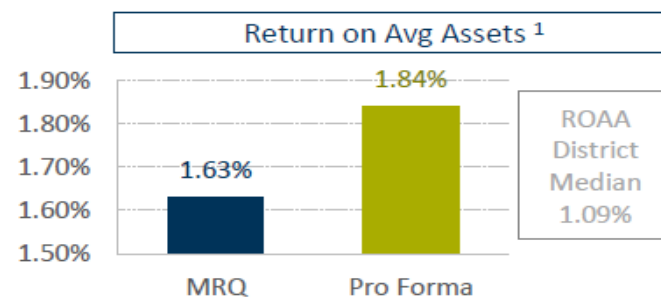
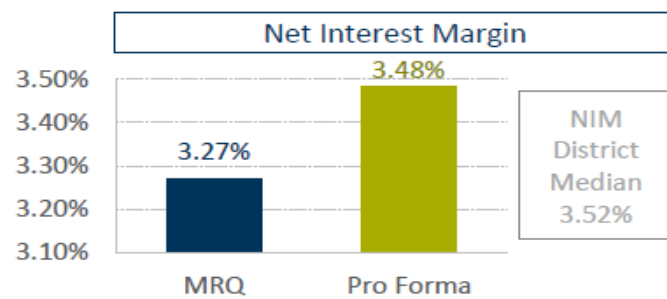
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Impact to Profitability Ratios (MRQ)



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
Incremental Benefit of Dividend	0.22%	0.14%	0.01%	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 dark blue header with the FHLBank Topeka logo and the text "Members Only". To the right of the header are links for "Contact", "FHLBank Public Site", "AHP", "HSP", "Logout", and a search icon. Below the header is a navigation bar with links for "ADVANCES", "LETTERS OF CREDIT", "WIRES", "COLLATERAL", "SAFEKEEPING", "CAPITAL STOCK", "DEPOSITS", "RATES", "REPORTS", and "RESOURCES". The "LETTERS OF CREDIT" link is highlighted, and a dropdown menu is open, showing options: "Application", "Documents", "Fees", "Forms", "Manage Letters", and "Reports". A red arrow points to the "Application" option. Below the navigation bar, the page is divided into three main sections. The left section is titled "Reports" and includes a "Daily Reports" section with a date selector set to "03/03/2021". Below this are links for "Advance Payments Due" (PDF), "General Activity Report" (PDF), and "Summary of Current" (PDF). The middle section is titled "Overnight Line of Credit" and displays the "Daily Overnight Line of Credit Rate" as of 03/03/2021 2:30:30 PM, which is 0.36%. It also includes a note: "The overnight line of credit rate reprices daily based on FHLBank's cost of funds." The right section is titled "Recent Activity" and shows a list of transactions. 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
 - 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
- Email us – fhlb.lending@fhlbtopeka.com
- Call us – 800.809.2733

➤ Guides for you and your beneficiaries

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



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