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Should the Fdic Worry About the Fhllb? The Impact of Federal Home Loan Bank Advances on the Bank Insurance Fund

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Abstract

Does growing commercial-bank reliance on Federal Home Loan Bank (FHLBank) advances increase expected losses to the Bank Insurance Fund (BIF)? Our approach to this question begins by modeling the link between advances and expected losses. We then quantify the effect of advances on default probability with a CAMELS-downgrade model. Finally, we assess the impact on loss-given-default by estimating resolution costs in two scenarios: the liquidation of all banks with failure probabilities above two percent and the liquidation of all banks with advance-to-asset ratios above 15 percent. The evidence points to non-trivial increases in expected losses. The policy implication is that the FDIC should price FHLBank-related exposures.

Keywords: Deposit-insurance pricing, Federal Deposit Insurance Corporation (FDIC), Federal Home Loan Bank (FHLB), moral hazard, secured funding

JEL Classification: G21, G28, K23

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