

# 7th District (Chicago) Borrower-In-Custody of Collateral Program (BIC) Guidelines

---

Last Updated: 1/11/2012

## **Please note:**

The information in this document is specifically for the Federal Reserve Bank of Chicago's BIC Program. Information regarding your Federal Reserve Bank's BIC program may be available on [your district's Contacts and Resources page](#).

## **1. Introduction**

- Loan Types Ineligible for Pledge
- Foreign Obligor Loans

## **2. Applying for the BIC Program**

- Initial Review/Approval
- Perfection of Security Interest
- Collateral Certification
- On-Site Inspection
- Legal Documents
- Ongoing Requirements/Collateral Reporting

## **3. Types of Collateral Eligible for Pledge**

- Commercial Loans
- Commercial Loans – Floor Plan Loans
- Commercial Real Estate Loans
- Construction Loans
- Vacant Land Loans
- Participation Loans
- Consumer Loans
- Residential Real Estate Mortgage Loans
- Home Equity Loans and Lines of Credit
- Student Loans

## **4. Collateral Controls**

- Collateral Identification
- Collateral Valuation
- Annual Review of Eligibility

- Questions or Comments

## 5. Appendix

- Collateral Maintenance
- Withdrawals
- Imaging Policy

## 1. Introduction

A depository institution obtaining discount window credit must pledge acceptable collateral in an amount sufficient to secure an advance and accrued interest. Institutions should maintain a pre-determined amount of collateral pledged at the Reserve Bank to ensure that sufficient collateral is available for ongoing programs, such as the Seasonal Credit Program, or for contingency situations.

As an alternative to delivering loan collateral to the Reserve Bank (or third-party custodian) a BIC arrangement allows depository institutions to assign residential real estate mortgage loans, student loans and commercial loans, among other loan types, to the discount window for pledge while the collateral is housed and maintained at the institution. The purpose of this Borrower-In-Custody (BIC) arrangement is to provide institutions the ability to increase their pools of collateral, while avoiding the inconvenience and cost of transporting the loans and supporting documentation to the Reserve Bank.

Eligibility for the BIC Program is based on the following criteria:

- CAMELS composite rating of "1" or "2"(Composite ratings of "3" are generally acceptable)
- "Adequately" or "Well" capitalized as evidenced by most recent capital ratios
- FBO and corresponding branches are in satisfactory condition
- Asset quality is satisfactory
- Acceptable management oversight of credit and controls, including loan review/rating system

(Please check with the Reserve Bank about the eligibility of holding certain types of collateral in a BIC arrangement for securing Treasury Tax and Loan deposits.)

### Loan Types Ineligible for Pledge

- Consumer loans or Residential Real Estate Mortgage loans more than **60** days past due
- Commercial, Commercial Real Estate, Construction, and Vacant Land loans more than **30** days past due
- Loans to affiliates of the pledging institution, including direct/indirect subsidiaries and consumer finance companies
- Insider loans (i.e. loans to a director, officer or bank employee)
- Loans collateralized by mutual funds or stock
- Loans issued to an Employee Stock Option Plan (ESOP) or secured by ESOP stock

- Loans already pledged or secured under a specific or blanket lien unless expressly subordinated to the Federal Reserve Bank
- Loans to foreign or domestic entities that are not denominated in U.S. dollars
- Loans classified by internal/external auditors or by a supervisory agency as below pass grade, i.e., special mention, substandard, doubtful, or loss
- Loans secured by certificates of deposits or other deposit liabilities of the pledging institution, including deposit accounts and overdraft lines of credit
- Loans that have assignability or transferability restrictions. Government Guaranteed Loans, including S.B.A. loans, will need to be warranted against such restrictions.
- All Off-Balance Sheet Commitments (i.e. Commercial Letters of Credit, Standby Letters of Credit, Loan Commitments, Futures/Forwards/Standby Contracts for Securities, Foreign Exchange Commitments, Swaps, etc.)
- Loans that do not meet a minimum standard of quality, based on the Reserve Bank's review of the depository institution's internal risk ratings

**NOTE: The Reserve Bank reserves the right to amend collateral requirements or terminate the BIC Program for any reason for any institution at any time.**

### Foreign Obligor Loans

In general, foreign obligor loans are not accepted as collateral unless a legal opinion is submitted to and deemed satisfactory by the Reserve Bank. Foreign obligor loans are defined as commercial or commercial real estate loans to entities incorporated outside the U.S. or whose principal place of business or main office is outside the U.S. For loans that rely on the strength of guarantors, the domicile of the guarantor determines the classification (e.g., loans to U.S. shell companies that are guaranteed by foreign parents would be considered foreign).

## 2. Applying for the BIC Program

Information on the BIC program may be obtained from this website or by contacting discount window staff at (800) 380-3762.

### Initial Review/Approval

Institutions interested in the BIC program will be asked to execute the necessary legal documents and complete a collateral certification attesting to their internal controls and the location of their loans. Applicants are also required to provide a list of the institution's internal loan grade definitions.

Approval for the program is contingent on Reserve Bank evaluation of the applicant, responses to the collateral certification, and an on-site inspection of the loan documents and controls of the collateral.

Loans originated by an affiliate or subsidiary of the pledging institution are generally considered ineligible collateral. Please contact the Federal Reserve Bank of Chicago for more information on the supplementary documentation that must be completed and approved by legal counsel in order to pledge affiliate or subsidiary loans.

### Perfection of Security Interest


All extensions of credit must be secured to the satisfaction of the Reserve Bank by collateral that is acceptable for that purpose. As such, the Reserve Bank will file a UCC-1 Financing Statement with the following language in order to perfect security interest in the pledged collateral:

*All accounts, chattel paper, inventory, equipment, instruments, investment property, general intangibles, documents, and all assets, now owned or hereafter acquired, that are identified, from time to time, by Debtor to Secured Party in writing, by electronic means (including by CD-ROM) or by any other means agreed by the parties, as collateral securing the obligations of Debtor to Secured Party under a written agreement between the parties, and all proceeds thereof; and all collateral, guarantees, letters of credit, surety bonds and other supporting obligations pertaining to the foregoing, and all proceeds thereof.*

It may be necessary take other actions, such as obtaining inter-creditor releases or subordination agreements, deemed necessary to perfect the Reserve Bank's security interest in the collateral. Value will not be assigned to the collateral until such arrangements are finalized.

## Collateral Certification

A BIC collateral certification must be completed prior to enrollment and annually thereafter. Information provided in the collateral certification must include: a brief description of the physical location of the collateral and related documentation; the protective measures taken to ensure the safety of the collateral; and various other matters pertaining to the BIC arrangement. **BIC collateral certifications for the Federal Reserve Bank of Chicago can be [downloaded](#) from our website.**

An authorized individual (as authorized in the Authorizing Resolution for Borrowers within Appendix 3 of [Operating Circular No. 10](#) [PDF; 249K] ) , as well as an internal auditor, must sign the completed collateral certification. The signatures attest to the fact that the institution's responses contained within the collateral certification are complete and accurate. This collateral certification assists in confirming that the collateral is being properly maintained and protected.

## On-Site Inspection

On-site inspections are a requirement of the BIC program. Reserve Bank staff will review the premises where the collateral is stored, confirm that the collateral is clearly and properly identified as pledged to the Federal Reserve Bank of Chicago, inspect a sample of loans to be pledged, and assess the controls and other procedures used to protect the collateral. **All pledged loans must have original documents (notes, mortgages, security agreements, etc.) in the loan file at the pledging institution.**

## Legal Documents

To qualify for the BIC program, an institution must have [the following documents](#) on file with the Reserve Bank: a current *Authorizing Resolutions for Borrowers, Letter of Agreement, Certificate, and Official Authorization List*. The Certificate will provide the Reserve Bank with the information needed to make an effective UCC-1 financing statement filing against the borrower. Additionally, an [Electronic Pledge Authorization Letter](#) ("EPAL") must be submitted during the application process. The EPAL authorizes those individuals approved to pledge collateral on the OC-10 Official Authorization List to email the monthly pledge listing and [Cover Letter](#).

If an institution stores loans with an affiliate of the organization, such as a mortgage company, or an unaffiliated third party such as a custodian, both the pledging institution and the affiliate or custodian must execute the [Agreement for Third-Party Custodian to Hold Collateral](#) (within Appendix 5 of Operating Circular 10). This agreement allows for the assignment of these loans as collateral to the Reserve Bank. Please contact the Federal Reserve Bank of Chicago for more information.

## Ongoing Requirements/Collateral Reporting

On a monthly basis, a listing of all loans pledged to the Reserve Bank should be submitted along with a [Cover Letter](#) [MS Word; 42K], signed or emailed by an authorized borrower from the institution. The pledging institution must complete an [Electronic Pledge Authorization Letter](#) [MS Word; 35K], which authorizes those individuals on the OC-10 Official Authorization List to email the monthly pledge listing and Cover Letter to the Reserve Bank at [Collateral@chi.frb.org](mailto:Collateral@chi.frb.org). This email may be sent securely through the [Federal Reserve Secure Message Center](#). The Reserve Bank must receive this information by the assigned monthly reporting date or the value assigned to the collateral will be reduced to zero. The Cover Letter and listing update the loans being assigned and the outstanding loan balances and reaffirms the Reserve Bank's security interest in the loans. The total number of pledged loans and the sum of the outstanding balances of pledged loans on the listing should match the totals stated on the Cover Letter. **The Reserve Bank reserves the right to request an updated pledge listing at any time between reporting dates.**

The monthly pledge listing should contain the following information:

- Bank name
- Name and account number of the obligor or maker
- Original principal balance
- Current outstanding principal balance
- Maturity date
- Paid through or next payment due date (payment frequency also required if reporting paid through date)
- Current interest rate
- Internal loan grade (a credit score is acceptable for consumer loans)
- Branch/location code if loan documentation is maintained at multiple locations
- Pledge code (if applicable)
- Address of collateral (if loan is secured by real estate)
- Total number of loans pledged and the current total outstanding principal balance for each loan type
- Any additional fields requested by the Reserve Bank

In addition, the Reserve Bank may request other information needed to properly value the loans or to perfect interest in the collateral. The pledge listing should indicate that the loans are pledged to the Federal Reserve Bank. Whenever possible, this should be noted on the files and/or within the internal loan operation system.

The monthly pledge listing must be submitted as a Microsoft Excel document. A [pledge listing template](#) [MS Excel; 31K] is available to assist you with the formatting. It is very important to **avoid changing the format** of these electronic pledge listings unless otherwise instructed. If a consistent reporting format is not maintained, we cannot process pledges in a timely manner<sup>1</sup>. If the file format changes between reporting periods, the pledged loan listing may need to be re-processed or have a reduced margin applied until changes can be made to support the revised reporting format. Contact the Federal Reserve Bank of Chicago at (800) 380-3762 for further information or to set up an electronic reporting arrangement.

The aggregate outstanding principal balance of pledged loans must be monitored between reporting periods to ensure that it does not decrease by more than 10%. If the overall value of the pledged loans decreases by 10% or more between reporting periods, the pledging institution is required to submit a new updated pledge listing immediately. For example, if the aggregate

outstanding principal balance of the most recently submitted monthly pledge is \$1.0 Million, a new pledge listing would need to be submitted immediately if the balance of that pledge falls to \$900 thousand or below at any point prior to the next required reporting date. Typical reasons for declines in a monthly pledge consist of payments, removal of past due/delinquent loans from pledge (see Ineligible Loan Types section of these guidelines), risk rating changes, and maturities. Loans that were not on the most recent pledge listing may not be used to offset these declines. An updated pledge listing must be submitted prior to pledging additional loans. As a general rule, weekly monitoring of collateral levels should be sufficient to fulfill this requirement.

### 3. Types of Collateral Eligible for Pledge

All loans should be classified and coded according to the Report of Condition and Income (“call report”) definitions. A [loan classification guide](#) [MS Word; 37K] is available to assist you with the classifications. Please contact the Reserve Bank if your institution is imaging and destroying loan documentation or accepting digital/electronic signatures on loan documentation. Such practices are generally not acceptable for loans pledged through the BIC program. In addition to the documentation outlined below, the Reserve Bank also requires that other documents used to secure a pledged loan be maintained and made available for on-site inspections. If you have specific questions on unique loan documents, please contact us at 800-380-3762.

**Trust Arrangements:** If the underlying collateral is held in a trust, a copy of the trust agreement must be made available, as well as a document evidencing that the beneficiary of the trust has signed the appropriate documentation.

**Cross-Collateralization:** All loans in a cross-collateralized borrowing relationship should be pledged to the Federal Reserve Bank. If not all loans in a cross-collateralized relationship are pledged, the institution must ensure that the loans not pledged to the Federal Reserve Bank are not pledged to another party (e.g. the FHLB) and meet BIC eligibility requirements for pledge.

#### Commercial Loans

Customer notes or promissory notes evidencing loans made to customers for commercial, agriculture and/or industrial purposes are eligible to be pledged as collateral under a BIC arrangement.

Loans that are 30 days or more delinquent, or are adversely classified by a bank regulator, are not acceptable for pledge. Please contact the Reserve Bank if your institution is pledging loans connected to swap arrangements.

#### *REQUIRED DOCUMENTS*

The following commercial loan documents must be in the loan files in order for the loan to be acceptable as collateral. **Originals are required.** Copies certified by the pledging institution are generally not acceptable. Third-party certifications (i.e. Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan cannot be pledged to the Reserve Bank.

**Customer Note.** A signed note is required. The general data elements that must be included within the note are: obligor's name; origination and maturity dates; original loan amount; and interest rate (including the index and spread if variable rate note).

**Security Agreement and Evidence of Lien Placement.** A signed security agreement containing a collateral description is required if the loan is secured. Evidence of lien placement on the collateral (i.e. UCC filing, auto title, assignment of life insurance, etc.) is also required.

**Evidence of Insurance.** Proof of current insurance covering the collateral is required. Documented procedures on insurance tracking may be accepted in lieu of evidence of current insurance.

**Credit Agreement.** If certain data elements such as the rate, maturity, or amount are not contained in the note but are referenced in a separate credit agreement, the credit agreement must be present in the loan file. If this information is held in a separate credit file, this file must also be labeled as pledged to the Reserve Bank.

### **Commercial Loans – Floor Plan Loans**

Floor plan loans are eligible to be pledged as collateral under a BIC arrangement as long as the following guidelines are adhered to. Loans that are 30 days or more delinquent, or adversely classified by a bank regulator, are not acceptable for pledge. **Originals are required.** Copies certified by the pledging institution are generally not acceptable. Third-party certifications (i.e., Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan should not be pledged to the Reserve Bank.

Due to the high loan-to-value ratios typical of floor plan financing, the exposure to loss is generally greater than in other types of inventory financing. It is the responsibility of the pledging institution to conduct surprise collateral inspections on a monthly basis. Floor plan inspection reports should be reviewed and retained by the institution. Where practical, inspection duties should be rotated among the institution's staff. The pledging institution should verify the floor plan inventory by comparing serial numbers with manufacturers' certificates of origin or titles and records, and the inspection reports should reflect whether the floor plan inventory is available for sale. Any missing inventory or other exceptions revealed by the inspection, and the dealer's explanation, should be noted in the inspection report.

Many dealers have minimal liquidity and capital relative to total debt. Therefore, the institution should closely and frequently review the dealer's financial information. Annual and interim financial statements are necessary to monitor the dealer's condition.

The institution's loan policy should establish sound standards to control the credit and operational risks associated with floor plan lending. At a minimum, the policy should address the need for detailed tri-party (manufacturer, dealer, and banker) floor plan agreements, loan-to-value requirements, the percentage amount and timing of curtailment payments, inspection standards, and the frequency of obtaining and evaluating financial statements.

#### *REQUIRED DOCUMENTS*

The following commercial loan documents must be in the loan files in order for the loan to be acceptable as collateral.

**Customer Note.** A signed note is required. The general data elements that shall be included within the note are: obligor's name; origination and maturity dates; original loan amount; and interest rate (including the index and spread if variable rate note.)

**Security Agreement.** The security agreement must have a sufficient description of the collateral. For most institutions, the security interest in floor planned inventory is evidenced by a trust

receipt.

**Credit Agreement.** If certain data elements such as the rate, maturity, or amount are not contained in the note but are referenced in a separate credit agreement, the credit agreement must be present in the collateral loan file. If this information is held in a separate credit file, this file must also be labeled as pledged to the Reserve Bank.

## Commercial Real Estate Loans

Customer notes or promissory notes evidencing loans made to customers secured by office buildings, warehouses, factories, apartment buildings, shopping malls, and income producing properties, such as parking lots and golf courses, are eligible as collateral under a BIC arrangement.

Loans that are 30 days or more delinquent, or adversely classified by a bank regulator, are not acceptable for pledge. Existing leases should be noted as secured in the credit file if the property produces income. If the property was recently completed, the institution should have a copy of the certificate of completion and an endorsement to the title policy indicating that there are no mechanic liens. Please contact the Reserve Bank if your institution is pledging loans connected to swap arrangements.

### *REQUIRED DOCUMENTS*

The following commercial real estate loan documents must be in the files in order for the loan to be acceptable as collateral. **Originals are required.** Copies certified by the pledging institution are generally not acceptable. Third-party certifications (i.e. Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan should not be pledged to the Reserve Bank.

**Customer Note.** A signed note that contains an original loan amount equal to or greater than the current outstanding principal balance shown on the monthly pledge listing is required.

**Security Agreement.** If certain data elements such as the rate, maturity, or amount are not contained in the note but are referenced in a separate security agreement, the security agreement must be present in the collateral loan file shall. If this agreement is held in a separate credit loan file, this file must also be labeled as pledged to the Reserve Bank.

**Mortgage Agreement or Trust Deed.** A signed, properly recorded mortgage or trust deed is required.

**Evidence of Title Insurance.** A commitment is not acceptable. Please contact the Bank to discuss the acceptance of alternate forms of title insurance such as a Torrens Certificate or Abstract of Title.

**Evidence of Appraisal.** The appraisal must be completed by a licensed appraiser and should be for an amount equal to or greater than the current outstanding principal balance.

**Evidence of Hazard Insurance.** The amount of property insurance should be greater than or equal to the assessed value of the structure on the property. Documented procedures on insurance tracking may be accepted in lieu of evidence of current insurance.

## Construction Loans

For purposes of the Federal Reserve Bank of Chicago's BIC program, construction loans are defined as those issued for the development of residential and commercial real estate. Construction loans

are used to finance the initial construction of a project or the renovation of an existing property. Construction-permanent loans are considered construction loans until construction is completed or principal amortization payments begin, whichever occurs first.

Loans with a construction term greater than two years are ineligible for pledge. One renewal period, for up to two additional years, is permitted on construction loans. Loans that are 30 days or more delinquent, or adversely classified by a bank regulator, are not acceptable for pledge.

#### *REQUIRED DOCUMENTS*

The following construction loan documents must be in the files in order for the loan to be acceptable as collateral. **Originals are required.** Copies certified by the pledging institution are generally not acceptable. Third-party certifications (i.e., Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan should not be pledged to the Reserve Bank.

**Customer Note.** A signed note that contains an original loan amount equal to or greater than the current outstanding principal balance shown on the monthly pledge listing is required.

**Construction Loan Agreement.** This agreement must outline the cost and terms of construction.

**Construction Mortgage.** A signed, properly recorded mortgage or trust deed is required.

**Construction Title Insurance or Title Commitment.** Please contact the Reserve Bank to discuss the acceptance of alternate forms of title insurance.

**Evidence of Appraisal (projected value).** The appraisal must be completed by a licensed appraiser and the projected value must be for an amount equal to or greater than the current outstanding principal balance. Appraisals completed in conjunction with draw disbursement requests must also be present in the file.

**Evidence of Builders Risk Insurance.** Evidence that the mortgaged property is insured is required. Documented procedures on insurance tracking may be accepted in lieu of evidence of current insurance.

#### **Vacant Land Loans**

For purposes of the Federal Reserve Bank of Chicago's BIC program, vacant land loans are defined as those secured by undeveloped land or land that is not being actively developed. Vacant land loans should not be secured by income producing properties (i.e., golf courses, parking lots, agricultural, etc.).

Loans that are 30 days or more delinquent, or adversely classified by a bank regulator, are not acceptable for pledge.

#### *REQUIRED DOCUMENTS*

The following loan documents must be in the files in order for the loan to be acceptable as collateral. **Originals are required.** Copies certified by the pledging institution are generally not acceptable. Third-party certifications (i.e. Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan should not be pledged to the Reserve Bank.

**Customer Note.** A signed note that contains an original loan amount equal to or greater than the

current outstanding principal balance shown on the monthly pledge listing is required.

**Mortgage Agreement or Trust Deed.** An original, signed, properly recorded mortgage or trust deed is required.

**Evidence of Title Insurance.** A title commitment is not acceptable. The insurance should be greater than or equal to the outstanding balance of the loan. Please contact the Bank to discuss the acceptance of alternate forms of title insurance, such as a Torrens Certificate or Abstract of Title.

Evidence of Appraisal. The appraisal must be completed by a licensed appraiser, and should be for an amount equal to or greater than the current outstanding principal balance.

## Participation Loans

Participation loans are eligible as collateral under a BIC arrangement. Participation loans originated at or purchased by the pledging institution are acceptable; however, only the retained or purchased loan balance may be pledged.

Participation loans with assignability restrictions, including loans that restrict the pledge, sale, or assignment without permission from the other party, are ineligible for pledge. Please contact the Reserve Bank for more information. Loans that are 30 days or more delinquent, or adversely classified by a bank regulator, are not acceptable for pledge. Residential real estate mortgage participation loans are not acceptable as collateral under the BIC program without review and prior approval.

### *REQUIRED DOCUMENTS*

The following participation loan documents must be in the files in order for the loan to be acceptable as collateral. Original participation certificates and agreements are required in all instances. If the pledging institution originated the participation loan, all other documents must also be original. If the pledging institution purchased the participation loan, copies of the applicable collateral and loan documentation are required. Third-party certifications (i.e. Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan should not be pledged to the Reserve Bank.

**Participation Certificate and Agreement.** A signed participation certificate executed by the selling and purchasing institution detailing the terms of the deal is required.

**Applicable Collateral and Loan Documentation.** Please see the individual loan categories sections for additional loan documentation requirements relating to each loan type.

## Consumer Loans

Customer notes or promissory notes evidencing loans made to customers for personal use are eligible to be pledged as collateral under a BIC arrangement.

Loans that are 60 days or more delinquent, or adversely classified by a bank regulator, are not acceptable for pledge. Third-party certifications (i.e. Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan should not be pledged to the Reserve Bank.

### *REQUIRED DOCUMENTS*

The following consumer loan documents must be in the files in order for the loan to be acceptable as collateral. **Originals are required.** Copies certified by the pledging institution are generally not

acceptable.

**Customer Note.** A signed note that contains an original loan amount equal to or greater than the current outstanding principal balance shown on the monthly pledge listing is required.

**Other Documentation.** If the loan is secured, a security agreement (i.e., auto title, marine title, etc.) must be included and available for review.

**Evidence of Current Insurance.** Proof of current insurance covering the collateral is required. Documented procedures on insurance tracking may be accepted in lieu of evidence of current insurance.

### **Residential Real Estate Mortgage Loans**

Customer notes or promissory notes evidencing closed-end loans made to customers secured by first liens on 1-4 family residential properties are eligible to be pledged as collateral under a BIC arrangement.

Residential real estate mortgage loans that are 60 days or more delinquent are not acceptable for pledge.

#### *REQUIRED DOCUMENTS*

The following mortgage loan documents must be in the files in order for the loan to be acceptable as collateral. **Originals are required.** Copies certified by the pledging institution are generally not acceptable. Third-party certifications (i.e. Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan should not be pledged to the Reserve Bank.

**Mortgage Note.** A signed note that contains an original loan amount equal to that shown on the mortgage, and equal to or greater than the current outstanding principal balance shown on the monthly pledge listing is required.

**Mortgage Agreement or Trust Deed.** A signed, properly recorded mortgage or trust deed is required.

**Evidence of Title Insurance.** A commitment for title insurance is not acceptable. Please contact the Reserve Bank to discuss the acceptance of alternate forms of title insurance such as a Torrens Certificate or Abstract of Title.

**Evidence of Appraisal.** The appraisal must be completed by a licensed appraiser and must be for an amount equal to or greater than the current outstanding principal balance.

**Evidence of Hazard Insurance.** The amount of property insurance must be greater than or equal to the assessed value of the structure on the property. Documented procedures on insurance tracking may be accepted in lieu of evidence of current insurance.

### **Home Equity Loans and Lines of Credit**

Customer notes or promissory notes evidencing closed-end loans secured by second liens or lines of credit secured by first or second liens on 1-4 family residential properties are eligible to be pledged as collateral under a BIC arrangement.

Home equity loans and lines of credit that are 60 days or more delinquent are not acceptable for pledge.

#### *REQUIRED DOCUMENTS*

The following mortgage loan documents must be in the files in order for the loan to be acceptable as collateral. **Originals are required.** Copies certified by the pledging institution are generally not acceptable. Third-party certifications (i.e. Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan should not be pledged to the Reserve Bank.

**Mortgage Note.** A signed note that contains an original loan amount equal to that shown on the mortgage, and equal to or greater than the current outstanding principal balance shown on the monthly pledge listing is required.

**Mortgage Agreement or Trust Deed.** A signed, properly recorded mortgage or trust deed is required.

**Evidence of Title Insurance or Title Search.** The search must indicate that the title is in the borrower's name, list the property address and/or legal description, and reflect the pledging institution as a lien holder.

**Evidence of Appraisal.** The appraised value shall be for an amount equal to or greater than the current outstanding principal balance.

**Evidence of Hazard Insurance.** The amount of property insurance must be greater than or equal to the assessed value of the structure on the property. Documented procedures on insurance tracking may be accepted in lieu of evidence of current insurance.

#### **Student Loans**

Student loans are eligible to be pledged as collateral under the BIC arrangement. Loans that are in repayment, grace or in-school status are acceptable.

Loans in repayment status that are 60 days or more delinquent, in forbearance, or adversely classified by a bank regulator, are not acceptable for the BIC program. For those loans that were originated by another organization and sold to the pledging institution, the notes should be properly endorsed and assigned to the pledging institution.

#### *REQUIRED DOCUMENTS*

The following student loan documents must be in the files in order for the loan to be acceptable as pledged collateral. **Originals are required.** Copies certified by the pledging institution are generally not acceptable. Third-party certifications (i.e. Recorder of Deeds) are acceptable on an exception basis only. If any of the required documents are missing, the associated loan should not be pledged to the Reserve Bank.

**Application.** A completed, signed application is required.

**Note.** A signed, original note that contains an original loan amount equal to or greater than the current outstanding principal balance shown on the monthly pledge listing is required.

**Guaranty.** The notice of guaranty must be included and available for review.

## 4. Collateral Controls

### Collateral Identification

Collateral pledged to the Reserve Bank must be explicitly identified. There are several ways to adequately identify collateral pledged to the Reserve Bank. Electronic identification should be used when possible. The pledging institution should place computer-generated notations on loan ledgers (or similar record) identifying the loans as pledged to the Reserve Bank. This identification could include changing or amending general ledger codes or loan codes to note that a particular block of loans has been pledged.

In addition, physical identification of pledged loans is required.

The physical identification can be accomplished in several ways, including:

- Labeling individual file folders that hold the original documents
- Labeling file cabinets that contain the documents and/or
- Posting a highly visible sign in the area where the pledged loans are located, with wording such as, "Some or all of these loans are pledged to the Federal Reserve Bank of Chicago."

### Collateral Valuation

Please see the [Discount Window and PSR Collateral Margins Table](#) for valuation information. Either the Individually Deposited Loans margin or the Group Deposited Loans margin<sup>1</sup> will be assigned, provided that the pledge listing and [Cover Letter](#) [MS Word; 42K] have been submitted on properly and within the required timeframe. If the pledge listing is not received by the assigned monthly reporting date, the collateral will be valued at zero. These valuations are subject to change at any time without prior notice.

An institution may be able to receive a higher valuation for pledging loans through our legacy [Automated Loan Deposit](#) arrangement. Please [contact us](#) for additional information.

### Annual Review of Eligibility

On an annual basis, the Reserve Bank will complete a review of the financial condition of the pledging institution to verify eligibility for the program. Analysis will be based on the institution's CAMELS ratings, Prompt Corrective Action Designation (PCAD), capital levels and ratios, and any other relevant information available to the Reserve Bank.

In addition, discount window staff may perform a short, periodic on-site inspection of the pledged collateral to ensure that all of the loan documents are in proper order. The institution will be notified prior to the inspection. The length of the inspection (usually one to two days) and sample size is dependent on the size of the portfolio pledged to the Reserve Bank.

During the inspection, a sample of loans from the most recent monthly pledge listing will be reviewed. The institution will be asked to demonstrate that it is exercising appropriate control over the collateral. As a part of the inspection, the reviewer will ask questions regarding collateral

---

<sup>1</sup> See the June 7, 2010 announcement '[Enhancement to Automated Loan Deposited Processing](#)' for more information.

safeguards and operational procedures. Also, copies of the latest internal audit reports relating to the pledged collateral, the delinquency report, and the Errors and Omissions Insurance Policy should be provided to the reviewer.

The on-site sample of loans will be reviewed to verify that the notes are original, made payable to the institution, show the institution as the lender on the notes, and that the notes are supported by applicable required documents.

In the case of mortgage loans, the institution must be shown as lender and mortgagee. If the institution is not shown as the lender and the mortgagee, there should be proper evidence of a transfer of the note and mortgage to the institution.

Following the inspection, findings are discussed with the official(s) responsible for the collateral as well as the institution's senior management. This discussion will cover the results of the inspection, including any exceptions found and suggestions for improvement. After the visit, a letter confirming the results of the review will be sent to the officer(s) responsible for the pledge of the collateral, as well as to the institution's senior management and treasury official(s). The types of findings and number of exceptions, including any legal issues relating to the pledge itself, will be taken into account to determine overall compliance with Borrower-In-Custody program guidelines and [Operating Circular No. 10](#). Should the review uncover severe breaches of the collateral arrangement in violation of the Borrower-in-Custody program guidelines or Operating Circular No. 10, participation in this program may be terminated.

## Questions or Comments

Questions or comments related to participation in the BIC program may be directed to the Federal Reserve Bank of Chicago's Credit Risk Management department at (800) 380-3762.

## 5. Appendix

### Collateral Maintenance

1. Storage cabinets, files, or folders containing notes and related information such as security agreements, mortgages, title policies and appraisals, must be readily identified as being pledged to the Reserve Bank. Additionally, the storage area containing the notes should indicate that notes are being pledged to the Reserve Bank.

2. If possible, all loans pledged to the Reserve Bank should be identified as such on your loans system.

### Withdrawals

Assets can be withdrawn from the collateral pledge at any time as long as the withdrawn assets do not:

1. Have an aggregate value of more than 10 percent of the "Total Unpaid Balance" stated in the most recently submitted Cover Letter, or
2. Result in the level of collateral decreasing below the value of any outstanding obligations.

Please contact the Reserve Bank if your institution needs to substitute loans or adjust asset levels between reporting periods.

## **Imaging Policy**

Please contact the Reserve Bank if your institution wishes to pledge imaged loan documentation. A comprehensive review of your institution's imaging procedures and policy will need to be performed and approved prior to pledging such loans.