Introduction

The Federal Reserve Bank of New York accepts from qualified institutions pledges of one-to-four family mortgage loans to secure their borrowings from the discount window, subject to certain terms and conditions. This document outlines the requirements of this collateral program (also referred to as a "Borrower-in-Custody" or "BIC" program).

The BIC program provides qualifying institutions with the ability to increase the amount of collateral pledged for discount window purposes while avoiding the costs of physically delivering notes, loan agreements and other documentation in respect of the pledged mortgage loans to the Federal Reserve Bank of New York.

The integral foundation of the BIC program is the ability of the Federal Reserve Bank of New York to take possession of the notes, loan agreements and other documentation in respect of the pledged mortgage loans in the event that circumstances warrant such action. Therefore, the Federal Reserve Bank of New York needs to be fully informed of the location, security, and completeness of all such documentation.

The U.S. Treasury Department has also approved qualifying institutions to pledge one-to-four family mortgage loans to secure deposits received under its Special Direct Investment Program, subject to terms and conditions substantially similar to those outlined in this document.

Institutional Eligibility

General

Eligibility for this BIC program is based on the Federal Reserve Bank of New York's comfort level with an institution's overall financial condition, loan administration controls, documentation practices, asset quality, and ability to meet all of the requirements of this program. To qualify for this BIC program, an institution must be in sound financial condition in the judgement of both its primary regulator and the Federal Reserve Bank of New York. Generally, institutions rated CAMELS 4 or 5 will be excluded; other institutions will be accepted on a case-by-case basis. Before accepting pledges of one-to-four family mortgage loans from an institution, the Federal Reserve Bank of New York will require that the institution complete a BIC pre-qualification form. At its discretion the Federal Reserve Bank of New York may also require an inspection of the collateral site before accepting an institution into this program.

Legal Documentation Requirements

To qualify for this BIC program, an institution must have on file with the Federal Reserve Bank of New York a current Letter of Agreement (Exhibit 1 to Operating Circular 10), Authorizing Resolutions for Borrowers (Exhibit 2 to Operating Circular 10), Borrower in Custody of Collateral Agreement (Appendix B to Operating Circular 10), authorized borrower's letter, and signature card for pledging assets and all other documentation required by Operating Circular 10 http://www.frbdiscountwindow.org/oc10.pdf. It is normal policy of the Federal Reserve Bank of New York to file UCC financing statements with respect to pledged collateral.

Collateral

Eligible Collateral

A loan in which proceeds are used to purchase or refinance residential property and which is itself secured by a first lien on the purchased property (a mortgage loan) is eligible to be pledged under this BIC program.

Only *FIRST* mortgage loans on one-to-four family residential property (i.e., a single family home or up to a four family home or condominium complex) are acceptable collateral. The underlying property should be an owner-occupied primary residence.

A mortgage loan originated by another organization, including an affiliate mortgage company, and subsequently purchased by an institution will be eligible collateral under this BIC program only if (i) the note has been properly endorsed and (ii) the mortgage has been assigned to such institution. *A mortgage that is in the name of the mortgage company or an affiliate is not eligible under this BIC program* unless the institution provides evidence acceptable to the Federal Reserve Bank of New York that it has legal title to these mortgages.

A mortgage loan originated by another organization which was subsequently acquired by an institution will be eligible collateral under this BIC program only if such institution provides evidence acceptable to the Federal Reserve Bank of New York that the mortgage loan (i) was subject to the acquisition transaction and (ii) is owned by such institution. In the case of any merger that resulted in a name change, an institution should provide evidence of the merger to affirm that such institution is in fact the successor and sole owner of the pledged mortgage loan.

A mortgage loan with a loan-to-value ratio greater than 80% should be accompanied by private mortgage insurance (PMI).

Ineligible Collateral

The following types of loans are not eligible collateral under this BIC program:

- Loans secured by a mortgage on property which is a secondary residence;
- Participations in mortgage loans otherwise constituting eligible collateral under this BIC program;
- Any loans secured by mortgages on other than one-to-four family residential property, including loans secured by mortgages on the following types of property: commercial property, vacation property, investment property, or raw land;
- Loans already pledged to another institution;
- Loans secured by a mortgage on co-ops;
- Loans that are 60 days past due within the past 12 months;
- Loans on non-accrual status;
- Loans that are adversely classified by bank regulators;
- Loans that have either been paid-off or matured.

Collateral Valuation

Prior to assigning value to the collateral pledged, a pre-qualification form must be completed by the institution and approved by Federal Reserve Bank of New York staff. Generally, the Federal Reserve Bank of New York will assign a collateral value to the pledged mortgage loans consistent with the collateral margin specifications detailed in the Federal Reserve System Discount and PSR Collateral Margins Table. The Federal Reserve Bank of New York's determination of collateral value will also be based on several other factors, including the timeliness of the collateral schedule submission and the outcome of on-site inspections.

Loan Documentation Requirements

A one-to-four family mortgage loan will be eligible collateral under this BIC program only if an institution maintains the following documents in respect of such mortgage loan:

- ORIGINAL NOTE. The mortgage loan documentation should include a signed, original note, and any amendments or modifications thereto, containing a loan amount (i) equal to that shown on the mortgage, and (ii) equal to or greater than the current outstanding principal balance shown on the current collateral schedule. The note should contain a "promise to pay" and be payable to the pledging institution. Notes that are not payable to or endorsed to the pledging institution will not be accepted unless they have been assigned to the pledging institution in a manner satisfactory to the Federal Reserve Bank of New York.

- ORIGINAL MORTGAGE. The mortgage loan documentation must include a signed, original and properly recorded mortgage, and any amendments or modifications thereto. The county recorder's stamp or seal should appear on the mortgage. In the absence of an original recorded mortgage, a copy certified by the county recorder's office of the original document is acceptable.

- ORIGINAL TITLE INSURANCE, ABSTRACT OF TITLE, OR ATTORNEY CERTIFICATE. The insurance should be at least equal to the amount of the note, the lending institution should be named as the insured, and the legal description of the property should match that in the mortgage. A title insurance commitment is not acceptable.

- EVIDENCE OF APPRAISAL. The original appraisal should be for an amount equal to or greater than the current outstanding principal balance. It should be certified by a professional licensed appraiser. Unless PMI coverage is evident, the loan-to-value ratio should be within a benchmark of 80 percent.

- HOME INSURANCE COVERAGE. *(Flood, Hazard).* Flood insurance coverage, if required, should be in an amount at least equal to the lesser of the current outstanding principal balance or the maximum required by law. Hazard insurance coverage should be in an amount at least equal to the lesser of the current outstanding principal balance or the replacement cost of the property. Documentation showing that the policy is current should be available upon request, and the institution should demonstrate that procedures exist to monitor whether insurance coverage is current.

- PROPERTY TAX. The institution should provide evidence that (i) property taxes are paid on a timely basis and (ii) procedures exist to monitor tax payments.

- PRIVATE MORTGAGE INSURANCE COVERAGE. The institution should provide evidence acceptable to the Federal Reserve Bank of New York that mortgage loans with loan-to-value ratios greater than 80% are covered by PMI.

Power of Attorney and Endorsements

The Federal Reserve Bank of New York prefers that an institution deliver to it a notarized Power of Attorney appointing the Federal Reserve Bank of New York attorney-in-fact to sell and assign any pledged collateral. In some cases, the Federal Reserve Bank may accept an endorsement of pledged notes instead of the Power of Attorney.

Collateral Custody and Controls

Storing Collateral Documents

An institution should house all pledged mortgage loans and any related documents in a segregated location that is both accessible to and known by the Federal Reserve Bank of New York. All documents should be stored in a fire-resistant environment where physical access is controlled, limited to specific individuals, and tracked. For example, unlocked file cabinets are not an acceptable storage environment. Ideally, the collateral should be maintained in a secured vault that allows for easy removal in the event the Federal Reserve Bank of New York needs to take possession of the collateral.

The Federal Reserve Bank of New York prefers that all legal documents evidencing the pledged mortgage loans be held together in a secured, fire-resistant environment; however, when space is limited, an institution may hold such documentation (other than the promissory notes) in a separate location (file room, cabinets etc.) in close proximity within the secured facility where the promissory notes are kept.

Moving Collateral Documents

An institution may not move any promissory notes, loan agreements or other supporting documentation (together, the “Collateral Documents”) relating to the pledged mortgage loans without prior written notification to, and approval from, the Federal Reserve Bank of New York.

An institution must make any request to move the Collateral Documents in writing to the Federal Reserve Bank of New York. The request must be made thirty days prior to the requested move in order to ensure the necessary protective measures are taken. Before the transfer can take place, the Federal Reserve Bank of New York may require, at its discretion, that an institution (i) obtain the written approval of the move by the Federal Reserve Bank of New York and (ii) submit the new location where the Collateral Documents will be housed to a site inspection by the Federal Reserve Bank of New York. Federal Reserve Bank of New York staff will then work with the institution to develop a suitable schedule to transfer the collateral to the new site.

The Federal Reserve Bank of New York will not give value to the pledged mortgage loans while the notes evidencing such loans are in transit. While the notes are in transit and depending on the circumstances, the Federal Reserve Bank of New York may request an institution to pledge other assets as collateral.

Collateral Identification

The Collateral Documents relating to the pledged mortgage loans should be segregated from other documents and clearly identified as being pledged to the Federal Reserve Bank of New York so that a potential purchaser of such assets would be aware of the pledge and so that the institution does not transfer or re-pledge such assets. The notes evidencing the pledged mortgage loans should be identified as pledged to the Federal Reserve Bank of New York in the following manner:

- Label individual notes or folders with a conspicuous stamp or affix a legend that indicates the note is pledged to the Federal Reserve Bank of New York; or
- Label file cabinets/file cabinet drawers with a sign indicating that all of the notes filed in the cabinet/drawer are pledged to the Federal Reserve Bank of New York; or
- Place a prominent sign indicating that all of the notes residing in the general area are pledged to the Federal Reserve Bank of New York.

In addition, an institution should clearly identify the pledged mortgage loans as pledged to the Federal Reserve Bank of New York in the institution's information management system in a manner satisfactory to the Federal Reserve Bank of New York, or an institution must otherwise provide evidence of internal control sufficient, in the judgment of the Federal Reserve Bank of New York, to prevent the sale or other transfer of the loans pledged to the Federal Reserve Bank of New York.

Collateral Reporting Requirements

On a monthly basis, or more frequently as deemed necessary by the Federal Reserve Bank of New York, an institution should submit a collateral schedule (hardcopy or electronic form) of all mortgage loans pledged to the Federal Reserve Bank of New York. An institution should also submit, simultaneously with the collateral schedule, a signed deposit application for the new outstanding principal balance of pledged mortgage loans along with a signed withdrawal application for the previous outstanding principal balance of pledged mortgage loans. Each collateral schedule must be initialed on the page where the totals are shown by an individual listed on the institution's signature card for pledging assets.

Each collateral schedule should include the institution's name and its ABA number, a statement that the mortgage loans identified on the collateral schedule are pledged to the Federal Reserve Bank of New York and the following information for each pledged mortgage loan:

- Name and account number of the obligor or maker,
- Location of the property (street address, city, state, and zip),
- Original amount of the note,
- Current outstanding principal balance,
- Maturity date, and
- Current interest rate (with a notation as to whether the interest rate is fixed or variable).

Collateral Monitoring by the Participating Institution

An institution must promptly notify the Federal Reserve Bank of New York if, at any time, the aggregate outstanding principal balance of the pledged mortgage loans declines by 10 percent or more from the most recently reported aggregate outstanding principal balance. Depending on the circumstances, at any time the Federal Reserve Bank of New York may request that an institution pledge additional collateral.

Borrower In Custody of Collateral Certification

The Borrower in Custody of Collateral Certification (the "Certification") attests to the controls and other procedures in place to safeguard the pledged mortgage loans and related documentation. An institution shall perform an initial and, thereafter, periodic Certification. All Certifications should be submitted to the Federal Reserve Bank of New York on a yearly basis or within the internal auditor cycle of between 12 and 18 months.

The completed Certification should be signed by (i) an internal or external auditor, or in the case where the institution does not have an internal audit department, an independent director, or officer of the bank, and (ii) by an individual listed on the institution's signature card to pledge assets or an authorized individual designated in the Borrowing Resolution on file with the Federal Reserve Bank of New York.

On-Site Inspections

Federal Reserve Bank of New York staff will perform periodic on-site inspections of the institution's facility and the Collateral Documents to ensure that they are secure and in proper order. The length of an inspection will depend on, among other things, the number of pledged mortgage loans. During the inspection, Federal Reserve Bank of New York staff will review a sampling of currently pledged mortgage loans and will request a tour of the facility where the pledged mortgage loans are housed to ensure that they are properly safeguarded and that the pledge to the Federal Reserve Bank of New York is identified appropriately.

Following the on-site inspection, Federal Reserve Bank of New York staff will discuss their findings with the official(s) responsible for the maintenance of the pledged mortgage loans and any related custodial services. This discussion will cover the results of the inspection, including any exceptions found and recommendations for improvement. Federal Reserve Bank of New York staff will document their findings in a letter to the officer(s) responsible for the pledge of the mortgage loans and their ongoing maintenance. The institution must promptly correct each exception found during the inspection or remove the mortgage loan subject to the exception from the collateral pledge by submitting a new collateral schedule excluding all such mortgage loans to the Federal Reserve Bank of New York.

Should the review uncover severe breaches of the requirements of this BIC program, participation in the program may be suspended or terminated at the discretion of the Federal Reserve Bank of New York.

Please contact the Discount Window (866-226-5619) for more information.