

Introduction

The Federal Reserve Bank of New York accepts from qualifying institutions pledges of commercial 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 (if any), loan agreements and other documentation in respect of the pledged commercial loans to the Federal Reserve Bank of New York.

Depending on whether the pledged commercial loan is evidenced by a promissory note (“noted commercial loan”) or is noteless (“noteless commercial loan”), somewhat different requirements apply. Accordingly, an institution must categorize each pledged commercial loan as noted or noteless and, based on such categorization, monitor compliance with the requirements of this collateral program.

The integral foundation of the BIC program is the ability of the Federal Reserve Bank of New York to take possession of the notes (if any), loan agreements and other documentation in respect of the pledged commercial 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 noted commercial 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. In addition, an institution must demonstrate to the satisfaction of the Federal Reserve Bank of New York that it qualifies for the Federal Reserve’s Qualified Loan Review Program (QLR) as described below. Before accepting pledges of commercial 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.

Qualified Loan Review Program Requirements

To qualify for the QLR, an institution must:

- Have an internal loan review and rating scale which has been approved by its primary regulator and which the Federal Reserve Bank of New York has mapped to the appropriate minimal/normal¹ risk rating scale to be used for purposes of meeting this program's reporting requirements and valuing collateral pledged under this collateral program;
- Pledge to the Federal Reserve Bank of New York only those commercial loans that have risk ratings acceptable to the Federal Reserve Bank of New York and that are not delinquent for more than 30 days;
- With respect to each pledged commercial loan, monitor the condition of the borrower on an ongoing basis and immediately withdraw any pledged commercial loan that falls below the acceptable risk ratings or otherwise becomes

¹ Minimal risk is defined as investment grade quality and normal risk is defined as below investment grade but a "pass" credit from a regulatory standpoint.

unacceptable after being pledged. Any commercial loan classified Special Mention, Substandard, Doubtful or Loss is not acceptable for pledging;

- Notify the Federal Reserve Bank of New York on a timely basis of any changes in its loan review policy or internal risk rating scale and provide copies of such changes; and
- Provide copies of financial statements, credit files and other information or documentation on any pledged commercial loans upon request by the Federal Reserve Bank of New York.

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-1 financing statements with respect to pledged collateral.

Collateral

Eligible Collateral

A commercial loan is eligible to be pledged under this collateral program if, at the time of the pledge, it: (i) meets the Federal Reserve Bank of New York's "minimal/normal" risk rating requirement; (ii) is current in terms of principal and interest; and (iii) is not subject to adverse legal actions. The types of commercial loans that may be pledged include revolving loans, syndicated loans, participations, secured loans and unsecured loans.

Ineligible Collateral

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

- Loans made to insiders, including loans to directors, officers or principal shareholders;
- Loans made to an affiliate (including an Employee Stock Ownership Plan (ESOP) or secured by stock held by an affiliate (including an ESOP);
- Loans already pledged to another institution;
- Loans that are not written in English;
- Loans that are not denominated in U.S. dollars;
- Loans that are not governed by U.S. law;
- Loans that are more than 30 days past due, on non-accrual status, or adversely classified by a bank regulator;
- Loans that have clauses with assignability or transferability restrictions;
- Loans that have either been paid-off or matured; or
- Foreign obligor loans that do not meet certain criteria (contact the Discount Window for details).

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 commercial 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. In addition, the Federal Reserve Bank of New York's determination of collateral value may be affected by industry-wide factors including current industry conditions and concentrations of credit risk.

Loan Documentation Requirements

For further information on controls and reporting of each type of commercial loan please refer to the “Collateral Custody and Controls” section of this document.

A commercial loan will be eligible under this collateral program only if an institution maintains the following documents in respect of such commercial loan:

- Credit agreement and any supporting documents evidencing the debtor's obligation;
- Security agreement, if any;
- Guarantee, if any;
- Any other supporting documentation, if any;
- Original promissory note if the pledged loan is a noted commercial loan (copies are not acceptable); and
- Any other pertinent updates.

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, including noted commercial loans. In some cases, the Federal Reserve Bank may accept an endorsement of pledged notes instead of the Power of Attorney.

Collateral Custody & Controls

Documentation for noteless commercial loans pledged under this BIC program must be maintained separately from, and not commingled with, the documentation for noted commercial loans pledged under this collateral program. All documentation must be maintained in accordance with the requirements outlined below.

Storing Collateral Documents

Noted Commercial Loans

An institution should house all pledged noted commercial 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 noted commercial 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.

Noteless Commercial Loans

An institution should house all pledged noteless commercial 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. Unlocked file cabinets, for example, 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.

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 commercial 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 the 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 Documents to the new site.

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

Collateral Identification

The Collateral Documents relating to the pledged commercial 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. If the collateral consists of noted commercial loans, the notes evidencing such 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 that 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 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 commercial 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

For reporting purposes, an institution must categorize the pledged commercial loans as noted or noteless and submit a separate collateral schedule for each loan type (i.e., submit one collateral schedule for all noted commercial loans pledged under this BIC program and submit another collateral schedule for all noteless commercial loans pledged under this BIC program). An institution must provide such collateral schedule (hard copy or electronic form) on a **weekly** basis, or more frequently as deemed necessary by 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 commercial loans along with a signed withdrawal application for the previous outstanding principal balance of pledged commercial 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 commercial loans identified on the collateral schedule are pledged to the Federal Reserve Bank of New York, and the following information for each pledged commercial loan:

- Name and internal loan number of the obligor,
- Location of the obligor (street address, city, state, zip),
- Original par amount,
- Current outstanding principal balance,
- Loan type (e.g. term, demand, revolver, etc.),
- Internal risk rating,
- NAIC Codes,
- Maturity date, and
- Current interest rate (with a notation as to whether the interest rate is fixed or variable).

According to Federal Reserve Bank of New York guidelines, loans are categorized as "minimal" or "normal" credit risk and mapped to an institution's internal risk rating scale. Minimal risk is defined as investment grade quality and normal risk is defined as below investment grade but a "pass" credit from a regulatory standpoint. For valuation purposes, the information about the aggregate pool of pledged commercial loans provided in the deposit and withdrawal application should be provided with respect to each of these risk categories.

Collateral Monitoring by the Participating Institution

An institution must promptly notify the Federal Reserve Bank of New York if, at any time, the outstanding principal balance of the pledged commercial 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.

On an ongoing basis, an institution should also monitor concentrations of credit risk within the pledged commercial loan portfolio. Generally, a given borrower or industry should not represent more than 25 percent of the value of the pledged commercial loans. Industry concentrations should be monitored on a NAIC code level.

Borrower in Custody of Collateral Certification

The Borrower in Custody of Collateral Certification ("Certification") attests to the controls and other procedures in place to safeguard the pledged commercial 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 commercial loans. During the inspection, Federal Reserve Bank of New York staff will review a sampling of currently pledged commercial loans and will request a tour of the facility where the pledged commercial 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 commercial 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 also document their findings in a letter to the officer(s) responsible for the pledge of the commercial loans

and their ongoing maintenance. The institution must promptly correct each exception found during the inspection or remove the commercial loan(s) subject to the exception from the collateral pledge by submitting a new collateral schedule excluding all such commercial loans to the Federal Reserve Bank of New York.

Should the review uncover severe breaches of the requirements of this collateral 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.