

BORROWER-IN-CUSTODY

Collateral Program



Federal Reserve Bank of Cleveland

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Borrower-In-Custody of Collateral Guidelines

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INTRODUCTION

A depository institution (DI) obtaining Discount Window credit must pledge acceptable collateral in an amount sufficient to secure an advance and accrued interest. DIs are encouraged to maintain a pre-determined amount of collateral pledged at the Reserve Bank (Bank) to ensure that sufficient collateral is available for contingency situations.

In addition to delivering securities to the Bank, or to a third-party custodian, we offer an arrangement for DIs to assign eligible loan portfolios as collateral and maintain them at your institution. The purpose of the Borrower-In-Custody (BIC) arrangement is to provide DIs with the ability to increase their collateral value, while avoiding the inconvenience and cost of transporting the loans and supporting documentation to the Bank.

ELIGIBILITY REQUIREMENTS

The Bank will conduct a review of each request for participation in the BIC program. Eligibility for the Borrower-In-Custody (BIC) Program is based on satisfaction of the following four “principles” of due diligence:

- Understanding the financial condition (and associated risks therein) of the pledging DI;
- Determining the status of perfection and priority of the Bank’s security interest in the proposed loan collateral;
- Understanding the type, characteristics, and quality of loans being proposed as collateral; and
- Ensuring that the DI’s operational controls with respect to identifying and safekeeping loan documents are acceptable.

APPLYING FOR THE BORROWER-IN-CUSTODY PROGRAM

Institutions interested in the BIC program will be asked to execute the necessary legal documents which are referenced in the section directly below. In addition, a BIC Collateral Certification document must be completed prior to enrollment and refreshed every 12-18 months thereafter. If applicable, the Image and Destroy Certification Form and Electronic Note Certification Form must be completed in conjunction with the BIC Collateral Certification. Information requested in the Collateral Certification includes: a brief description of the location of the notes and related documentation; the protective measures taken to ensure the safety of the documents; and various other matters pertaining to the BIC arrangement. The BIC Collateral Certification, Image and Destroy Certification Form, and Electronic Note Certification Form can be obtained from our website at www.clevelandfed.org. Applicants are also required to provide the following:

- List of your institution's internal loan grade definitions relating to the pledged loan types
- Complete copy of your institution’s most recent loan policy relating to the pledged loan types
- If applicable, policies and procedures regarding the imaging and destruction of original promissory notes and/or origination of electronic notes
- Complete copy of your institution’s most recent loan review report relating to the pledged loan types
- Complete copy of your institution’s most recent internal/external audit covering the applicable loan operations areas
 - It is expected that institutions with established BIC arrangements also conduct a BIC Audit. The Borrower-in-Custody Guidelines (this document) should be used to develop the scope.
- If applicable, a complete copy of the most recent internal audit regarding the imaging and destruction of original promissory notes
- If applicable, a complete copy of the most recent internal audit regarding the adequacy of internal controls for the electronic note process

- Trial balance report for loans being considered for pledge, formatted in accordance with the guidelines listed in Appendix A (optional) or an alternative format containing the data fields referenced in the interim reporting section of these guidelines and approved by the Federal Reserve Bank of Cleveland.

Approval for the program is contingent upon our evaluation of and satisfaction with the four principles referenced in the “Eligibility Requirements” section above. Compliance of the four due diligence principles will be assessed through an on-site or off-site review.

DOCUMENTS TO EXECUTE

The DI must have current documents and agreements in place to execute borrowings and establish the BIC arrangement. All documents must contain original signatures. The minimum documentation needed, which must be executed by an officer(s) authorized by the DI's board of directors as reflected in the Authorizing Resolutions for Borrowers, is as follows:

Basic Required Discount Window Borrowing Documents

- [Letter of Agreement](#) (*Operating Circular No. 10, Appendix 3*)

This letter binds your institution to the provisions of the Lending Operating Circular No. 10. The letter of agreement must be typed on your institution's letterhead and signed by an appropriately authorized officer(s) per the Authorizing Resolutions for Borrowers. If two individuals are required to execute documents per the Authorizing Resolutions for Borrowers, two must sign the Letter of Agreement.

- [Authorizing Resolutions for Borrowers](#) (*Operating Circular No. 10, Appendix 3*)

This document certifies that your institution's board of directors has provided authority to borrow from the Federal Reserve Bank of Cleveland and identifies, by title, those officers authorized to send in the names, titles and signatures of individuals permitted to issue instructions on the institution's behalf

- [Official OC-10 Authorization List](#)

A list of the individuals with authority to borrow from the discount window and pledge assets to the Federal Reserve Bank of Cleveland (name, title, signature and phone number for each person). This document must be signed by an appropriately authorized officer(s) per the Authorizing Resolutions for Borrowers. If two individuals are required to execute documents per the borrowing resolution, two must sign this document.

- [Form of Certificate](#) (*Operating Circular No. 10, Appendix 3*)

The Certificate will provide the Federal Reserve Bank all of the information needed to make an effective UCC-1 financing statement filing against the Borrower.

Additional Documents That May Be Required For Borrower in Custody

- [Letter of Agreement to Correspondent Credit and Payment Agreement](#) (*Appendix 5 of Operating Circular No. 10, Exhibit 1*) - (if applicable)

If your institution *does not* have a Federal Reserve account, this agreement allows your institution to select a correspondent to receive Discount Window advances and make payments on your institution's

behalf. This document sets forth the agreement (“Correspondent Agreement”) among the Bank, a Borrower, and another depository institution that maintains an Account and is designated by the Borrower as its Correspondent

(“Correspondent”) under which the Bank may make an Advance to and obtain repayment from the Borrower through the Correspondent.

- [Form of Agreement for Third Party Custodian to Hold Collateral](#) (Appendix 5 of Operating Circular No. 10) - (if applicable)

This Appendix sets forth the terms of agreement among the Federal Reserve Bank, the Borrower, and another institution (Custodian) that holds loans pledged by the Borrower to the Bank under the Lending Agreement between the Borrower and the Bank.

Once executed, the aforementioned documentation requirements are reviewed and verified during any scheduled BIC review. It is the institution’s responsibility to notify the Federal Reserve Bank of any subsequent changes that would require the re-execution of any / all borrowing documents.

ELIGIBLE LOAN TYPES

For detailed information regarding eligible loan types and margins, reference Collateral Valuation information [here](#). Loan categories are described by reference to FFIEC and NCUA call codes as identified [here](#) and described in more detail in the Eligible Loan Types and Performance Criteria section of the Collateral Guidelines and should be used as guidance when pledging loans to the Discount Window. Consult the applicable call report for additional details.

Note: Loans must be in readily negotiable, transferable or assignable form (i.e., loans should not be subject to restrictions on assignments or transfer, such as provisions requiring consent to an assignment or transfer) and not subject to any adverse legal, environmental or other action. Domestic syndicated loans that contain a provision explicitly allowing the lender(s) to pledge the loan(s) to a Reserve Bank are acceptable.

INELIGIBLE LOANS

- Consumer or 1-4 family mortgage loans more than 60 days past due (Credit card receivables - more than - 60 days past due)
- Commercial Real Estate, 1-4 Family Residential Mortgages and Home Equity loans that are imaged and destroyed.
- Commercial and Commercial Real Estate loans more than 30 days past due
- Loans risk rated ‘Watch’ or worse
- Loans owned by a subsidiary or affiliate
- Loans with assignability or transferability restrictions. Government Guaranteed Loans, including S.B.A., 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/Forward/Standby Contracts for Securities, Foreign Exchange Commitments, Swaps, etc.)
- Insider loans (i.e. loans to a director, officer, principal shareholder, or bank employee)
- Loans collateralized by stock of any depository institution or affiliate
- Loans secured by CD’s in excess of the most current FDIC insurance limits
- Loans issued to an affiliated Employee Stock Ownership Plan (ESOP) or secured by stock held by an affiliated ESOP

- Loans already pledged under a specific or blanket lien unless expressly subordinated to the Reserve Bank
- Loans to foreign or domestic entities that are not denominated in U.S. dollars
- Loans to entities or individuals that are incorporated or domiciled outside of the U.S. or whose principal place of business or main office is outside of the U.S.
- Loans classified as Other Loans Especially Mentioned; Substandard; Doubtful or Loss; or that are otherwise identified for management's special attention
- Loans that fall below the acceptable credit risk ratings or otherwise become unacceptable after being pledged must immediately be withdrawn
- Loans scheduled to mature within 30 days from the date of the loan trial.

NOTE: *The Reserve Bank may, at its discretion, amend collateral requirements or terminate the BIC Program for an Institution at any time.*

INITIAL INSPECTION AND ONGOING REVIEW OF ELIGIBILITY

Prior to acceptance into the BIC program, the Federal Reserve Bank may require an on-site inspection of the loans to be pledged. Our staff will review the premises where the loans are stored (e.g., a vault for original notes and a server for electronically originated loans); establish that the loans are clearly and properly identified as being pledged to the Federal Reserve Bank of Cleveland; inspect a sample of loans to be pledged; and assess the controls and other procedures used to protect the loan documents.

Subsequent to initial approval, the Reserve Bank maintains the right to perform ongoing inspections at its discretion. At minimum, a new BIC Collateral Certification will be required every 12-18 months. Additionally, it is an Operating Circular 10 requirement that the pledging institution's internal/external audit department include an annual review of the institution's compliance with the Borrower-in-Custody agreement as part of their regular audit schedule of the loan operations area(s). The Borrower-in-Custody Guidelines Document should be used to establish the scope of the BIC Audit. A complete audit report of these areas, including any findings, management's response, and corrective action plan, must be forwarded to the Federal Reserve Bank for review upon request. An auditor's certification letter or auditor's signature on the BIC Collateral Certification must also be forwarded stating their opinion as to the institution's compliance level with the BIC agreement.

Loans, and any related documents, must remain in the location designated in the BIC Collateral Certification. Removal and relocation without approval of the Federal Reserve Bank of Cleveland is prohibited and may result in termination of the BIC arrangement.

Institutions with established BIC arrangements that wish to transition from origination and retention of notes to imaging and destruction of notes and/or origination of electronic notes must notify the Reserve Bank before implementation.

Institutions considered in-scope are subject to a loan data element (LDE) validation every three years. Refer to the "Interim Reporting - New ALD Collateral Report Submissions Requirements" section for more details on the difference between in-scope and out-of-scope pledging institutions.

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 Federal Reserve Bank will file a UCC-1 Financing Statement

with the following language in order to perfect our security interest in the pledged loans:

“ All accounts, loans and other extensions of credit (whether an instrument, a promissory note, a payment intangible, a general intangible or a participating interest in a loan) and all chattel paper (including electronic chattel paper), wherever located, now owned or hereafter acquired, or in which Debtor now or hereafter obtains an interest, that are identified from time to time by Debtor to Secured Party in writing or by electronic means as collateral securing the obligations of Debtor to Secured Party under a written agreement between the parties, and all proceeds, substitutions, and accessions thereof; and all collateral, guarantees, letters of credit, surety bonds and supporting obligations pertaining to the foregoing, and all proceeds thereof.”

CUSTODY AND CONTROL STANDARDS

All pledged loans held under a BIC arrangement should be clearly indicated as such by either labeling the individual assets as pledged to the Federal Reserve Bank of Cleveland, electronically designating loans as pledged to the Federal Reserve Bank of Cleveland on the institution's loan system or general ledger and/or segregating the pledged assets from other assets of the institution. Institutions that pledge imaged and destroyed notes or electronic notes must designate the loans as being pledged to the Federal Reserve Bank of Cleveland on its loan system or general ledger. In all cases, the loans should be adequately secured and controlled. File cabinets housing pledged original notes should be clearly labeled as such. If an entire loan center has been pledged, then there generally is no need for individual files or cabinets to be labeled as mentioned above. However, the institution must post a highly visible sign in the area where the documentation is housed stating to the effect that “some or all of these loans are pledged to the Federal Reserve Bank of Cleveland as Discount Window collateral.”

The original promissory notes should be stored in a fireproof vault or other secured enclosure. The container must clearly indicate that the contents are pledged to the Reserve Bank and be accessible only to a limited number of people. However, for large pools of loans, it may not be feasible to house the original loan documents in a container, and other means of storage of these documents would need to be discussed. Preferably, the container housing this documentation should not contain other assets of the institution.

INTERIM REPORTING

All depository institutions that pledge loans as collateral for Federal Reserve purposes are required to submit updated reports via the Federal Reserve's secure email service (FRSecure/Zix) detailing the pledged loans on a periodic basis (at least monthly), as well as any time the total current outstanding principal balance of all loans pledged decreases by 10 percent or more. Also, a completed “BIC Pledge Transmittal Form” must accompany the monthly loan report submission. This form must be signed by an authorized officer(s) per the Authorizing Resolutions for Borrowers. A copy of the “BIC Pledge Transmittal Form” and an Excel spreadsheet loan report template will be provided to you by Federal Reserve staff. Monthly update submissions are required no later than 15 days following month-end. Should an updated submission not be received by the Federal Reserve Bank of Cleveland by the stated deadline, loan collateral value may be revalued to \$0.

COLLATERAL REPORT SUBMISSION REQUIREMENTS

In-Scope File Specifications (New ALD)

The Federal Reserve announced new ALD collateral report submission requirements affecting certain identified institutions for Discount Window lending and Payment System Risk purposes, beginning in 2019 and taking effect on March 14, 2022. These changes are part of an initiative to ensure that institutions continue to receive precise fair market estimates for collateral pledged to the Federal Reserve.

Automated Loan Deposit (ALD) is the Federal Reserve's process for recording loan pledges at the individual loan detail level, and, in most instances, reports must be submitted in an ALD format.

The process for pledging loan collateral to a Reserve Bank depends in part on whether the pledging institution is in the in-scope category or out-of-scope category. The difference between the two groups is the amount of information the pledging institution must provide about each pledged loan. In-scope institutions must provide a more detailed set of data elements for pledged loans.

An institution is considered in-scope if it meets one of the following criteria:

- All depository institutions that are controlled (12 CFR 225.2(e)) by a Bank Holding Company (12 CFR 225.2(c)(1)) (including a Financial Holding Company (12 CFR 225.81)) or an Intermediate Holding Company (12 CFR 252.2(y)) with Fifty Billion Dollars (\$50,000,000,000) or more in total consolidated assets, defined as the average over the last four calendar quarters;
- All Foreign Banking Organizations (12 CFR 211.21(o)(1));
- All other domestic depository institutions with Fifty Billion Dollars (\$50,000,000,000) or more in total consolidated assets, defined as the average over the last four calendar quarters; or
- An institution that voluntarily becomes an in-scope institution.

General Reporting Requirements

- On a periodic basis (at least monthly), in-scope institutions will send a plain text file of vertical pipe (|) separated fields containing the required loan fields on loans pledged as collateral.
- Each file should only contain data for one ABA number and Reserve Bank loan type. An institution can submit multiple files for the same Reserve Bank loan type and pledgee account code.
- Each file must contain a unique loan identifier that will be maintained and matched in future file submissions; each new file will replace the previous file with the same loan identifier. Loan identifiers are created by local Reserve Banks for internal purposes.
- Files should only contain loans that meet all applicable collateral eligibility requirements.
- Depository institutions should encrypt files in transit (using an [approved secure transmission method](#)) before sending the files electronically. The following methods may be used to securely transmit ALD collateral reports: ZixCorp, Intralinks or Email with Mandatory Transport Layer Solution (TLS).

Each file:

- Must provide updated loan fields for loans currently pledged (revaluations).
- Must exclude loans that the institution no longer wishes to pledge (withdrawals).

- May contain new loan deposits (loans that were not included on the prior report).

Record Types and Requirements

- Each file should include only one Header Record (the first record in the file) and only one Trailer Record (the last record in the file).
- In the format fields for the header and trailer record as well as the loan detail record: when a numerical value is required, it is represented by a 9 and when alphabetic characters are required, they are represented by an X. The numbers in parentheses identify the maximum number of characters in each loan field.
- When coding fields, the following rules should be applied:
 - Decimal points and negative signs in numeric fields should be explicit.
 - Leading zeros in numeric fields should be suppressed.
 - Credit card pledges are to be reported based on credit score “pools”, with each “pool” having a set credit score threshold. In-scope institutions should report Credit Card receivables in segments (The unique identifier for the reported credit card pool should be classified as: 1 = (>760); 2 = (660-760); 3 = (620-659); 4 = (<620).) Do not report a pool if it does not contain any pledged credit cards.
 - Separate submissions of prime and subprime credit cards are no longer required for in-scope institutions; since credit card reporting is now “pool”-based, only one submission covering all credit cards is needed. However, the format in which an in-scope institution will be required to deliver the new loan fields will be at the discretion of each Reserve Bank.
 - All dates should be in CCYYMMDD format.
 - All times should be in HHMMSS format.
- The Asset Code (for the Reserve Bank loan type) in the header record is used to determine the specific detail record format. Additional information can be found in the [In-Scope File Format Specifications and Definitions](#) document.

Out-of-Scope File Specifications

General Reporting Requirements

- On a periodic basis (at least monthly), an institution will send a fixed position text file containing detail on loans pledged as collateral, or with a file in Microsoft Excel® format, or select other formats.
- Each file should only contain data for one ABA number and Reserve Bank loan type. An institution is allowed to submit multiple files for the same Reserve Bank loan type and pledgee account code.
- Each file must contain a unique Loan Identifier that will be maintained and matched in future file submissions; each new file will replace the previous file with the same Loan Identifier.
- Files should only contain loans that meet all applicable eligibility requirements for the pledge program.
- Credit Card Receivables will be reported as a group deposit and will subsequently have fewer loan data elements to report.
- Depository institutions should encrypt files in transit (using an [approved secure transmission method](#)) before sending Collateral Schedules electronically. The following methods may be used to securely transmit ALD collateral reports: ZixCorp, Intralinks or Email with Mandatory Transport Layer Solution (TLS).

Each file:

- Must provide updated principal balances for loans currently pledged (revaluations).
- Must exclude loans that an institution no longer wishes to pledge (withdrawals).
- May contain new loan deposits (loans that were not included on the prior report).
- While certain fields are optional and may be left blank (as indicated in the descriptions in the tables below), loans where *required* fields are left blank or not completed in accordance with the tables below will not receive value.

Record Types and Requirements

The specifications listed below pertain to formatting only and are not intended to serve as a comprehensive list of fields that are required to be reported by institutions that pledge loans.

Option 1: Text File Specifications

- Each file should include only one header record (the first record in the file) and only one trailer or expanded trailer record (the last record in the file).
- Reporting requirements depend on whether a loan is subject to a “master note facility,” an overarching lending agreement that allows for multiple individual drawdowns to be outstanding at one time.
 - For each master note facility, the file should include (i) one Obligor Record; (ii) one Master Note Record; and (iii) a Loan Detail Record for each individual drawdown under the facility. There can be multiple Loan Detail Records under a Master Note Record.
 - For each loan that is not part of a master note facility, the file should include (i) one Obligor Record and (ii) one Loan Detail Record.
- Additional information can be found in the [Out-of-Scope Text File Format Specifications and Definition](#) document.

Option 2: Microsoft Excel® Format Specifications

- Files should be saved in Excel 97-2003 (.xls) or Excel Workbook (.xlsx) format. Contact your Reserve Bank regarding the possibility of submitting files in other formats
- Files should be saved without Excel password protection
- Files should not include merged cells, hidden rows, or hidden columns
- The following Excel number formats should be utilized:
 - “Currency” for dollar amounts (\$0.00)
 - “Short date” for dates (mm/dd/yy or mm/dd/yyyy)

Once an institution’s file format has been accepted by a Reserve Bank, the institution is required to utilize the same file layout for each successive collateral report submission

- Column headers, including names, spellings, and positions, must remain unchanged
- Worksheet (tab) names and positions must remain unchanged
- New fields should be appended to the right of all columns in the existing file layout

The interest method should be reported as follows:

- The interest method field is required to be reported by institutions with total assets of \$10 billion or more.
- Use the value **Fixed** for loans that carry a fixed interest rate:

- A fixed interest rate is a rate that is specified at the origination of the transaction, is fixed and invariable during the term of the loan or lease and is known to both the borrower and the lender. A fixed rate may change during the term of the loan on a predetermined basis, with the exact rate of interest over the life of the loan known with certainty to both the borrower and the lender when the loan is acquired. Examples of predetermined-rate transactions are:
 - Loans that carry a specified interest rate six months and thereafter carry a rate equal to a specific percentage over the initial rate
 - Loans that carry a specified interest rate while the loan amount is below a certain threshold amount but carry a different specified rate above that threshold (e.g., a line of credit where the interest rate is 10% when the unpaid balance of amounts advanced is \$100,000 or less, and 8% when the unpaid balance is more than \$100,000)
- Use the value **Floating** for loans with an interest rate that floats:
 - A floating interest rate is a rate that varies, or can vary, in relation to an index, to some other interest rate such as the rate on certain U.S. Government securities or the bank's "prime rate," or to some other variable criterion the exact value of which cannot be known in advance. Therefore, the exact rate the loan carries at any subsequent time cannot be known at the time of origination.

For demand loans, which are loans without a stated maturity date that are due upon demand by the lender, the maturity date should be reported with one of the following options:

- Leave the maturity date field blank
- Report a maturity date of 01/01/9999
- Report a maturity date of 12/31/9999

RELEASE OF COLLATERAL

Should an institution desire to withdraw ten percent or more of a pledged pool of loans, upon Reserve Bank approval of the withdrawal, a new [BIC Pledge Transmittal Form](#) (signed by an authorized individual(s)) and updated trial balance report for the loans remaining for pledge must be submitted to the Reserve Bank. A request to cancel the Borrower In Custody program should be in writing and accompanied by a completed [BIC Withdrawal Transmittal Form](#). In this case, a trial balance report is not required.

HOW TO GET STARTED

To begin the application process for qualification under the Borrower-In-Custody Program, the following summarizes the required information, which must be provided prior to acceptance:

- Provide a complete copy of your institution's most recent Internal Audit covering the applicable loan operations areas
- Provide a complete copy of your institution's most recent internal audit regarding the imaging and destruction of original promissory notes (if applicable)
- Provide a complete copy of your institution's most recent internal audit regarding the adequacy of internal controls for the electronic note process (if applicable)
- Provide a complete copy of your institution's Errors and Omissions Policy (if applicable)
- Provide a complete copy of your institution's internal loan grading system(s). (Commercial Type

Loans)

- Provide a complete copy of your institution's most recent internal/external loan review report.
- Provide a complete copy of your institution's loan policy relating to pledged loans.
- Provide a complete copy of your institution's policies and procedures regarding the imaging and destruction of original promissory notes and/or origination of electronic notes
- Complete the respective Borrower-In-Custody Collateral Certification(s)
- Complete the Image and Destroy Certification Form and/or Electronic Note Certification Form (if applicable)

The documents mentioned above must be sent electronically. Please contact Discount Window staff at (888) 719-4636 for submission instructions.

BORROWER-IN-CUSTODY OF COLLATERAL CERTIFICATIONS

The following applicable certifications should be completed by the depository institution's internal audit function. If your institution does not have an internal audit function, then two officials of your institution may complete the applicable certification(s), pending the Reserve Bank's approval.

- ❑ [1-4 Family Certification](#)
- ❑ [Commercial Certification](#)
- ❑ [Consumer Certification](#)
- ❑ [Image and Destroy Certification](#)
- ❑ [Electronic Note Certification](#)

ADDITIONAL INFORMATION AND CONTACTS

All documents referenced above and any additional information on participation in the BIC program may be obtained from the Federal Reserve Bank of Cleveland's website at [Discount Window and Collateral \(clevelandfed.org\)](#); the Federal Reserve System's Discount Window website at: www.frbdiscountwindow.org; or by contacting the Credit Risk Management staff at (888) 719-4636.