

## BORROWER-IN-CUSTODY

### Collateral Program



Federal Reserve Bank of Cleveland

Revised: January 2025

## INTRODUCTION

A depository institution (DI) obtaining Discount Window credit must pledge acceptable collateral in an amount sufficient to secure an advance and accrued interest. 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 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 form must be completed prior to enrollment and refreshed every 12-18 months thereafter. Additional forms may be required. Applicable forms can be obtained from [our website](#). 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
  - o 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
- Completed Loan Trial balance report for loans being considered for pledge, formatted in accordance with the guidelines referenced [here](#).

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.

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

## 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

❑ [Form of 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 the [Loan Valuation and Margins Tables](#). Loan categories are determined by [FFIEC and NCUA Call Report codes](#). 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.

## 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 accessionsthereof; 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) or Intralinks 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 a loan trial 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**

All DIs (12 CFR 201.2(c)(1)) that pledge loans as collateral for Federal Reserve purposes are required to submit reports 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. 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. Please review [File Specifications](#) for more information.

## **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 BIC program should be in writing and accompanied by a completed BIC Withdrawal Transmittal Form. In this case, a trial balance report is not required. Both forms are located [here](#).

## **BORROWER-IN-CUSTODY OF COLLATERAL CERTIFICATIONS**

[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.

## **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](#); the [Federal Reserve System's Discount Window website](#); or by contacting the Credit Risk Management staff at (888) 719-4636.