

# **BORROWER-IN-CUSTODY**

## **Collateral Program**



# **FEDERAL RESERVE BANK OF MINNEAPOLIS**

*August 1, 2023*

## Introduction

All extensions of credit by the Federal Reserve Bank of Minneapolis (FRB) must be secured to the satisfaction of the FRB. The Borrower-In-Custody (BIC) collateral arrangement allows depository institutions to pledge loans to the FRB without physically delivering the collateral to the FRB or another custodian. This booklet is intended to provide general information regarding the BIC collateral program.

## General Eligibility Requirements

The FRB conducts a due diligence review of each request for participation in the BIC program, relying on information from the applicant, its regulator(s), and other sources. Eligibility for the program is determined based on satisfaction of the following four principles of due diligence:

- Understanding the financial condition of an applicant and any related risks.
- Understanding the type, characteristics, and quality of loans being proposed as collateral.
- Ensuring the priority of the FRB's perfected security interest in proposed collateral.
- Ensuring that an applicant's operational controls with respect to identifying and safekeeping loan documents are acceptable.

After an applicant is approved to participate in the BIC program, the FRB performs ongoing due diligence reviews to confirm continued eligibility. The FRB may amend or terminate a participant's BIC arrangement any time at the FRB's sole discretion.

## Loan Acceptance Criteria

- For Discount Window and Payment System Risk collateral: [www.frbdiscountwindow.org](http://www.frbdiscountwindow.org). Besides acceptance criteria for loans, this site's Collateral section includes loan collateral margins table and a mapping of call report codes to the loan types that may be maintained in BIC arrangements.
- Electronically originated or imaged notes may be acceptable for certain types of loans; see Appendix A: Electronic Collateral for more information.
- For collateral pledged for Treasury purposes, eligibility rules may differ from those for the Discount Window. See the TreasuryDirect website for a complete list of eligible Treasury collateral: <https://treasurydirect.gov/laws-and-regulations/collateral-programs/>.

## Perfection of Security Interest

The FRB will file a UCC-1 Financing Statement with the following description of collateral in order to perfect its security interest in pledged loans:

*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.*

## Collateral Storage and Labeling Requirements

The original promissory notes and supporting loan documents must be securely stored, with appropriate physical and operational controls. Collateral documentation should be protected against loss from unauthorized access, fire, theft, and other dangers.

The FRB encourages, but does not require, segregating the original promissory notes, mortgages, note amendments and assignments, and participation agreements (collectively, "pledged notes") that are pledged to the FRB from all other notes maintained by the BIC participant.<sup>1</sup> There is no need to segregate any other documents related to

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<sup>1</sup>Minor deviations from physical note segregation are acceptable. For instance, some notes may be excluded from a pledge because they are past due or otherwise ineligible. If the ineligible notes are maintained with pledged notes, the segregation requirement would be deemed satisfied as long as the ineligible notes constitute a very small portion of the overall pledge.

pledged notes. Pledged notes that are segregated must be identified as pledged by signage or labeling that clearly states that notes are pledged to the Federal Reserve Bank of Minneapolis. Signage or labeling must be placed prominently in at least one of the following ways: directly on pledged notes, on individual files containing the pledged note, on the container(s) or drawer(s) containing the pledged notes, and/or in the note storage area.

In situations where physical segregation of pledged notes is not feasible, the following two requirements must be met:

1. An electronic indicator that a pledged note is pledged to the FRB must appear in the BIC participant's general ledger/loan system, or a current list of all pledged notes must be readily obtainable or available in all areas in which pledged notes are stored; and,
2. Signage in the note storage area must indicate that the pledged notes are pledged to the Federal Reserve Bank of Minneapolis and must include how and where pledged notes can be identified. Examples of acceptable signage are:

a.

**Notes stored in this [drawer/container/area] and coded as [describe code used] in [name of system/application] are pledged to the Federal Reserve Bank of Minneapolis.**

or

b.

**Notes stored in this [drawer/container/area] may be pledged to the Federal Reserve Bank of Minneapolis. FRB Pledged notes are identified on a paper schedule located at [physical location of paper schedule\*].**

or

c.

**Notes stored in this [drawer/container/area] may be pledged to the Federal Reserve Bank of Minneapolis. FRB Pledged notes are identified in an electronic schedule of loans that can be obtained at [identify how to obtain the schedule\*].**

\*The schedule of pledged notes must be immediately available or individuals requesting the schedule must be able to obtain the schedule within a reasonably short time. Signage must specify the exact physical location of the paper schedule, the intranet website or page where the electronic schedule is available, and/or the name and/or title of the employee who could provide the schedule.

## Monitoring Compliance with BIC Program Requirements

### BIC Participant's Loan Reviews/Audits

BIC participants should provide the FRB with periodic independent audits of assets pledged through the BIC arrangement. This audit may be performed by a participant's internal or external auditors. The auditors should include a review of compliance with all BIC guidelines as an independent engagement or as part of a regular audit/review of loan operations. A complete audit or loan review report, including any BIC-related findings, management's response and corrective action plans, and accuracy of the BIC participant's internal risk rating policy, should be provided with the BIC Certification (described in the [How to Get Started](#) section).

### FRB Inspections

At its discretion, the FRB will perform periodic on-site or off-site inspections to verify a BIC participant's compliance with the BIC program requirements. In determining inspection frequency, the FRB will consider factors such as financial condition and adherence to BIC program requirements. The FRB will review pledged notes, either original notes for an on-site inspection or scanned copies of originals for off-site inspections. The FRB may also request reports from your general ledger/core loan system, evidence of labeling, and other relevant documentation when conducting such inspections.

## Periodic Reporting

### Monthly Reporting

BIC participants are required to submit the [BIC Cover Letter](#) and BIC Collateral Schedule at least once per month, regardless of borrowing frequency. Listings of pledged loans are generally submitted on a BIC Collateral Schedule, an electronic form suitable for automated loan deposit (ALD). With ALD, each pledged loan is recorded and valued individually. Additional information about ALD is available in the File Specifications section on the [Discount Window website](#). BIC participants are expected to transmit collateral schedules using an FRB-approved secure method, such as [Zix FRSecure Message Center](#) or IntraLinks.

The BIC Collateral Schedule format and content depends on whether the FRB considers the pledging institution to be “in-scope” or “out-of-scope.” Most institutions will fall into the out-of-scope category, and the fields for their BIC Collateral Schedule will include:

- Obligation (Loan) Number
- Obligor Name
- Face Amount
- Current Outstanding Balance
- Interest Rate
- Issue Date
- Maturity Date - *Exclude loans that mature 30 days or less after the “Effective Date of Data”*
- Location of Notes
- Internal Risk Rating
- Principal Next Due Date
- Interest Next Due Date
- Days Past Due
- Participated Lender - *For participated loans*
- Purchased or Sold - *For participated loans*
- Interest Method (Fixed or Floating) - *Optional for domestic institutions with less than \$10 billion in total assets*
- FFIEC/NCUA Call Report Code

In-scope institutions must provide a more detailed set of data elements for pledged loans. Contact the FRB for the BIC Collateral Schedule template and to determine whether the FRB considers your institution to be “in-scope” or “out-of-scope.”

A monthly due date will be established for each BIC participant upon approval into the program. The FRB may also request more frequent updates or additional required fields. The effective date of data on the collateral schedule is expected to be within a few days of the assigned due date.

All BIC participants are required to pledge loan(s) with an outstanding balance value from at least one collateral category at all times.

### Reporting Between Monthly Reporting Dates

BIC participants are required to monitor pledged collateral levels to ensure that the current total outstanding balance of pledged loans does not decrease by 10% or more between collateral schedule reporting dates. If, at any time, the total outstanding balance of pledged loans declines by 10% or more compared to the most recent collateral submission, participants are required to submit an interim collateral schedule with an explanation of the cause of the decrease.

### Other Considerations

- If the FRB does not receive updated collateral schedules by the assigned due date each month, the collateral value of the pledged loans may be reduced to zero.
- If a BIC participant decides to terminate its BIC arrangement, it must send a request for termination of the BIC arrangement to the FRB in writing.

## How to Get Started

After a potential BIC participant is familiar with the BIC program and has identified eligible loans to pledge, provide the FRB with the following:

- Legal Agreements:** Operating Circular 10 (OC-10) agreements must be completed unless already filed with the FRB.

The Form of Certificate is required to apply for the BIC collateral program. The FRB will use information in this document for its UCC filing and searching. If a conflicting UCC filing is identified the FRB will seek a subordination agreement or revision/termination of filing from the other lien holder before accepting the collateral.

OC-10 agreement templates are located at: [www.frbdiscountwindow.org/Pages/Agreements/Required-Agreements.aspx](http://www.frbdiscountwindow.org/Pages/Agreements/Required-Agreements.aspx)

To request a review of documents before completion, email [mpls.credit@mpls.frb.org](mailto:mpls.credit@mpls.frb.org) via the encrypted [Zix FRSecure Message Center](#) or send a fax to 612-204-5911.

Once completed, send the original Legal Agreements to the [Federal Reserve Bank of Minneapolis](#).

- BIC Certification:** Complete a [BIC Certification](#) ("Certification") that describes the loans intended for pledging and the status of compliance with the BIC program requirements. The Certification must be signed by the OC-10 authorized borrower(s) and certified by an auditor.

Additional addendums may be needed in special circumstances:

[Addendum to BIC Certification – Electronically Created or Imaged Notes](#) [Addendum to BIC Certification – Records and Information Management Firm](#)

At a minimum, a BIC participant is required to submit an updated BIC Certification every 18 months. The FRB will notify the participant's primary BIC contact by email shortly before the BIC Certification is due. Participants must also submit a new BIC Certification anytime a significant change is made to the arrangement (e.g., moving collateral to a new location, changing pledged loan type(s), or implementing electronically created or imaged notes).

- Audit Report/Loan Review:** With the initial Certification, include a copy of the most recent internal or external audit report and/or loan review relevant to the types of loans intended for pledge. Current reports should be provided with each updated BIC Certification, for details refer to the [Monitoring Compliance with BIC Program Requirements](#) section above.
- Loan Risk-Rating Policy:** The BIC applicant should include an excerpt from its policy that defines the internal loan risk ratings for the types of loans intended for pledge. We expect that some loan types, such as consumer loans, may not be risk rated. Provide the FRB an update when any material changes occur to the Loan Risk Rating policy.
- Samples of Promissory Notes:** Provide a sample copy of an actual promissory note that represents the type of documentation used for each type of loan in the proposed pledge. Depending on the loan arrangements, the FRB may request additional documentation.
- Collateral Schedule and Cover Letter:** Complete a preliminary listing of loans intended for pledge, using the Collateral Schedule (contact the [FRB](#) for the template) and [Cover Letter](#) templates from the Discount Window website. Group and subtotal loans by the Call Report category codes.

The links above can also be found at [https://www.frbdiscountwindow.org/pages/select-your-district/minneapolis/09\\_bic-cfm](https://www.frbdiscountwindow.org/pages/select-your-district/minneapolis/09_bic-cfm).

Email the BIC Certifications and supporting documentation via the encrypted [Zix FRSecure Message Center](#) to [mpls.credit@mpls.frb.org](mailto:mpls.credit@mpls.frb.org). To mail the hard copies, use the addresses listed for Legal Agreements above.

The FRB will inform a BIC applicant in writing when the BIC arrangement is approved and will assign value to eligible collateral listed in the collateral schedule based on the [Collateral Margins Table](#).

At any time during the BIC program application process, feel free contact a Credit/PSR analyst with any questions at 1-877-837-8815 or [mpls.credit@mpls.frb.org](mailto:mpls.credit@mpls.frb.org).

To send documents by mail:

*Via regular mail:*

Federal Reserve Bank of Minneapolis  
Attn: Credit/PSR, T-5  
P.O. Box 291  
Minneapolis, MN 55480-0291

*Via courier:*

Federal Reserve Bank of Minneapolis  
Attn: Credit/PSR, T-5  
90 Hennepin Avenue  
Minneapolis, MN 55401

## Appendix A: Electronic Collateral

### Introduction

The FRB accepts certain electronic loan collateral pledges from qualifying depository institutions participating in the BIC collateral program. Generally, all loans that are eligible for the BIC collateral program and meet the requirements outlined in this Appendix may be acceptable as electronic collateral, except for the loans where the original wet ink signed mortgage note was imaged and destroyed. Contact FRB Minneapolis about the permissibility of the loans where the original wet ink signed mortgage note was imaged and destroyed. The FRB will conduct a due diligence review of each request to pledge electronic collateral before these assets can be added to any new or existing BIC collateral arrangement. This appendix is intended to provide general information regarding pledging electronic loan collateral. General BIC collateral eligibility requirements discussed in this booklet also apply.

### Electronic Collateral

Electronic collateral can be either (1) originated electronically or (2) originated in paper form but converted to electronic form (imaged), with the originals intentionally destroyed. This electronic collateral definition excludes situations in which an institution images paper promissory notes for convenience or contingency purposes but retains the paper originals.

### Authoritative Copy and Non-Authoritative Copies

Only one authoritative copy (i.e., an electronic equivalent of the original) of the pledged electronic promissory note must exist. Each copy of the authoritative copy must be readily identifiable as a non-authoritative copy, e.g., labeled "This document is a non-authoritative copy." Non-authoritative copies often remain stored in the loan origination systems (including third-party systems) after the authoritative copy is created in a different system intended for permanently storing the documents. Such non-authoritative copies must be either purged or labeled as non-authoritative.

### Operational Controls Requirements Specific to Electronic Collateral

The FRB encourages, but does not require, segregating loan documentation for loan collateral pledged to the FRB.

Electronic collateral must be identified as pledged by labeling that clearly states that notes are pledged to the Federal Reserve Bank of Minneapolis. The BIC participant can use one of two methods:

1. The authoritative copy of all pledged electronic collateral must contain a legend indicating that it is pledged to the Federal Reserve Bank of Minneapolis (e.g., "This note is pledged to the Federal Reserve Bank of Minneapolis"), or a conspicuous notation or metadata value<sup>2</sup> indicating that the electronic collateral is pledged to the FRB must be associated with the authoritative copy in such a manner that it cannot be inadvertently removed.

**OR**

2. All of the conditions in the bullet points below must be met:
  - An electronic indicator that a note is pledged to the FRB appears in the BIC participant's general ledger/loan system or that a current list of pledged notes is available or readily obtainable.
  - A splash screen, pop-up message, or some other conspicuous notation meets all of these criteria:
    - Appears each time the user accesses the system in which electronic collateral pledged to the FRB is maintained.
    - Requires affirmative action by the system user to navigate away from or minimize the splash screen or pop-up message or remains on the screen for a reasonable period of time.

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<sup>2</sup> The metadata value must be prominently displayed and cannot be bypassed when accessing the pledged document.

- Indicates that loans in the system may be pledged to the FRB.
- Contains specific instructions for determining whether a particular loan is pledged to the FRB. The message or notation must specify the exact physical location of the paper collateral schedule, the intranet website or page where the electronic schedule is available, and/or the name and/or title of the employee who could provide the schedule.

Three examples of acceptable labels:

a. **Notes stored in [name of system/application] and coded as [describe code used] in [name of system/application] are pledged to the Federal Reserve Bank of Minneapolis.**

OK

or

b. **Notes stored in [name of system/application] may be pledged to the Federal Reserve Bank of Minneapolis. FRB Pledged notes are identified on a paper schedule located at [physical location of paper schedule].**

OK

or

c. **Notes stored in [name of system/application] may be pledged to the Federal Reserve Bank of Minneapolis. FRB Pledged notes are identified in an electronic schedule of loans that can be obtained at [identify how to obtain the schedule].**

OK

Example of metadata labeling:

| Member # | Account # | Account Type | First Name | Last Name | Document Type          | Pledged             | Document Date |
|----------|-----------|--------------|------------|-----------|------------------------|---------------------|---------------|
| XXXX     | XXX       | XXX          | Jane       | Smith     | Promissory Note        | Pledged to FRB Mpls | 5/15/20XX     |
| XXXX     | XXX       | XXX          | Jane       | Smith     | Security Agreement     | Pledged to FRB Mpls | 5/15/20XX     |
| XXXX     | XXX       | XXX          | Jane       | Smith     | Membership Application | Pledged to FRB Mpls | 5/15/20XX     |

If the pledged electronic collateral is segregated from electronic assets that are not pledged to the FRB, the following labeling method can be used:

- A splash screen, pop-up message, or some other conspicuous notation that meets both of these criteria:
  - Appears each time the user accesses the system/folder/directory in which electronic collateral pledged to the FRB is maintained.
  - Indicates that loans in that system are pledged to the FRB.

**Storage and Access**

To ensure adequate physical and operational controls over electronic collateral, the institution must:



- Establish appropriate software safeguards (such as passwords and access rights) and physical security of the system where electronic collateral records are maintained.
- Have controls in place to allow only authorized personnel to modify or delete electronic collateral records and have audit capabilities to track modifications and deletions.
- Label any non-authoritative copy of the pledged electronic collateral as non-authoritative upon or immediately after creation.
- Have a contingency plan to safeguard the accuracy, availability, and back-up of electronic records that comprise the electronic collateral.
- Periodically test the accuracy, quality, and completeness of the electronic origination and/or imaging process.

### **Requirements Specific to Imaged Electronic Collateral**

- The institution must have a process for destroying original paper documents in a timely and organized manner. This process may include maintaining destruction logs/receipts and periodic audits. If a third party is involved in the destruction process, the institution should appropriately audit the third party's practices or ensure the third party periodically audits its process.
- If paper collateral needs to be retained for a period of time in order to validate that an imaging process was successful, it should not be retained any longer than necessary and should be labeled and operationally controlled in a manner consistent with the physical storage and labeling requirements for paper collateral described in this booklet.

### **Documentation to Send to the FRB**

Prior to submitting the documentation pertaining to electronic collateral to the FRB, the pledging institution should call or email the FRB to discuss its electronic collateral proposal (see page 5 for contact information). After the initial discussion, the FRB will ask the institution to provide the following documents in addition to the documents listed in the How to Get Started section on page 5 of this booklet:

- Addendum to BIC Certification – Electronically Created or Imaged Notes (along with the BIC Certification).
- Copies of any internal policies and procedures regarding the institution's use of the electronic loan origination or imaging platform and the system used to create, maintain, and retrieve electronic records.
- Copies of the service agreements with the vendors or providers of electronic loan documentation services, if applicable.
- User/reference guide(s) provided by the electronic loan origination or imaging platform/system developer, if applicable.
- A sample authoritative copy of the electronic collateral.
- Sample screen-print(s) showing how the institution will be labeling the electronic collateral as being pledged to the FRB.
- If the institution maintains non-authoritative copies of electronic collateral, screen-print(s) showing how the institution will be labeling the non-authoritative copies.
- If the institution is pledging loans originated by another party (e.g., indirect loans), a sample screen-print evidencing the assignment of the loan to the pledging institution.
- If the institution uses a third-party custodian for storing electronic collateral, a copy of the agreement between the institution and the third-party custodian. The FRB may require the custodian to execute a Form of Agreement for Third-Party Custodian to Hold Collateral if the arrangement is such that the third party controls (rather than merely stores) electronic collateral on the institution's behalf.

- If available, a legal opinion by the institution's legal counsel addressing control over the electronic collateral, the pledgor's ability to enforce its rights in the electronic collateral in court, and the pledgor's ability to transfer or assign the electronic collateral to another party.