

FHLB 101
MAKING THE MOST OF YOUR MEMBERSHIP

Collateral
December 3, 2008

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Collateral Overview

- The Bank Is a secured lender
- Collateral is the primary protection against credit risk on advances
- Products Policy defines Collateral Status Groups and eligible assets that constitute qualified collateral
- Borrowing capacity is based on available qualified collateral

Agreement for Advances, Collateral Pledge, and Security ("Advances Agreement")

- All members are required to sign an Advances Agreement
- Key provisions
 - ◆ Grants the Bank a security interest in eligible collateral
 - ◆ Defines the members' obligations
 - ◆ Describes the assets on which the Bank files a UCC Financing Statement
 - ◆ Contains default provisions and remedies
 - ◆ Requires Members to maintain at all times sufficient qualified collateral to cover the its collateral maintenance level.

How is the collateral requirement calculated?

- "Collateral Maintenance Level" includes:
 - ◆ Outstanding Advances
 - ◆ IDEAL Way Line of Credit
 - ◆ FHLB Letters of Credit
 - ◆ Credit Enhancement Fees
 - ◆ Accrued Interest
 - ◆ Other Extensions of Credit

Other Agreements

- **Subsidiary Collateral Pledge Agreement**
 - ◆ Creates the security interest in the subsidiary's collateral
 - ◆ Incorporates all of the terms of the Advances Agreement
- **Subordination/Inter-creditor Agreement**
 - ◆ Entered into with other creditors
 - ◆ Also between FHLBanks when members change districts
 - ◆ Details how collateral is to be handled between the creditors
- **Third Party Custodian Agreement**
 - ◆ When collateral is held by a third party not affiliated with member or affiliate
 - ◆ The third party agrees in writing to hold collateral for the Bank, not the debtor
 - ◆ Dictates what third party can do with collateral

Collateral Status Groups

- Blanket – Lien Status
 - ◆ tangible capital of 4.5 percent or more of assets
- Listing Status
 - ◆ tangible capital below 4.5 percent of assets
- Delivery Status
 - ◆ tangible capital below 3.5 percent of assets

How is collateral pledged under the three collateral status groups?

- **Blanket Status:** Owner-occupied 1-4 family loan collateral is pledged in summary form from the Call Report or Qualified Collateral Report. Investment residential mortgages, other real estate-related collateral, and CFI-eligible collateral must be listed or delivered to the Bank.
- **Listing Status:** In addition to the above, provide a listing of to the Bank identifying specific owner-occupied 1-4 family loan collateral.
- **Delivery Status:** Required to deliver residential mortgages, other real estate-related collateral, and CFI-eligible collateral to the Bank.
- **Note:** Securities and deposits are only accepted on a delivered basis.

Where can I find the requirements for qualified collateral?

- The categories of qualified collateral and the criteria applied to each of them are detailed in Appendix A of the Products Policy.
- The five main categories of collateral are:
 - ◆ residential mortgages;
 - ◆ securities;
 - ◆ funds deposited in the Federal Home Loan Bank of Boston;
 - ◆ other real estate-related collateral, and
 - ◆ for Community Financial Institution (CFI) members, secured small-business, small agri-business, and small farm loans.

Fully Disbursed Whole First Mortgages On Owner-Occupied 1-4 Family Loans

- Is the primary source of collateral pledged by members
- Where do we get pledge totals for this collateral?
 - ◆ Regulatory Call Report
 - ◆ Qualified Collateral Report (QCR)
- Members can voluntarily update QCR at anytime
 - ◆ Benchmarks for advances and total indebtedness determine if member must submit QCR quarterly
- Fully disbursed, closed-end home equity loans secured by first liens on owner-occupied 1-4 family residential are included in this category.

Qualified Collateral Report Benchmarks

- Advances equal or exceed 15% of assets, or
- Total indebtedness equals or exceeds the lesser of:
 - ◆ 75% of qualified collateral on a discounted valuation basis, or
 - ◆ 20% of assets, or
 - ◆ At any time the Bank deems such report necessary.

Qualified Collateral Report (QCR)

- Some common mistakes in completing a QCR
 - ◆ Securities safekept at a non-approved Custodian
 - ◆ Collateral held in a Non-Qualified Subsidiary
 - ◆ Non-Owner occupied 1-4 family, Multifamily residential, and other real estate related loans not listed with the Bank
 - ◆ Funds in a non-collateral deposit account at the Bank
 - ◆ Loans with a loan-to-value ratios over 90% without private mortgage insurance

How can securities be pledged as collateral to the Bank?

- All securities pledged as collateral must be:
 - ◆ Safekept by the Bank; or
 - ◆ A Bank approved Third Party Custodian
- Member signs a Safekeeping Custodial Agreement with the Bank, or
- Member signs a tri-party Securities Control Agreement with the Bank and the Third Party Custodian.
- Account must only contain eligible securities

What is the difference in having pledged securities held at the Bank versus held at a Third Party Custodian?

- Securities held at a Third Party Custodian receive an additional 5% haircut than securities held at the Bank for the following reason:
 - ◆ Securities delivered to the Bank are held by the Bank's custodian, Citibank. The market value of these securities are updated on a daily basis.
 - ◆ Third Party Custodians send the Bank a monthly statement of holdings in hard copy. The market value of these securities are updated on a monthly basis.
 - ◆ Note: The additional 5% haircut can be eliminated if the Third Party Custodian provides the Bank with a daily market valuation for securities.

Approved Third Party Custodians With Control Agreements

- 1. State Street Bank
- 2. Fifth Third Bank
- 3. Citibank
- 4. Brown Brothers Harriman
- 5. The Northern Trust Company
- 6. Bank of America
- 7. First Tennessee Bank
- 8. Bank of New York
- 9. JP Morgan Chase
- 10. Mellon Financial Corporation

Can Non-Agency Residential MBS be used as collateral?

- Yes, publicly issued and rated non-agency residential MBS that represent an unsubordinated interest in cash flows from pools of 1-4 family residential properties are eligible collateral.
- The Security must be rated AAA or higher by the nationally recognized statistical rating organizations.
- Non-agency residential MBS are subject to individual review by the Bank prior to acceptance as eligible collateral for advances.
- Private placements, IO strips, and PO strips of any security typically are not eligible as collateral.

Can Commercial MBS be used as collateral?

- Yes, publicly issued and rated Commercial MBS may be eligible as Category 5, Other Real Estate Related Collateral on a case-by-case basis.
- The Security must be rated AAA or higher by the nationally recognized statistical rating organizations.
- Commercial MBS are subject to individual review by the Bank prior to acceptance as eligible collateral for advances.
- Private placements, IO strips, and PO strips are typically not eligible collateral.

Can funds on deposit at the Bank be included as qualified collateral?

- Must specifically pledge funds as collateral
- Must be held in a Collateral Overnight Deposit Account (OND)
- Deposits and withdrawals require collateral staff approval.
- A collateral overnight deposit account pays the same rate as other overnight deposit accounts.

Can loans secured by investment properties, second/vacation homes, commercial real estate, and HELOCs be included as qualified collateral?

- The following types of loans can be pledged as eligible collateral:
 - ◆ Non-owner-occupied 1-4 family mortgages
 - ◆ Multifamily residential mortgages
 - ◆ Other real estate related collateral including commercial real estate, home equity loans, and HELOCs
 - ◆ Community Financial Institution (CFI) collateral.
- In order to be accepted as collateral, they are subject to individual review by the Bank.

Other Real Estate Related

- Other real estate-related collateral in a discounted amount up to two times the member's GAAP capital.
- Such real estate-related collateral must have a readily ascertainable value
- FHLB must be able to perfect a security interest in it.
- Primarily commercial real estate loans, HELOC, and 2nd mortgages

Additional rules on pledging commercial real estate loans

- Owned by the member free and clear of all other liens and encumbrances, including tax liens.
- Cannot have been in default within the most recent 12-month period.
- Cannot be made to officers or directors of the institution or the Bank.

Bank may, in its sole discretion, refuse certain types of high risk collateral real estate loans to be pledged as collateral

High-risk property types are those that:

- Are management intensive, single purpose or have limited improvements.
- Are ineligible due to regulatory issues.
- Represent excessive credit or salability risk are ineligible.
- These conditions can cause an extended marketing period in case of liquidation.

Additional rules on pledging HELOC's and 2nd Mortgages

- Secured by a first or second lien on a 1-4 family owner-occupied residential property
- Combined LTV (1st and 2nd) no greater than 80 percent.
 - ◆ Note: Maximum credit line and current amount of first mortgage at origination of HELOC or 2nd mortgage shall be used in determining loan-to-value
- Must not violate any laws against predatory or abusive lending

What is the process for pledging additional mortgage collateral?

- Loans must be individually listed.
- Member delivers the completed loan file template to the Bank.
- The collateral staff performs an on-site collateral review of the loan files.
- The file of accepted loans are uploaded to the collateral system and included in the member's borrowing capacity.
- Loan balances must be updated on at least a quarterly basis.

On-Site loan file review

Review includes an analysis of the legal documentation, credit underwriting, and valuation of the loans.

The following files and source documents are typically reviewed:

- Legal Documentation
- Loan Credit Files
- Loan Underwriting and Property Analysis
- Original Appraisal
- Payment History
- Loan Seasoning

What is a Community Financial Institution?

- FDIC-insured depository institution that has less than \$1.0 billion in average total assets over the 3 most recent calendar yearends. (current average assets cap is effective April 1, 2008 through March 31, 2009)
- CFI-eligible members can pledge fully secured:
 - ◆ Small business loans, Small agri-business loans, and Small farm loans
- Loans are subject to individual review and acceptance as collateral, and maintained in listing status by the Bank.
- Loans are within the member's legal lending limit of loans to one borrower.

How do I pledge assets in a subsidiary as qualified collateral?

- To qualify collateral held in a REIT subsidiary, the following agreements must be completed:
 - ◆ Stock Pledge Agreement
 - ◆ Asset Pledge Agreement
 - ◆ Suretyship Agreement
- A Security Corporation subsidiary only requires the following agreement to be completed:
 - ◆ Stock Pledge Agreement

2008 Changes to Products Policy

- Reduced the collateral haircut from 5% to 3% for US Gov't and Agency securities that have a remaining term-to-maturity of three years or less.
- Established a limit on advances to a member equal to 50% of the member's assets.
- The Bank no longer accepts as eligible collateral 2nd lien closed-end home equity loans (HELs) and all home equity lines of credit (HELOCs) with a combined loan-to-value ratio greater than 80%.
- The Bank no longer accepts as eligible collateral 2nd lien closed-end HELs and all HELOCs on non-owner-occupied 1-4 family properties.

2008 Changes to Products Policy (cont'd)

- The Bank increased the collateral haircut on FHLMC and FNMA MBS from 5% to 10%.
- The Bank increased the collateral haircut on triple-A rated non-agency residential MBS from 10% to 25%.
- The Bank increased the collateral haircut on triple-A rated commercial MBS from 20% to 35%.
- The Bank no longer accepts as eligible collateral non-agency residential MBS and commercial MBS that are rated lower than triple-A (previously, the Bank did not accept MBS rated lower than single-A).

For More Information

- Visit Products and Services on the Bank's web site for updated Products Policy
- Forms and Instructions available on-line:
 - ◆ Qualified Collateral Report (QCR)
 - ◆ Documentation for pledging subsidiaries
 - ◆ Frequently Asked Questions (FAQs)
 - ◆ Guidelines and loan file template for pledging:
 - Commercial Real Estate Loans, HELOCs & Home Equity Loans
 - Multifamily Mortgage Loans & Non-owner-occupied 1-4 family loans

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Questions?