

Modifications to the Seattle Bank's Credit and Collateral Policy

Federal Home Loan Bank of Seattle
April 2011

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Today's Agenda

- **Review of Borrowing Availability:**
 - Determinants
 - Blanket Lien
 - Collateral Control Arrangements
- **Changes to Collateral Policy:**
 - Determination of New Loan Market Values and Borrowing Capacity Rates
 - Blended Borrowing Capacity Rates by Loan Category
 - Sample Impact Analysis and Online Services Changes
 - Updates: Responsible Lending Policy and Private-Label Mortgage-Backed Securities
- **Expanding Collateral Availability**
- **The Collateral Review Process**

Borrowing Availability Determinants

- **Credit Line**
- **Eligible Collateral**
- **Stock Requirement**

Blanket Lien

- **Advances Security & Deposit Agreement (ASDA):**
 - Grants a “Blanket Lien” on all assets to the Seattle Bank
 - Requires adherence to the Collateral Maintenance Requirement
- **UCC-1 Financing Statement – Filed on all members**
- **ASDA and UCC:**
 - Permits members to “sell, use, or dispose” of collateral not needed to meet Collateral Maintenance Requirement, without the Seattle Bank’s permission or release, provided that:
 - No event of default exists.
 - Collateral maintenance requirement is met.
 - Member is not under physical possession collateral arrangement.
- **Subordination with Other Parties (i.e., Federal Reserve Bank, corporate credit unions)**

Collateral Control Arrangements

- **Blanket and Blanket/Custody**
 - Single-family and multifamily – via call reports
 - Additional loan collateral – via quarterly certifications
 - Securities held in custody at the Seattle Bank or through an approved third-party custodian
- **Segregated/Listing**
 - Loan collateral reported on a set basis (weekly, monthly, etc.)
 - Securities held in custody at the Seattle Bank
- **Physical**
 - Loan collateral delivered to the Seattle Bank
 - Documents include: original note, copies of deeds of trust, title policies, appraisals, and others, as required by the Seattle Bank. Complete submittal and Seattle Bank review of a loan file is required for inclusion as eligible collateral.
 - Securities held in custody at the Seattle Bank

Collateral Control Arrangements: Transferring to Physical Possession

Although some of the factors considered differ between banks/thrifts and credit unions, a member's asset quality, measured in terms of its nonperforming asset (NPA) ratio, capital, and overall internal rating score with the Seattle Bank are key factors that apply to all members. A member will be moved to the physical possession collateral arrangement if any of the criteria shown in Table 1 below are met.

Table 1. Factors Resulting in a Physical Possession Collateral Arrangement

	<u>Banks/Thrifts</u>	<u>Credit Unions</u>
Nonperforming Asset (NPA) Ratio	> 75%	> 75%
Total Risk Based Capital (TRBC)	< 10%	N/A
Net Worth	N/A	< or = 5.5%
Overall Internal Rating Score ¹	(See table footnote)	(See table footnote)

¹The Seattle Bank calculates a member's overall rating score based on an analysis of the level and trend of a member's financial performance. The Seattle Bank uses a proprietary financial-ratio driven model to assess the member's financial results and the interrelationships among its capital, asset quality, earnings, reserves, and liquidity, based on the member's current quarterly Call Report. Other available public information and a current Report of Examination are also considered.

Collateral Control Arrangements: Transferring off Physical Possession

Each situation unique and review typically incorporates trend of financial performance with the following parameters:

- Quarter-over-quarter asset-quality improvement with the ability to sustain the NPA ratio below a baseline target of 50%
- Two consecutive quarters of sustainable positive core profitability
- Capital levels at least 100 basis points above prompt corrective action (PCA) limits for a well-capitalized institution, with continued capital augmentation through core earnings
- Allowance for loan and lease losses (ALLL) to nonaccrual loans and loans 90+ days past due greater than 50%

Physical Possession Process and Documentation Changes

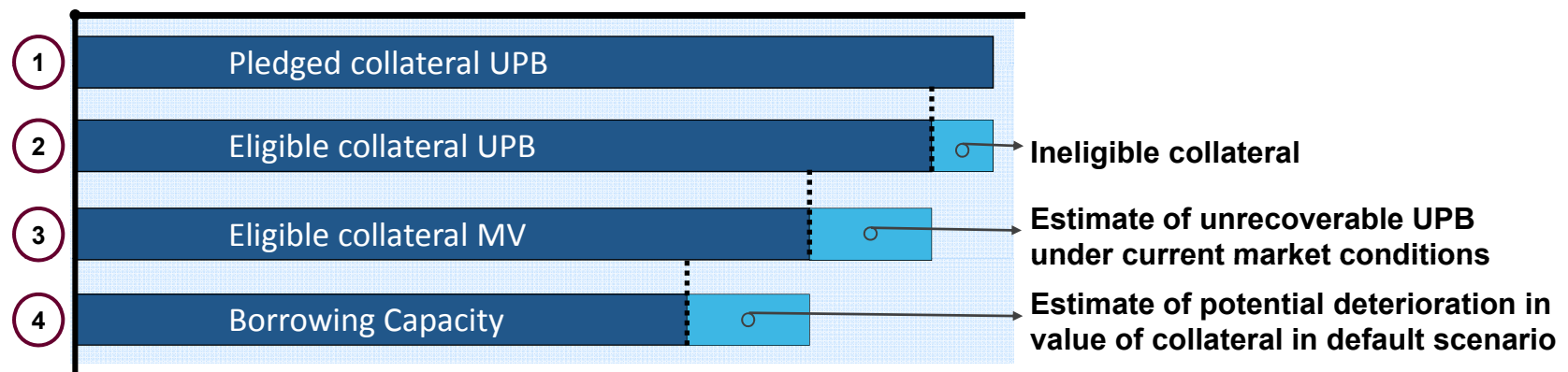
- **New process for migrating to Physical Possession Collateral Arrangement, including timeframe for delivery.**
- **Expanded documentation requirements, including documentation verifying compliance with Seattle Bank's Responsible Lending Policy (parallel with federal, state and local anti-predatory lending laws).**
- **Expanded monthly collateral reporting requirements.**

New Market Value and BCR Determination: Definitions

- **Unpaid Principal Balance (UPB)**
 - Historically used as the estimate of the current value of collateral
- **Eligibility Adjustment**
 - Determined via collateral verification efforts by the Seattle Bank
 - Represents portion of pledged collateral deemed eligible (e.g., an exception rate of 5% results in an eligibility adjustment of 95%)
- **Market Value (MV)**
 - Expressed as a percentage of UPB
 - Estimated collateral value in current market conditions; the amount expected for exchange between a willing buyer and seller
- **Borrowing Capacity Rate (BCR)**
 - Expressed as a percentage; the maximum potential advance amount relative to the collateral value (e.g., a 90% BCR implies ability to advance up to 90% of the estimated collateral value)
- **Haircut**
 - Expressed as a percentage and equal to $100\% - \text{BCR}$
 - The amount deducted from the estimated collateral value to account for exposure to potential decreases in collateral value

New Market Value and BCR Determination: Approach

- **Borrowing Capacity = (Pledged UPB * Eligibility Adjustment * MV * BCR)**



New Market Value and BCR Determination: Summary

- **The Seattle Bank is transitioning from using UPB as the basis for the estimated collateral value to a market-valuation based approach.**
- **The BCRs and haircuts associated with each collateral type are also being refreshed.**
- **Factors that led to the adoption of this updated market valuation and BCR approach:**
 - Increased market and price volatility for whole loan collateral.
 - Likelihood of full recovery of pledged collateral UPB in a stressed, default scenario, has declined.
 - Current BCRs, which should protect against the potential deterioration in the value of pledged collateral, were last refreshed in 2008.
 - Consistent with the practices of other sources of secured wholesale funding.
- ***Note: The policy for securities collateral remains unchanged.***

New Market Value and BCR Determination: Timetable

- **Prior to May 23, 2011:**
 - Each member will receive a Collateral Impact Analysis, which will depict their eligible collateral borrowing status, MV, and BCRs under the current arrangement, versus the arrangement that will be put in place on May 23.
 - Any institution-specific question may be addressed directly to your Relationship Manager.
- **Effective May 23, 2011:**
 - Borrowing capacity of collateral will be revised for each member, based on new MV and BCR parameters.
 - MV and BCR parameters will be calculated and applied to each loan category for all members.
 - Based on future plans involving development of internal procedures and systems changes, the Seattle Bank anticipates developing a more detailed collateral framework that would enable members to provide loan-level detail. This detail could be used to calculate and optimize member borrowing capacities based specific collateral risk drivers (e.g., FICO, LTV, DSCR).

New Market Value and BCR Determination: Sample Borrowing Capacity Rates

Collateral Category	Old BCR	New MV/BCR Blended Borrowing Capacity %
SFR	83%	72%
Multifamily	40% - 80%	28% - 57%
CRE	40% - 60%	37% - 56%
Jr. Lien/HELOC	45% - 60%	34% - 45%

New Market Value and BCR Determination: Sample Borrowing Capacity Rates

Collateral Category	Old BCR	New MV/BCR Blended Borrowing Capacity %
CFI – Agriculture	50%	57%
CFI – Farmland	50%	55%
CFI – Small Business	60%	55%

Collateral Impact Analysis: Example

Collateral Summary	OLD BCR	NEW BCR
<u>Collateral Type</u>	<u>Borrowing Capacity</u>	
Loans	71,673,754	65,667,839
Securities	11,977,840	11,977,840
CDs	0	0
Other Adjustments	0	0
Total Collateral Balance	83,651,594	77,645,679

Credit Summary		
<u>Account</u>	<u>Balance</u>	
Advances	30,000,000	30,000,000
Letters of Credits	10,000,000	10,000,000
Total Credit Outstanding	40,000,000	40,000,000

Collateral Sufficiency		
	<u>Balance</u>	
Total Collateral Balance	83,651,594	77,645,679
Total Credit Outstanding	40,000,000	40,000,000
Excess/(Deficient) Collateral	43,651,594	37,645,679

Loan Detail			OLD BCR		NEW BCR	
<u>Collateral Type</u>	<u>Adjusted Value</u>	<u>Exception Rate</u>	<u>Effective BCR</u>	<u>Borrowing Capacity</u>	<u>Effective BCR</u>	<u>Borrowing Capacity</u>
1st Lien SFR Mortgages	21,890,615	28.10%	83%	10,816,013	72%	9,382,566
Multifamily Mortgages	5,743,300	54.60%	80%	2,085,967	57%	1,479,993
Government Guaranteed Loans	0	0.00%	NA	0	NA	0
Commercial Real Estate Loans	55,032,218	11.40%	60%	29,255,127	56%	27,148,758
Junior Lien/Revolving SFR Loans	24,452,439	41.10%	45%	6,481,119	45%	6,463,836
CFI - Agricultural Production Loans	0	0.00%	NA	0	NA	0
CFI - Farmland Loans	0	0.00%	NA	0	NA	0
CFI - Small Business Loans	38,392,547	0.00%	60%	23,035,529	55%	21,192,686
Total	145,511,118			71,673,754		65,667,839

Changes to Online Services: Example

Collateral Summary

As of 03/31/2011 10:00 AM

Traditional Collateral

<u>Collateral Type</u>	<u>Market Value</u>	<u>Discount</u>	<u>Borrowing Capacity</u>
1st Lien SFR Mortgages	\$21,890,614.81	83.00%	\$10,816,013.24
Multifamily Mortgages	\$5,743,300.00	80.00%	\$2,085,966.56
Government Guaranteed Loans	\$0.00	90.00%	\$0.00
Pledged Securities	\$11,977,840.17		\$11,977,840.17
FHLB CD	\$0.00		\$0.00
Other Adjustment	\$0.00		\$0.00
Total Traditional Collateral	\$39,611,754.98		\$24,879,819.97

<u>New</u> <u>Discount</u>	<u>New</u> <u>Borrowing Capacity</u>
72.00%	\$9,382,565.91
57.00%	\$1,479,993.27
90.00%	\$0.00
	\$0.00
	\$0.00
	\$0.00
	\$10,862,559.19

Expanded Collateral

<u>Collateral Type</u>	<u>Market Value</u>	<u>Discount</u>	<u>Borrowing Capacity</u>
Commercial Real Estate Loans	\$55,032,217.65	60.00%	\$29,255,126.90
Junior Lien/Revolving SFR Loans	\$24,452,438.66	45.00%	\$6,481,118.73
Agricultural Production Loans	\$0.00	50.00%	\$0.00
Farmland Loans	\$0.00	50.00%	\$0.00
Small Business Loans	\$38,392,547.19	60.00%	\$23,035,528.63
Total Traditional Collateral	\$117,877,203.50		\$58,771,774.26

<u>New</u> <u>Discount</u>	<u>New</u> <u>Borrowing Capacity</u>
56.00%	\$27,148,757.77
45.00%	\$6,463,835.88
57.00%	\$0.00
55.00%	\$0.00
55.00%	\$21,192,686.05
	\$54,805,279.70

Changes to Online Services

Collateral Summary

As of 03/31/2011 10:00 AM

Credit Summary

<u>Account</u>	<u>Balance</u>	<u>Deposit</u>	<u>Balance</u>	<u>Stock</u>	<u>Balance</u>
Advances	\$30,000,000.00	DDA	\$0.00	Stock Class B	\$4,342,600.00
Letter of Credit	\$10,000,000.00	CD	\$0.00	Stock Class A	\$0.00
Commitments	\$0.00			Stock Requirement	\$3,745,000.00
Swaps	\$0.00			Excess Class B	\$597,600.00
Total	\$40,000,000.00			Excess Class A	\$0.00
				Excess Pool Used	\$0.00

Collateral Sufficiency

Collateral Balance	\$83,651,594.23
Advances	\$30,000,000.00
Letter of Credit	\$10,000,000.00
Swaps	\$0.00
Commitments	\$0.00
Balance**	\$43,651,594.23
Collateral/Assets	15.00%
Total Credit /Collateral	80.00%

**This amount represents the balance of available collateral and may not represent actual borrowing capacity

New Collateral Sufficiency

	\$65,667,838.89
	\$30,000,000.00
	\$10,000,000.00
	\$0.00
	\$0.00
	\$25,667,838.89
	15.00%
	80.00%

Update: Responsible Lending Policy and Private-Label MBS

- **Responsible Lending Policy Updates**
 - Previously all non-traditional and subprime mortgage loans and private-label MBS backed by such loans (i.e., non-traditional mortgage collateral) that did not comply with Interagency Guidance were ineligible.
 - Amended to apply that restriction only to non-traditional mortgage collateral originated, issued, or acquired after July 10, 2007.
 - Additionally, eligible non-traditional mortgage collateral acquired by a member from another member, through merger or acquisition or a purchase and assumption of substantially all assets, may continue to be eligible.
- **Private-label MBS issued, purchased, or acquired after July 10, 2007, is not permitted as eligible collateral unless enforceable reps and warranties of compliance with Interagency Guidance are present (FHFA Advisory Bulletin 2010-AB-01).**

Expanding Collateral Availability

“Docs in a Row”

- Property Valuations
- Proper Loan Coding
- Call Report Accuracy
- Policy Compliance, Including Sound Documentation
- Evidence of Corporate, Partnership, and Other Resolutions
- Required Signatures on Security Agreements and Trust Deeds

Add Collateral Categories

- Pledge Multiple Collateral Categories and *Don't Forget CFI Categories:* (examples)
- Small Business
- Agriculture
- Farmland
- HECM Securities
- NCUA-Guaranteed Securities

The Collateral Review Process

- **Federal Housing Finance Agency regulation requires that the Seattle Bank periodically inspect the collateral pledged by all members.**
- **Reviews ensure that the Seattle Bank is complying with regulations and internal policies governing the collateral that supports advances.**
- **The review is limited to eligible collateral. It is not an exam of a members' business practices, nor should it be considered a regulatory exam.**

The Collateral Review Process

- **Each year, the Seattle Bank reviews collateral from:**
 - Randomly selected members on five year cycle.
 - Specifically selected members based on credit factors and advance volume.
- **Many members will only be reviewed once every five years. Some are reviewed annually, based on exposure and risk rating.**
- **All reviews are conducted by Seattle Bank staff.**
- **No fees are charged for reviews.**
- **Review location:**
 - Reviews based on credit factors and advance volumes are generally conducted onsite at your institution.
 - Reviews based on the five-year cycle are generally conducted offsite at the Seattle Bank through a review of delivered or scanned documents.
- **Review is waived if:**
 - 12-month high credit balance was 100% covered by securities and/or CDs held by the Seattle Bank.
 - No loan collateral is pledged.
 - Member meets Seattle Bank's waiver criteria based on credit factors, advance volume and/or when last reviewed.

What to Expect During a Collateral Review

1. Member asked to prepare an estimate of eligible collateral pledged, using worksheets provided by the Seattle Bank.
2. Member provides a trial balance list of loans, along with other reports to identify eligible collateral.
3. Seattle Bank selects a sample of eligible loans to be reviewed.
4. Results are sent to the member to allow for corrections or further discussion of the findings.
5. Findings are converted into exception rates, which are applied to reduce eligible collateral balances.
6. Any loan types not reviewed are given a 100% exception rate.

How Can Collateral Review Exception Rates be Modified?

*Members can request to have an exception rate reviewed if...
the prior findings have been resolved.*

1. Send request on corporate letterhead to the Collateral Review Analyst, outlining why the exception rate no longer applies.
2. The Collateral Review Analyst will ask for documentation addressing why findings no longer apply or how they have been resolved.
3. Review of results will be scheduled to fit into Collateral Review Analyst's annual review schedule.
4. Adjustments to the exceptions will be considered once analysis is complete.

Contact Us!

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Resources:

- Seattle Bank Website: www.fhlbsea.com
- Financial Products and Services User Guide
- Collateral Manual – to be combined with Financial Product and Services User Guide, effective May 23, 2011

