



# COLLATERAL VERIFICATIONS

March 30, 2023 | 2 p.m. CT

To maximize your ability to hear the webinar, we're muting all participants. Please keep your line muted.

# ABOUT THE PRESENTERS



## **ELAINE SHUMAKER | AVP, Financial Services Manager**

Elaine joined FHLBank in 1987. She held various positions until 1999 when she was promoted to Safekeeping Manager. She now oversees Financial Services, which includes safekeeping and collateral operations.



## **Dedra Duran-Gray | VP, Director of Collateral and Safekeeping Operations**

Dedra joined FHLBank in 2010 as a Senior Member Credit Risk Analyst. In 2017 she joined the Legal department and was primarily responsible for establishing FHLBank's Compliance department. In 2022 she was promoted to the Director of Collateral and Safekeeping Operations, which includes the collateral review and verification process.



# WEBINAR GOALS

## GOALS

- Explain why FHLBank performs Collateral Verifications
- Identify types of Collateral Verifications
- Enhance knowledge of Collateral Verification process
- Discuss best practices to “pass” a Collateral Verification
- Provide resources for ongoing collateral information



# WHY FHLBANK PERFORMS COLLATERAL VERIFICATIONS

## Prudent credit practice

- Validate collateral pledged
- Monitor member loan policies and pledging practices

## Regulatory requirement

- Collateral eligibility
  - Perfect security interest
  - Readily ascertainable value
  - Reliably discounted
  - Liquidate in due course

## To protect FHLBank and its stockholders

- Collateral Assets
  - Properly classified
  - In compliance with FHLBank's underwriting requirements



# KEY TO COLLATERAL REPORTING

## Preparation is KEY!

- Individuals completing and approving the QCD form must be knowledgeable of the institution's assets and FHLBank's Policies for pledging collateral
- Review FHLBank's Policies, specifically the Schedule of Eligible Collateral guidelines
- Identify and retain critical reports that categorize the eligible collateral assets
- Verify that all ineligible loans have been removed



# TYPES OF COLLATERAL VERIFICATIONS

## QCD Desk Audits

- Performed electronically once member regulatory data is available

## Onsite Collateral Verifications

- Performed at member's location by FHLBank staff



# QCD DESK AUDITS

## Selection criteria

- All blanket pledge members reporting loans via the QCD form

## Purpose

- Reasonability test – comparison of loans pledged on the QCD form to loans reported on the member's regulatory reports
- Validate member's compliance in pledging restricted assets
- Verify current subordinations (if any)



# QCD DESK AUDITS

## Frequency

- Quarterly

## Process

- Comparison of assets reported on the QCD form vs. Call Report numbers

## Remediation

- If exceptions are noted, member contacted by email
- Resolution required from member





# ONSITE COLLATERAL VERIFICATIONS

## Selection criteria

- Risk based approach, taking into consideration the member's:
  - Outstanding FHLBank credit obligations
  - Financial performance
  - Approval/renewal of special collateral arrangements
  - Overall collateral coverage ratios
  - Changes in collateral reporting method (i.e., delivery to QCD reporting)
  - Results from a previous collateral verification



# ONSITE COLLATERAL VERIFICATIONS

## Purpose

- Validate the existence of the asset
- Validate asset classification
- Validate accuracy of data provided on the QCD Loan Support template (data integrity)
- Validate the eligibility of the asset (loan file review to determine if loan meets established underwriting guidelines for the specific asset type)



# ONSITE COLLATERAL VERIFICATIONS

## Frequency of the Reviews

- Annual
- Bi-annual
- Tri-annual

## Criteria

- Top 20
- Annual – Average CO/Total Unsubordinated Assets  $\geq$  15%
- Annual – Average CO/Total Unsubordinated Assets  $\geq$  5% and a financial narrative
- Bi-Annual – Average CO/Total Unsubordinated Assets  $\geq$  10% and have not had a review in the previous 12 months
- Tri-Annual – Average CO/Total Unsubordinated Assets  $\geq$  5% and have not had a review in the previous 24 months
- Manual



# ONSITE COLLATERAL VERIFICATIONS

## Process

- Annual Selection
  - 1st Business day in November
- Notification
  - Members are notified by email
- Initial contact
  - Brief phone conversation with a Collateral Review Officer
  - Determine amicable date for onsite visit
  - Establish main contact
- Provide formal engagement letter
  - Solidify the agreed upon date and provide expectations for the onsite collateral review



# ONSITE COLLATERAL VERIFICATIONS

## Process

- Request documentation
  - QCD Loan Support template
  - CV Questionnaire
  - Loan delinquency report
  - Watch list
  - Director/officer/employee loan list
  - List of all participation loans
  - List of subordinated loans (if applicable)
  - Loan Policy
  - Quality Control or Credit Review Policy
  - Member's internal procedures for completing QCD form
  - Servicing/Custodian agreements (if applicable)



# ONSITE COLLATERAL VERIFICATIONS

## Process

- Sample Selection
  - Depends on number of loans pledged
    - > 500 – use statistical sampling method (90% confidence, 5% precision, 5% error)
    - < 500 – use 10% of loans pledged
  - Based on the distribution of the asset categories utilized
  - Core Sample (20 minimum, 102 maximum)
  - Additional Selection: Largest 5 loans pledged
  - List of loans to be reviewed provided to you prior to arriving onsite



# ONSITE COLLATERAL VERIFICATIONS

## Process

- Complete review on-site
  - Initial meeting with member's management, if needed
  - Review each sampled loan for eligibility
    - Note
    - Mortgage
    - Title
    - Appraisal
    - Credit Review
  - Review additional requested materials (i.e., loan policy, reports, etc.)



# LOAN REVIEW – WHAT ARE WE LOOKING FOR?

## Does the loan meet our eligibility criteria?

- Original note (and any modifications, change in terms, renewals, etc.) with appropriate terms
- Security of the note
  - Mortgage/Deed of Trust
  - Security Agreement
- Lien position
  - Title policy or UCC search
- Loan to Value
  - Appraisal or valuation





# LOAN REVIEW – WHAT ARE WE LOOKING FOR?

## Does the loan meet our eligibility criteria?

- Credit review
  - FICO and Debt to Income
  - Income/Employment Verification
  - Debt Service Coverage Ratio
- Supplemental information/documentation, if needed
  - Phase 1
  - Annual Financial Statement
  - PACE validation
- Technical exceptions
  - Security Instrument Issues
  - Rate charged differs from note



# LOAN REVIEW – WHAT ARE WE LOOKING FOR?

## Does the loan meet our eligibility criteria?

- Additional qualifications
  - Past due
  - Wholly owned (participation information)
  - Classified
  - Director/Officer/Employee
  - Servicer/Custodian information
  - Consistency throughout the file



# ONSITE COLLATERAL VERIFICATIONS

## Process

- Collateral Verification Findings
  - Contact with management throughout the review
    - Work with management or assigned staff while onsite
    - Provide daily update on progress and exceptions found
  - Exception threshold
    - Exception percentage is based on the number of exceptions identified divided by number of loans in Core sample
    - Must maintain a 90% confidence level
  - Collateral Verification results provided in exit conference
    - Officer will share findings and cost for review
  
- Collateral Opportunities
  - Work with the Officer to identify any potential eligible collateral not currently pledged



# ONSITE COLLATERAL VERIFICATIONS

## Process

- Upon return to FHLBank
  - Officer compiles and finalizes results
  - Report provided to management for review and approval
  - Final letter provided to member
  - Collateral review fee assessed at end of month following finalization



# ONSITE COLLATERAL VERIFICATIONS

## Possible Collateral Actions

- No action/response required
- Written response required from member
- Amended QCD form required
- Discount of collateral
- Follow up Onsite Collateral Verification
- Listing requirement
- Delivery of collateral
- Other actions



# OTHER CREDIT AND COLLATERAL CHANGES

## Collateral Guideline Changes

- LIBOR Indexed Loans
  - No adjustable rate IBOR-indexed (including LIBOR) loans
    - Note date after December 31, 2021; or
    - U.S. dollar LIBOR tenors of 1-week or 2-months or all remaining IBOR tenors (overnight, 1-month, 3-month, 6-month and 12-month) without effective fallback language that remains IBOR-linked after June 30, 2023 (please refer to definition section for effective fallback language);
  
- Effective Fallback Language Definition
  - Language provided for in security offering documents or agreed to by the borrower which specifies how the replacement index will be determined in the event of the permanent cessation of IBOR; language granting the member with unilateral rights to make changes to the index, including but not limited to substituting a replacement reference rate and setting the appropriate spread adjustment as necessary; or covered under the Adjustable Interest Rate (LIBOR) Act enacted by Congress on March 15, 2022.



# OTHER CREDIT AND COLLATERAL CHANGES

## Collateral Guideline Changes

- Collateral Loan Listing Requirement

The FHLBank will require Blanket pledge members to report their loan collateral to the FHLBank using the Collateral Loan Listing – Limited template if the following condition is met:

- Non-Performing Assets:

- Banks and Thrifts: Non-Performing Assets (excluding any government guaranteed loans) to Tier 1 Capital plus Loan Loss Reserves greater than 75 percent; or
- Credit Unions: Non-Performing Assets to Net Worth plus Loan Loss Reserves greater than 55 percent.



# COMMON EXCEPTIONS IDENTIFIED

## Frequently encountered issues:

- Missing documentation
- Phase 1 environmental reports not provided or available when required
- Subprime/predatory/non-traditional lending characteristics
- Title evidence/final title
- Loans not fully secured by eligible collateral
- Unpaid principal balance exceeding the Mortgage/Deed of Trust amount
- Revolving lines of credit or loans not fully advanced
- Exceeding interest only term limitations
- Matured loans





# BIGGEST TOPIC OF DISCUSSION

## “Wet” signature

- Electronic signatures vs scanned documents vs eNotes

### WHAT AN eNOTE IS:

A note executed electronically and stored in an eVault that meets the requirements for an eNote

### WHAT AN eNOTE IS NOT:

A scanned image of a wet ink signature or a note with an electronic signature that is not stored in an eVault and doesn't meet eNote requirements

- Current Status
- <https://www.fhlbtopeka.com/products/collateral/enotes>



# Q&A

# ACCURATE REPORTING OF ELIGIBLE COLLATERAL

- Establishes borrowing capacity at FHLBank
- Maximizes liquidity by allowing non-liquid assets to be used as collateral
- Reduces expenses associated with collateral verifications



# EDUCATIONAL OPPORTUNITIES

## Annual Management Conference

- Overland Park, Kansas | April 19-21, 2023

## Regional Meetings

- August through October in Colorado, Kansas, Nebraska and Oklahoma
  - August 21, 2023 – Littleton, CO
  - August 28, 2023 – Lincoln, NE
  - September 28, 2023 – Manhattan, KS
  - October 4, 2023 – Oklahoma City, OK

## Collateral Review Contact

- One-on-one guidance



# HELPFUL RESOURCES



**Elaine Shumaker**

AVP, Financial Services  
Manager

PH: 785.478.8204

[elaine.shumaker@fhlbtopeka.com](mailto:elaine.shumaker@fhlbtopeka.com)



**Dedra Duran-Gray**

VP, Director of Collateral and  
Safekeeping Operations

PH: 785.478.8203

[dedra.duran-gray@fhlbtopeka.com](mailto:dedra.duran-gray@fhlbtopeka.com)

## Collateral Review Staff

800.809.2733 | [CollateralReview@fhlbtopeka.com](mailto:CollateralReview@fhlbtopeka.com)

## Financial Services Operations Staff

877.933.7803 | [FinancialServices@fhlbtopeka.com](mailto:FinancialServices@fhlbtopeka.com)

FHLBank Topeka Website | [www.fhlbtopeka.com](http://www.fhlbtopeka.com)

Collateral Landing Page | [www.fhlbtopeka.com/Products/collateral](http://www.fhlbtopeka.com/Products/collateral)

Member Products & Services Guide | [www.fhlbtopeka.com/mpsg](http://www.fhlbtopeka.com/mpsg)

