



FEDERAL HOME LOAN BANK OF DALLAS

# member products & credit policy



## **MISSION STATEMENT**

*The Federal Home Loan Bank of Dallas*

*is a member-owned financial intermediary*

*with the primary mission of supporting*

*homeownership, affordable housing and*

*community lending through its member institutions.*

# TABLE OF CONTENTS

<b>Introduction</b> .....	1	Collateral Status – Custody .....	18
<b>Financial Products &amp; Other</b>		Collateral Maintenance Level.....	19
<b>Services</b> .....	1	<i>Collateral Audit Verification</i> .....	20
Advances.....	1	Collateral Valuation Methodology.....	21
Deposit Account Services .....	2	<b>General Limitations</b> .....	21
<i>Reserve Pass-Through</i> .....	2	<b>Borrowing Procedures</b> .....	22
<i>Settlement Services</i> .....	2	Advances Agreement & Related	
<i>Wire Transfers</i> .....	2	Documentation.....	22
Securities Safekeeping.....	2	Advances & Funding .....	22
Security Custody & Pledging Services...	2	Interest Payments.....	22
MPF® Program.....	3	Transfers of Advances.....	22
Letters of Credit/Confirmation .....	3	Prepayment of Advances .....	23
AssetConnection™ .....	3	Prepayment Fee Calculation .....	24
Affordable Housing Program.....	4	<b>Special Provisions</b> .....	27
Community Investment Program.....	4	Exceptions.....	27
Economic Development Program.....	4	Default .....	27
Community Investment Cash Advance ..	4	Termination & Withdrawal .....	27
<b>Product Pricing Considerations</b> .....	5	Mergers & Acquisitions .....	27
Advances Pricing .....	5	Maintenance of Operations	
Commitment Fees for Advances.....	5	& Systems.....	28
Deposit Pricing .....	6	<b>Information</b> .....	28
Letter of Credit/Confirmation Pricing		Additional Copies .....	28
& Fees .....	6		
<i>Issuance Fees</i> .....	6		
<i>Negotiation Fees</i> .....	6		
<b>Credit Availability</b> .....	7		
Credit Underwriting.....	7		
Ratings Standards .....	8		
Thresholds for Internal Modifiers.....	8		
Restricted Lending Status .....	9		
Credit Underwriting – MPF.....	9		
Capital Stock Requirements .....	12		
Minimum Investment Requirements ....	12		
Capital Stock Redemption			
& Repurchase.....	13		
Dividends.....	14		
<b>Security for Advances &amp; Other</b>			
<b>Indebtedness</b> .....	14		
Eligible Collateral.....	14		
Anti Predatory Lending			
Collateral Policy .....	16		
Collateral Status – Blanket Lien .....	17		

## **INTRODUCTION**

The Federal Home Loan Bank of Dallas (Bank) provides financial products and other services to help members fund housing, small business, small agri-business, and economic and community development loans in their communities. The Bank also supports the expansion of affordable housing opportunities and community revitalization through specialized community investment advances and grant programs. The Bank is committed to offering these products and services in a fair and impartial manner and without discrimination in favor of or against any member.

The financial products and services offerings described in this Member Products and Credit Policy (Policy) and other marketing literature are designed to meet the needs of the Bank's members. The Bank stands ready to modify its products and services to meet the specific funding needs of members whenever reasonably possible, while protecting the financial integrity of the Bank and producing a profit sufficient for the payment of a market rate dividend to its members.

For purposes of this Member Products and Credit Policy, the term 'member' generally will be used to refer to any of the following entities which do business with the Bank: members, borrowers, customers, Participating Financial Institutions, Community Financial Institutions, Large Financial Institutions, non-member borrowers, or housing associates.

In those cases where a product, service, term or condition applies to any of these entities specifically, they will be referred to individually and appropriately defined.

Administration of this Policy, where defined, will be consistent with the provisions of applicable law. The Federal Housing Finance Board (FHFB) has adopted regulations (Regulations), which generally govern advances and other products offered by the Bank. Such Regulations are currently set forth in the Rules and Regulations of the Federal Housing Finance Board. The Bank's Board of Directors (Board) approves the Policy in accordance with these Regulations. This policy is subject to change from time to time. To the extent this Policy may be found to be inconsistent with applicable law, applicable law shall govern.

## **FINANCIAL PRODUCTS & OTHER SERVICES**

### **ADVANCES**

The primary function of the Bank is to provide its members with a reliable source of secured credit in the form of advances. Advances enhance the financial strength of the Bank's members by providing a vehicle to match-fund residential mortgage loans, fund deposit withdrawals, and meet liquidity needs.

The use of advances also enables members to reduce the impact of rate volatility. As a result, members are more competitive as they offer longer-term, fixed-rate loans to their customers. Advance maturities range from overnight to 30 years, which allow flexibility in selecting the maturity that best complements a member's financial strategy. In addition, the Bank provides a commitment plan that permits guaranteed availabilities and rates for future-term borrowings. Advances are offered at fixed or floating rates with specific maturities or with embedded options for early redemption.

## **DEPOSIT ACCOUNT SERVICES**

The Bank offers interest-bearing deposit accounts to all members. These deposit accounts are efficient, simplified cash management tools that may be used for all transactions with the Bank. Interest is paid on all collected balances without requiring the transfer of balances between accounts. Several types of deposit accounts are available, which earn interest at a competitive interest rate, based on the specific term. The Bank's Demand Deposit Account (DDA) offers members the flexibility of increasing or decreasing their balances based on their daily needs. The Bank also offers term deposits, which offer members a fixed rate of interest for a specific term. Please visit the Bank's website at [www.fhlb.com](http://www.fhlb.com) for detail regarding fees and pricing.

Some additional services offered along with the deposit accounts are:

### ***Reserve Pass-Through Services***

The Bank provides member thrifts and state-chartered banks a means to hold required reserve balances with the Bank. To establish a pass-through relationship, both the member and the Bank must complete the Federal Reserve Bank's (FRB) Pass-Through Agreement and comply with record keeping and other responsibilities imposed by the Federal Reserve System.

### ***Settlement Services***

The DDA may be used to settle debits and credits arising from transactions conducted with or through any FRB, regardless of location. Before this service may be provided, a member must complete a Transaction Settlement Authorization, which instructs the FRB to settle transactions in the Bank's account. These transactions are received by the Bank and posted to the designated DDA.

### ***Wire Transfers***

The Bank also provides a comprehensive wire transfer service that allows members to efficiently execute funds transfer transactions (both domestic and international) through their DDA accounts and receive same-day credit on all incoming funds transfers. Please refer to the current Correspondent Services Guide for detail regarding fees and pricing.

## **SECURITIES SAFEKEEPING**

The Bank acts as custodial agent for members in security transactions for all types of publicly traded financial instruments. Upon receipt of instructions via fax, e-mail or electronic transmission, the Bank executes the settlement, receipt or delivery of securities through its master custodian. Securities principal and interest payments are posted to the member's DDA.

## **SECURITY CUSTODY & PLEDGING SERVICES**

The Bank, acting as agent, accepts the receipt of securities to collateralize member advances. These securities are analyzed and assigned a collateral value by the Bank's Capital Markets Department. The securities are then available to be pledged to secure advances. The Bank also acts as third-party custodian under the Custodial Agreement and Confirm. The Bank accepts instructions from members and then pledges and/or segregates all or part of the security to a specified depositor. The Bank also acts on behalf of its securities customers to aid in the timely resolution of questions and disputes relating to the securities being held. For detail regarding pricing and fees, please see the current *Securities Safekeeping Guide* provided by the Bank.

## **MORTGAGE PARTNERSHIP FINANCE® PROGRAM**

The Mortgage Partnership Finance Program\* (MPF Program®) provides a means for the Bank to purchase mortgage loans from qualifying members. Under the MPF Program, the mortgage lender is assigned the primary responsibility for managing the credit risk of the loans the member originates, while participating Federal Home Loan Banks are responsible for managing the interest rate, prepayment, and liquidity risks associated with those loans. The credit risks of MPF Program loans are managed by structuring possible losses into several layers. Private Mortgage Insurance (PMI) is required for MPF Program loans with down payments of less than 20 percent of the original purchase price. Losses beyond the PMI layer are absorbed by a first loss account established by the Bank. If losses beyond this layer are incurred, they are absorbed through a credit enhancement provided by the participating member.

The credit enhancement layer ensures that the lender retains a credit stake in the loans it originates. For managing this risk, participating lenders receive monthly credit enhancement fees from the participating Federal Home Loan Bank. The size of each lender's credit enhancement is calculated so that any losses in excess of the second layer are equivalent to those of an investor in an AA-rated security.

## **LETTERS OF CREDIT/CONFIRMATION**

The Bank may issue Standby Letters of Credit/Confirmation (LOC) on behalf of members to facilitate the following types of business transactions the member may have with third parties:

- Residential housing finance
- Community lending that is eligible for any of the Bank's Community Investment Cash Advance (CICA) programs under the Regulations
- Asset/liability management
- To provide liquidity or other funding
- To facilitate the collateralization of public unit deposits

Generally, the Bank does not anticipate that a Standby Letter of Credit/Confirmation will be funded. However, if funding does occur, an advance to the member is structured to fund the Letter of Credit/Confirmation, with an appropriate term and interest rate determined at that time. In addition, any required capital stock purchase for the advance will be calculated and sufficient collateral will be required at the time of funding.

## **ASSETCONNECTION™**

AssetConnection is the Bank's online bulletin board, designed to give members a place to post listings for buying or selling a variety of different assets. Through AssetConnection, members can access an additional source of liquidity while helping to facilitate the flow of funds for mortgages and small business and agricultural loans throughout the District. Only Bank members may access AssetConnection, which is available online through SecureConnect.

AssetConnection is a source for information: the final terms of all AssetConnection transactions are negotiated and completed off-line. Interested buyers use the information provided by the posting institute to initiate contact and negotiate and process a purchase, without input or intervention from the Bank. Detailed information on terms and pricing, including the fee structure, can be found on SecureConnect.

\*Mortgage Partnership Finance® and MPF® are registered trademarks of the FHLB Chicago.

## **AFFORDABLE HOUSING PROGRAM**

The Affordable Housing Program (AHP) provides grant funds to members and their community partners to assist in the development of affordable owner-occupied and rental housing for very low-, low- and moderate-income families through a District-wide competition. The Bank provides technical assistance to members, non-profit organizations, community groups, and for-profit housing providers to assist them in developing an effective housing proposal. Applications are evaluated according to the criteria outlined in the AHP regulations and are graded using a 100-point scoring system.

The Bank will score all applications that meet the eligibility requirements contained in those regulations and elaborated on in the Bank's Implementation Plan. After grading, applications are ranked in descending order and funding is allocated beginning with the highest-ranking projects until all available funds are exhausted.

## **COMMUNITY INVESTMENT PROGRAM**

The Community Investment Program (CIP) is the Bank's at-cost advance program, designed to provide members with low-cost funds for affordable housing. To qualify, funds used for housing purposes (rental or homeownership) must benefit low- to moderate-income households whose incomes are at or below 115 percent of the area median income. Funds used for multifamily projects must provide a benefit to household tenants, of which at least 51 percent must have incomes at or below 115 percent of the area median.

## **ECONOMIC DEVELOPMENT PROGRAM**

The Economic Development Program (EDP) offers at-cost advances to members who are making loans for economic and commercial development projects. To qualify, funds used for these projects must meet one of the following qualifications:

- Located in an urban area (population greater than 25,000) in which the average family income is at or below 100 percent of the area median income (AMI).
- Located in a rural area (population less than 25,000) in which the average family income is at or below 115 percent of the AMI.
- At least 51 percent of the project's employees have incomes at or below the qualifying percent of the AMI.
- Services provided from the finished project will benefit households with incomes at or below the qualifying percent of the AMI.

## **COMMUNITY INVESTMENT CASH ADVANCE PROGRAMS**

Periodically, the Bank may establish programs that are available for a limited time period, specialized to meet identified needs in the District. These initiatives are approved by the Bank's Board. Details regarding these special programs can be found in the Bank's marketing literature or on the website ([www.fhfb.com](http://www.fhfb.com)). Special advance pricing to fund such programs may be established under applicable CICA regulations, based on the following criteria:

- Geographically defined
- Individual
- Activity
- Other targeted beneficiaries that the Bank may designate, with a prior approval of the FHFB.

## **PRODUCT PRICING CONSIDERATIONS**

Products and services are priced in accordance with applicable regulations, taking into account the Bank's cooperative nature, the cost of raising funds in the capital markets, and its financial objectives. These objectives include preserving the value of our members' investment in the Bank while producing earnings sufficient to pay a market rate dividend to our members after paying the Bank's AHP and Resolution Funding Corporation (REFCO) obligations.

### **ADVANCES PRICING**

The Bank prices advances at or above the marginal cost of raising matching maturity funds in the marketplace, including the cost of embedded options and the administrative and operating costs associated with making advances. The Bank may offer advances priced more favorably than its posted rates, provided that the standards and criteria for such differentially priced advances are applied consistently and without discrimination to any member applying for advances. The pricing of Community Investment Cash Advances will be governed by the CICA regulations.

The Bank currently offers two levels of pricing to all members for qualifying advances – Standard and SecureConnect. Please note that these pricing levels do not apply to advances made under the Community Investment Program. All advances executed electronically through SecureConnect, the Bank's virtual private network for transaction processing, are made at the lowest rate charged under the Bank's customary advances pricing criteria. The automated execution and processing incorporated into the SecureConnect network combine to reduce the Bank's operating cost for these transactions, and therefore, allow the Bank to offer discounted rates compared to Standard pricing.

### **COMMITMENT FEES FOR ADVANCES**

Members can lock in current advance rates for a specified period of time by utilizing mandatory and optional commitments. A member using a mandatory commitment is guaranteed a current advance rate for future borrowing. The member specifies, at the time of the commitment, the term and type of borrowing required and the length of the commitment. Mandatory commitment fees may be paid as an upfront fee, or may be incorporated into the rate of the advance. If the member decides not to fund the advance, or only partially funds the advance, the Bank will charge the member a cancellation fee determined by the unfunded advance balance and the term of the advance.

Optional commitments allow the member the flexibility to fund the advance, to partially fund the advance, or to cancel the commitment entirely – all without a cancellation fee. Optional commitment fees are paid up front, at the time of commitment.

Commitment fees are determined by taking into account the type of commitment (mandatory or optional), the cost of carrying the commitment funding (which is a function of the maturity of the committed advance), the length of the commitment period, the amount of the commitment, and fees charged by competing sources of guaranteed funding.

The Bank will guarantee the rate for qualified CIP/EDP advances for a term of 180 days without a rate guarantee fee. To qualify for the no-fee rate guarantee, the member must provide assurances acceptable to the Bank that a specific project or program for which the guarantee is requested will fund within the commitment period.

**Example:**

30-day commitment fee for a 5-year, fixed-rate advance with a rate of 5.50 percent:	
Advance principal	= \$500,000
Advance term	= 5 years
Bank's annualized cost of carry to fund 5-year advance	= 3.45%
Value of Bank's cost of carry for commitment term	= 0.284%
Mandatory commitment upfront fee	= \$1,420
Mandatory commitment fee as additional spread to advance rate	= 0.06%
Optional commitment upfront fee (0.98%)	= \$4,900

## **DEPOSIT PRICING**

The Bank may offer fixed- and variable-rate callable and non-callable deposits (collectively referred to as term deposits) with maturities ranging from overnight to 10 years. The deposits are generally offered on a weekly basis via auctions that are conducted on SecureConnect. Members may also invest in Bank term deposits by contacting the Bank.

The Bank prices all term deposits relative to the liabilities that it issues in the capital markets. When pricing deposits, the Bank factors elements such as differences between where its debt is trading in the primary and secondary markets, the absence of underwriting fees when issuing deposits, and cost differences in hedging deposits relative to hedging other liabilities.

The Bank also offers its members a DDA, which is priced daily at a spread to the average rate the Bank receives on its overnight investment portfolio.

## **LETTERS OF CREDIT/CONFIRMATIONS PRICING & FEES**

The Bank may issue Standby Letters of Credit/Confirmations (LOCs) to facilitate members' ability to conduct business. Fees are set by evaluating competing sources of similar credit enhancements and issuance costs. LOCs that facilitate projects under the Bank's CICA Program are provided special consideration in accordance with CICA regulations. Funded drafts are priced as like-maturity advances.

### ***Issuance Fees for LOCs***

The issuance fee for an LOC is calculated by multiplying the dollar amount of the LOC by a designated number of basis points (bps) and by the number of days the LOC will be outstanding, then dividing by 365. A minimum fee of \$125 will be charged for each LOC issued. Issuance fees are nonrefundable, regardless of whether the LOC is cancelled or drafts are presented prior to the expiration of the LOC. For details regarding pricing and fees, please visit the Bank's website at [www.fhfb.com](http://www.fhfb.com).

### ***Negotiation Fees for LOCs***

Drafts presented to the Bank by a third party (beneficiary) pursuant to an LOC and funded by the Bank will be deemed an advance disbursement. In addition to the issuance fee, a negotiation fee equal to 1 percent of the amount funded pursuant to the LOC will be charged to the member at the time the funding advance is made.

## **CREDIT AVAILABILITY**

The availability of advances to each member is based on the financial condition of the member, the adequacy of collateral pledged to the Bank to secure such advances, and the member's compliance with the community support requirements for membership in the Federal Home Loan Bank System.

Other factors, such as the Bank's liquidity position and the capital market conditions may also affect credit availability. A member's access to advances is contingent upon:

1. Membership in the Bank or authority provided in Section 10b of the Federal Home Loan Bank Act (Act), as amended for housing associates;
2. Demonstration and maintenance of creditworthiness and the required commitment to residential housing finance as required by applicable law;
3. The Bank's maintenance of adequate liquidity to meet credit needs;
4. Execution of an appropriate advances agreement; and,
5. Adequate collateral.

## **CREDIT UNDERWRITING**

The Bank's credit underwriting is based upon a risk-focused approach. Each member is reviewed quarterly to determine the ongoing lending relationship between the Bank and the member. For each member, the Bank determines aggregate credit risk based upon its internal risk analysis of each member's financial condition and performance. The Bank may also review other relevant information, including but not limited to, periodic reports by independent rating agencies and the most recent regulatory Report of Examination. At the minimum, the Bank's credit analysis weighs each member or housing associate's standing against its peers for the following: 1) the level and stability of capital as defined by prompt correction action standards (PCA); 2) satisfactory asset quality; and 3) record of operational profitability.

Occasionally, a member may be required to submit supplemental information for credit underwriting purposes.

The Bank's Credit Review Committee determines all final credit ratings. Ratings are assigned at the sole and exclusive discretion of the Bank. A member or housing associate's credit rating and the Bank's analysis of other risk factors determine whether a member may borrow under a blanket lien or be required to deliver acceptable collateral to secure existing or future advances activity. Generally, members assigned credit ratings of A, B or C may borrow under the blanket lien (blanket status) while members rated D or E must deliver collateral to the Bank (custody status). Each quarter, the Committee selects federally insured members for collateral status reviews on the basis of the criteria below, as measured using PCA standards. The Committee may use other appropriate criteria to select members for collateral status review.

**Adjusted Margin Over All Profitable Quarters  
Credit Rating PCA Standards As % to Total Quarters**

A	$\geq 1.4\%$	$\geq 90\%$
B	$\geq 1.4\%$	80 – 89%
C	$\geq 1.4\%$	70 – 79%
D	$\geq 1.4\%$	55 – 69%
E	$< 1.4\%$	$< 55\%$ or $< 7$ total quarters

**RATINGS STANDARDS**

***Critical Capital Cushion***

To be rated A, B, C or D, all of a member’s capital ratios, adjusted for charge off of nonperforming assets, must exceed PCA standards for adequate capitalization by 1.4 percent. Banks and thrifts with NRSRO ratings of double-B or better have critical capital cushions of 1 percent or more at least 95 percent of the time. Single-B rated banks and thrifts meet this standard 50 percent of the time. Rated banks are 40 percent more efficient in the use of capital than unrated institutions.

***Income reliability***

Once the capital cushion test is met, a profitability standard is used to further define an institution’s rating. To be rated “A”, an institution must have been profitable in at least 90 percent of past quarters. A B-rated institution was profitable in at least 80 percent; C-rated in at least 70 percent; and D-rated in at least 55 percent. This profitability criterion will be applied as a percentage to all members with more than 7 but less than 20 quarters of results. Banks and thrifts with NRSRO ratings of double-B or better meet these standards at least 95 percent of the time.

**THRESHOLDS FOR ASSIGNING INTERNAL RATING MODIFIERS**

I = Unusual quarterly loss for the rating.

Quarterly ROA:  $\leq -1\%$  if rated A;  $-2\%$  if B;  $-3\%$  if C;  $-4\%$  if D.

P = Quarterly provision for losses of 15 percent or more of net interest income.

The cutoff for the worst 10 percent of quarterly provisions for all U.S. banks and thrifts in the 20 quarters ended.

C = Marginal critical capital cushion for rating.

Typically  $\geq 1.4\%$ , but  $< 1.6\%$  if rated B,  $< 1.8\%$  if rated C,  $< 2\%$  if rated D.

GE = Inadequate critical capital cushion if federal guarantees are not valid.

Cushion  $\leq 1.4\%$  if rated A,  $1.6\%$  if rated B,  $1.8\%$  if rated C and  $2\%$  if rated D.

L = Unusual liquidity history for rating. Liquidity ration  $\geq 0.5$  in  $< 18$  quarters if rated A, 16 quarters if B, 14 quarters if C, 12 quarters if rated D.

## **RESTRICTED LENDING STATUS**

In the event a member's creditworthiness significantly deteriorates and the member is determined to be a "restricted member," such "restricted member" will carry a credit rating of "E\*" in the Bank's customer information system. In addition, unless the Bank's Credit Review Committee decides otherwise the following restrictions will apply to a member with a credit rating of "E\*":

- limit transactional access to SecureConnect;
- require the approval of the President of the Bank or a designee of the President for wires, the release of collateral, the substitution of collateral, and the repurchase of excess Bank stock;
- require the approval of the Bank's Credit Review Committee to continue such member's participation in the mortgage purchase programs and the community development programs beyond such member's current delivery commitments;
- limit the terms for new advances and renewals of advances for a period not to exceed 30 days and limit the terms for new letters of credit and renewals of letters of credit for a period not to exceed 6 months;
- require such member to utilize only first-lien single family mortgages and eligible securities to support both existing obligations and renewals of existing obligations; provided, however, such member may utilize mortgages on multi-family property, other real estate related collateral, and small business and small farm/agriculture collateral types to secure obligations outstanding at the time such member became "E\*" rated and to secure the subsequent renewal of such of those existing obligations that the Bank determines it may safely renew; permit such member to request and receive new advances and letters of credit only if at the time any such new advance or letter of credit, as applicable, is made such new advance or letter of credit, as applicable, and all outstanding obligations of such member are fully secured by first-lien single family mortgage collateral and eligible securities only;
- reduce the collateral value for such member's collateral to the percentage applicable for such collateral under a blanket lien; and
- subject such member to any other applicable restrictions set forth in the Federal Housing Finance Board Regulations, the Federal Home Loan Bank Act, and any other laws, statutes, rules, or regulations, as each may be amended or replaced from time to time.

Any restrictions determined to apply to an "E\*" rated member will be communicated by letter and through discussion with the member's senior management, and will remain in effect until the member is notified of a change in status.

## **CREDIT UNDERWRITING – MORTGAGE PARTNERSHIP FINANCE PROGRAM**

### *Credit Underwriting*

In order to be approved as a participant in the MPF Program and classified as a Participating Financial Institution (PFI), a member must comply with the Bank's credit underwriting policy. Additionally, the member must provide evidence of satisfying the following eligibility requirements as set forth in the MPF® Program PFI Agreement:

## *Eligibility Requirements to Sell Mortgages*

- 1. General Requirements** - These are the general requirements the PFI must meet to be eligible to sell mortgages to the Bank:
  - a. Meet the Bank's Standards** - The PFI must have and maintain as one of its principal business purposes the origination or purchase of mortgages of the type that the PFI will sell to the Bank under this Contract. In addition, the PFI, must, at all times, have the capacity to originate or purchase mortgages that meet the MPF Program standards and the standards generally imposed by other GSEs and private institutional mortgage investors. The PFI must, at all times, satisfy the applicable requirements for PFIs to originate or sell mortgages set forth in the MPF Guides ("Guides") and, if issued, comply with the MPF Program Requirements.
  - b. Have Qualified Staff and Adequate Facilities and Systems** - The PFI must, at all times, employ personnel or agents who are well trained and qualified to perform the functions required under the PFI Agreement, and maintain facilities and systems that are able to perform its functions under the PFI Agreement.
  - c. Maintain Fidelity Bond and Errors and Omissions Coverage** - The PFI must maintain, at its own expense, a fidelity bond and errors and omissions insurance, as required by the Guides.
  - d. Report Basic Changes** - The PFI must notify the Bank promptly in writing of any material changes that occur in its or its agents' principal purpose, activities, manner of originating or acquiring mortgages, ownership, financial condition, staffing, facilities, fidelity bond or errors and omissions insurance, which changes adversely affect the PFI's ability to perform its obligations under the PFI Agreement.
- 2. Ownership and Status of PFI** - In approving a PFI in connection with the obligations of the PFI Agreement, the Bank relies on the information the PFI has provided about the eligibility, qualifications and financial status of the PFI and its owners. The PFI covenants and agrees to comply with the provisions of the Guides and, if issued, the MPF Program Requirements regarding these matters, including, without limitation, the delivery of notices regarding these matters as required by the Origination Guide. Changes in any such matters may affect the PFI's eligibility to sell mortgages to the Bank.
- 3. Financial Information** - In order to become and remain a PFI approved to originate or sell mortgages under the PFI Agreement, the PFI agrees to provide the financial information required by the Guides and, if issued, MPF Program Requirements from time to time and the PFI shall, at all times, satisfy the standards set forth in the Guides and the MPF Program Requirements. The PFI agrees that the Bank may make such information available to the MPF Provider and to Participants or potential Participants.
- 4. Access to PFI's Records** - As set forth in the Guides, the PFI agrees to permit, and cause its agents to permit, the Bank's employees and designated representatives to examine or audit books, records and information pertaining to the Mortgages.

## *Eligibility Requirements to Service Mortgages*

- 1. General Requirements** - These are the general requirements the PFI must meet to be eligible to service mortgages for the Bank:
  - a. Meet the Bank's Standards** - The PFI must have and maintain as one of its principal business purposes, the servicing of mortgages of the type that PFI will service under this Contract. In addition, the PFI, in the Bank's judgment, must, at all times, have the capacity to service mortgages for the Bank in a manner satisfying the Bank's servicing standards and the standards generally imposed by other GSEs and private institutional mortgage investors. Finally, the PFI must, at all times, satisfy the applicable requirements for servicers of mortgages set forth in the Guides and, if issued, in the MPF Program Requirements.
  - b. Have Qualified Staff and Adequate Facilities and Systems** - The PFI must, at all times, employ personnel or agents who are well trained and qualified to perform the functions required of the PFI, as Servicer, under this Contract, and the PFI and any agents must maintain facilities and systems that, in the Bank's judgment, are able to perform its functions as Servicer under the PFI Agreement.
  - c. Maintain Fidelity Bond and Errors and Omissions Coverage** - The PFI must maintain, at its own expense, a fidelity bond and errors and omissions insurance, as required by the Guides.
  - d. Report Basic Changes** - The PFI must notify the Bank promptly in writing of any material changes that occur in its principal purpose, activities, financial condition, staffing, facilities, fidelity bond or errors and omissions insurance.
- 2. Ownership and Status of Servicer** - In approving a PFI as Servicer, the Bank relies on the information the PFI has provided about the eligibility, qualifications and financial status of the PFI and its owners. The PFI covenants and agrees to comply with the provisions of the Guides and, if issued, the MPF Program Requirements, regarding these matters, including, without limitation, the delivery of notices regarding these matters as required by the Servicing Guide. Changes in any such matters may affect the PFI's eligibility to service Mortgage for the Bank.
- 3. Financial Information** - In order to become and remain an approved Servicer under this Contract, the PFI must provide the financial information required by the Guides from time to time and must satisfy the standards set forth in the Guides and the MPF Program Requirements. The PFI further agrees that the Bank may provide such financial information to the MPF Provider and other Participants or potential Participants in the Mortgages.
- 4. Access to PFI's Records** - As set forth in the Guides, the PFI agrees to permit, and cause its agents to permit, the Bank's employees and designated representatives to examine or audit books, records and information pertaining to the Mortgages.

## CAPITAL STOCK REQUIREMENTS

The Gramm-Leach-Bliley Act of 1999 required each FHLBank to replace its existing capital stock with a new class or classes of capital stock, establish new minimum investment requirements for its members, and comply with new minimum leverage and risk-based capital requirements. The Dallas Bank implemented its new Capital Plan on September 2, 2003, by exchanging shares of new Class B Stock for shares of capital stock held on that date. Class B Stock is redeemable with five years' written notice.

The following is a summary of the major provisions of the capital stock requirements and other major provisions of the Dallas Bank's Capital Plan, but does not describe all of its provisions. The Capital Plan itself, which is available on the Bank's website at [www.fhlb.com](http://www.fhlb.com), provides more detail on each provision.

## MINIMUM INVESTMENT REQUIREMENTS

Effective November 1, 2005 members are required to maintain an investment in Class B Stock equal to the sum of:

1. A membership investment requirement equal to 0.09 percent of the member's total assets, initially as of June 30, 2005 or the most recent calendar quarter for which financial data is available, and subsequently based on year end financial data, up to a maximum of \$25 million, but not less than \$1,000; and
2. An activity-based investment requirement equal to:
  - a. 4.10 percent of the member's currently outstanding advances; and
  - b. 4.10 percent of the currently outstanding balance of Acquired Member Assets (AMA), if any, held on the Dallas Bank's balance sheet that were delivered under master commitments executed on or after September 2, 2003.

Pursuant to the Capital Plan, the Dallas Bank's Board of Directors may adjust these percentages and amounts from time to time to ensure the Bank maintains compliance with its minimum capital requirements as defined by statute and regulation. The table below indicates the current amounts and the ranges within which they can be adjusted by the Board of Directors. Any changes in minimum investment requirements beyond these ranges would require an amendment to the Bank's Capital Plan, which must be approved by the Finance Board.

	<b>Minimum Amount</b>	<b>Current Amount</b>	<b>Maximum Amount</b>
<b>Investment Requirement</b>			
<b><i>Membership Investment Requirement</i></b>			
Percent of each member's total assets	0.05%	<b>0.09%</b>	0.30%
Maximum membership investment requirements	\$10 mm	<b>\$25 mm</b>	\$50 mm
Minimum membership investment requirements		<b>\$1,000</b>	
<b><i>Activity-Based Investment Requirement</i></b>			
<b>Advances</b> (percent of current outstanding advances)	3.5%	<b>4.10%</b>	5.0%
<b>AMA</b> (percent of current outstanding principal balance of loans retained by the Dallas Bank that was delivered under master commitments executed on or after September 2, 2003).	0.0%	<b>4.10%</b>	5.0%

## CAPITAL STOCK REDEMPTION & REPURCHASE

In accordance with the statute, regulations and the Bank's Capital Plan, members may either withdraw from membership or have their excess stock redeemed with five years' written notice, provided certain conditions exist at the end of that period. The Dallas Bank may also, in its discretion, repurchase excess stock at any time, but is only obligated to redeem stock at the end of a five-year redemption period.

### *Redemption of Capital Stock*

A member wishing to redeem excess Class B Stock may do so by submitting a written redemption notice to the Bank. The redemption notice must identify the shares to be redeemed by date of issuance and amount. If the redemption notice fails to identify the particular shares to be redeemed, the member shall be deemed to have requested redemption of the most recently issued shares that are not already subject to a pending redemption request. Members may not have more than one redemption notice in effect at any one time for the same shares of Class B Stock.

Only Class B Stock that is excess stock at the end of the five-year redemption notice period will be redeemed. The Bank may not redeem Class B Stock if certain conditions are not met at the time of redemption, including among others, that the member must be in compliance with its minimum investment requirement and the Bank must be in compliance with all of its minimum capital requirements following the stock redemption.

A member may cancel a redemption notice prior to maturity by submitting a written cancellation notice to the Bank. Redemption cancellation notices are subject to cancellation fees as follows: 1 percent of the par amount of stock for which a redemption notice is cancelled if the notice is cancelled during the first year after it was submitted; 2 percent of the par amount of stock during the second year; 3 percent during the third year; 4 percent in the fourth year; and, 5 percent in the fifth year.

### *Repurchase of Capital Stock*

The Bank may, in its sole discretion, repurchase excess stock at any time without regard for the five-year redemption period related to stock redemptions. The Bank may repurchase excess stock at the request of a member, or initiate a mandatory repurchase of some portion of members' excess stock with 15 days' written notice to members.

The Bank has established a policy of periodically repurchasing a portion of members' excess stock to avoid the accumulation of large amounts of excess stock. Under this policy, the Bank will generally repurchase surplus stock at the end of the month following the end of each calendar quarter. Surplus stock is currently defined as the amount of stock held by a member in excess of 120 percent of the member's minimum investment requirement. A member's surplus stock will not be repurchased if the amount of surplus stock is \$250,000 or less.

The Bank anticipates that the percentage used to define surplus stock will decline to 110 percent of members' minimum investment requirement over the next two quarters. The Bank will provide members at least 15 days' notice of its intent to repurchase surplus stock. The Bank reserves the right to modify the definition of surplus stock or to modify the timing or frequency of surplus stock repurchases.

## **DIVIDENDS**

Dividends on Class B Stock are generally paid quarterly in the form of capital stock and/or cash, at the discretion of the Bank's Board of Directors. All holders of the Bank's Class B Stock will be entitled to receive dividends as long as the stock is outstanding. Dividends are calculated based on the member's average capital stock balance for the quarter, using an actual / 365 day-count basis. Dividends paid in the form of capital stock are issued in full shares valued at \$100 per share, with fractional shares paid in cash.

The Bank's dividend rate will generally be aligned with the Bank's rate of return on members' invested capital stock, which typically tracks short-term money market interest rates such as Federal funds.

## **SECURITY FOR ADVANCES & OTHER INDEBTEDNESS**

### **ELIGIBLE COLLATERAL**

The Bank is required by law to make advances solely on a secured basis. The Regulations and the Bank's borrowing agreements (which must be executed prior to receiving advances or other extensions of credit) require members to maintain sufficient acceptable collateral in order to fully secure all advances and other indebtedness to the Bank, including Letters of Credit and the member's MPF credit enhancement obligation. Upon execution of a master commitment, the maximum credit enhancement obligation is collateralized. Upon master commitment completion, the collateral is adjusted to reflect the member's actual credit enhancement obligation. The Bank will not accept as collateral for advances or Letters of Credit/Confirmation any loan or class of loans that do not comply with the Bank's Anti-Predatory Lending Collateral Policy set forth below.

The collateral position of each member must also be in compliance with the requirements of this Policy prior to the approval or funding of an advance or other extension of credit. For additional detail on pricing and fees, please visit the Bank's website at [www.fhfb.com](http://www.fhfb.com).

The Bank may accept the following types of collateral for securing advances and other extensions of credit:

1. First Mortgage Collateral, which consists of whole, fully disbursed, residential (i.e., one- to four-family and multifamily) first-mortgage loans (excluding participations and other fractional interests or mortgage warehouse lines) that are owned by the member free and clear of any liens and encumbrances (other than those that are junior to the liens and encumbrances of the Bank) and are not past due 90 days or more. Additionally, any home mortgage loan made to any director, officer, employee, attorney or agent of the borrowing member cannot be considered eligible collateral securing advances.
2. U.S. Government and federal agency securities including:
  - i. Mortgage backed securities issued or guaranteed by a federal agency; and
  - ii. Mortgages or other loans (including securities backed by, or representing an equity interest in, such mortgages or loans) that are insured or guaranteed by the U.S. Government or a Federal agency where the insurance or guarantee is for the direct benefit of the holder of the mortgage or loan.

3. Privately-issued residential mortgage-backed securities rated in the highest category by a Nationally Recognized Statistical Rating Organization, excluding the following:
  - i. Securities that represent a share of only the interest payments or only the principal payments from the underlying mortgage loans;
  - ii. Securities that represent a subordinate interest in the cash flows from the underlying mortgage loans;
  - iii. Securities that represent an interest in any residual payments from the underlying pool of mortgage loans; or
  - iv. Such other high-risk securities as the Bank in its sole discretion may determine.
4. Term deposits from the Bank.
5. Small Business Administration (SBA) Guaranteed Loans may be acceptable collateral to the extent that they are secured by eligible real estate collateral, or, in the case of Community Financial Institutions (defined below)), by non-real estate collateral. The Bank relies solely on the underlying collateral and does not ascribe value to the SBA guaranteed portion.
6. Other non-securitized real estate-related collateral including commercial real estate loans, home equity and second mortgage loans that are secured by junior liens on residential real estate (but only if the member also holds the first mortgage on the property), participations and mortgage warehouse lines, as well as commercial and multifamily real estate construction. For other real estate related-collateral to be acceptable it must have a readily ascertainable value, be capable of being reliably discounted and liquidated in due course, and the Bank must be able to perfect a security interest in such collateral.
7. Securities representing undivided equity interests (e.g., shares of certain types of mutual funds) in the collateral described above.
8. For Community Financial Institutions (CFIs), fully secured loans to small businesses, small farms and small agri-businesses, or securities representing whole interests in such fully secured loans.

Assets held by an affiliate of a member that otherwise constitute eligible collateral under the descriptions above may be used to secure advances to that member, provided the collateral is pledged to secure: (a) the member's obligation to repay advances; or, (b) a surety or other agreement under which the affiliate and the member have assumed a primary obligation to repay advances. In such case, the Bank must obtain a legally enforceable security interest in the collateral that is the functional equivalent in all material respects to the rights and privileges the Bank would possess if the member pledged that same collateral directly. If the Bank deems itself to be under-collateralized and all eligible collateral under the categories above has been pledged to the Bank, the Bank may consider accepting other assets to secure advances and other extensions of credit, provided such assets have a readily ascertainable value and the Bank can perfect a security interest in such assets.

## ANTI-PREDATORY LENDING COLLATERAL POLICY

The Bank supports the expansion of fair and equitable home ownership opportunities. To discourage predatory lending practices, which are inconsistent with such opportunities, and to protect the Bank from potential liabilities, the Bank has established the following anti-predatory lending policy (APL Policy) with respect to residential mortgage loans and securities backed by residential mortgage loans pledged to it as collateral (Residential Mortgage Collateral).

The Bank requires that Residential Mortgage Collateral comply with applicable federal, state and local anti-predatory lending laws and the laws, regulations, orders, interpretations, agreements, and other similarly binding documents issued or enforced by a member's primary regulator designed to prevent or regulate predatory lending practices and loan terms (collectively, Anti-Predatory Lending Laws). For example, Anti-Predatory Lending Laws may prohibit or limit certain practices and characteristics, including, but not limited to the following:

Requiring the borrower to obtain prepaid, single-premium credit life, credit disability, credit unemployment, or other similar credit insurance; Requiring mandatory arbitration provisions with respect to dispute resolution in the loan documents; or Charging prepayment penalties for the payoff of the loan beyond the early years of such loan.

Any Residential Mortgage Collateral that does not comply with all applicable Anti-Predatory Lending Laws will be ineligible as collateral to support advances or other activity with the Bank. Additionally, the Bank will not give collateral value for any Residential Mortgage Collateral that exceeds the annual percentage rate, or points and fees thresholds of the Home Ownership and Equity Protection Act of 1994 and its implementing regulations (Federal Reserve Board Regulation Z) or exceeds the annual percentage rate, or points and fees thresholds of any applicable state or local anti-predatory lending law.

Entities pledging Residential Mortgage Collateral to the Bank as collateral (pledgors) are responsible for avoiding all unlawful practices and terms prohibited by applicable Anti-Predatory Lending Laws, regardless of whether they originate or purchase the Residential Mortgage Collateral being pledged to the Bank. The Bank will take those steps it deems reasonably necessary in order to confirm or monitor pledgors' compliance with this policy. In addition, the Bank reserves the right to require evidence reasonably satisfactory to the Bank that Residential Mortgage Collateral does not violate applicable Anti-Predatory Lending Laws. With respect to Residential Mortgage Collateral purchased by the pledgor, the pledgor is responsible for conducting due diligence reasonably sufficient to support its certification and indemnification agreements with the Bank.

Pursuant to the terms and conditions of the Bank's Advances and Security Agreement, each member and each housing associate has (1) represented and warranted to the Bank that: (a) all of such entity's collateral meets the standards and requirements with respect thereto from time to time established by the Bank, which includes this APL Policy; (b) it is in compliance with the requirements of all applicable Anti-Predatory Lending Laws; (c) it will maintain qualifying collateral; and (d) in cases where such entity is specifying or delivering collateral to the Bank, such entity will substitute eligible collateral for any Residential Mortgage Collateral that does not comply in all material respects with applicable Anti-Predatory Lending Laws or this APL Policy; and (2) agreed to indemnify and hold the Bank harmless against all costs, claims, expenses, damages, and liabilities resulting in any way from such entity's failure to comply with any laws, rules, regulations, or ordinances applicable to or binding upon such entity or the Collateral.

Each non-member pledgor (other than housing associates) must execute a written agreement with the Bank that: (1) certifies its understanding and compliance with this APL Policy and all applicable Anti-Predatory Lending Laws; (2) certifies it will substitute eligible collateral for any Residential Mortgage Collateral that does not comply in all material respects with applicable Anti-Predatory Lending Laws or this APL Policy; and (3) indemnifies, defends and holds the Bank harmless from and against all losses, damages, claims, actions, causes of action, liabilities, obligations, judgments, penalties, fines, forfeitures, costs and expenses, including, without limitation, legal fees and expenses, that result from the pledge of any Residential Mortgage Collateral that does not comply in all material respects with applicable Anti-Predatory Lending Laws or this APL Policy.

The Bank will not knowingly accept as eligible collateral Residential Mortgage Collateral that violates applicable Anti-Predatory Lending Laws or this APL Policy. If the Bank knows or discovers that such Residential Mortgage Collateral violates applicable Anti-Predatory Lending Laws or this APL Policy, the Bank may, in addition to all available rights and remedies at law or in equity (1) require the pledgor to substitute eligible collateral, (2) value such Residential Mortgage Collateral at zero for collateral purposes, and (3) require the pledgor to undertake a review of its policies, practices, and procedures for complying with the Bank's collateral policies.

The foregoing policy addresses collateral pledged to the Bank. Residential mortgage loans purchased or acquired by the Bank from members will be governed by the terms set forth in the MPF Origination Guide.

## **COLLATERAL STATUS - BLANKET LIEN**

Members accorded blanket lien status may borrow up to a loan value percentage of the book value of eligible collateral as determined by the Bank (not to exceed 35 percent of the member's total assets) without specifically listing, segregating or delivering collateral to the Bank. Book values for eligible collateral are derived initially from appropriate regulatory filings, and are reduced by the principal balance of any respective collateral delivered to the Bank, the appropriate credit haircut established for each category, delinquencies 90 days and greater, and the exception values determined by the collateral verification process.

Access to advances secured with small business, small farm and small agri-business loans is restricted to members meeting the criteria for CFIs. A CFI is currently defined as a member which has: 1) deposits insured under the Federal Deposit Insurance Act; and 2) average total assets of less than \$567 million based on regulatory reports for the three most recent calendar yearends as determined by the Bank (the CFI asset cap). The CFI asset cap is adjusted annually by the FHFb to reflect any increase in the Consumer Price Index. A member that exceeds the CFI asset cap or is not insured by the FDIC (as is the case with insurance companies and credit unions) will be referred to as a Large Financial Institution (LFI).

Members under blanket lien status pledge their eligible collateral for the blanket lien, plus their demand deposit accounts, capital stock, and certain other assets pursuant to the Bank's Advances and Security Agreement. These members need not specifically identify and assign the collateral securing advances, provided that advances to such members do not exceed the foregoing limits and the following conditions are met:

- The member meets all statutory and regulatory capital standards.
- The member meets all Bank credit underwriting standards as determined by the Bank.

NCUA-insured credit unions that keep their books according to GAAP and obtain annual financial statement audits prepared according to GAAS and attested to by independent, state-licensed accountants may be placed on blanket lien status, provided that their financial conditions warrant blanket lien status and the Bank receives an executed subordination agreement subordinating any security interest in the member's assets held by a corporate credit union to the security interest of the Bank.

Members on blanket lien status agree to inform the Bank within a designated time period of any event that materially reduces the principal amount of, or otherwise changes, collateral pledged to the Bank under the Bank's blanket lien. In any event, the members must update information relating to pledged collateral on a quarterly basis, or as requested by the Bank.

***Eligible Collateral and Maximum Collateral Values Under the Blanket Lien for CFIs***

- First-lien mortgages, one- to four-family (up to 75 percent)
- First-lien mortgages, multifamily (up to 75 percent)
- Small farm/agriculture loans (up to 40 percent)
- Small business loans (up to 60 percent).

***Eligible Collateral and Maximum Collateral Values Under the Blanket Lien for LFIs***

- First-lien mortgages, one- to four-family (up to 75 percent)
- First-lien mortgages, multifamily (up to 75 percent)
- Other real estate loans (up to 45 percent).

***Eligible Collateral and Maximum Collateral Values Under the Blanket Lien for Credit Unions***

- First-lien mortgages, one- to four-family (up to 75 percent)
- First-lien mortgages, multifamily (up to 75 percent)
- Other real estate loans (up to 45 percent).

## **COLLATERAL STATUS - CUSTODY**

The Advances and Security Agreement provides the Bank with the right to require delivery of collateral. The Bank will require the delivery of collateral if:

- The member is an insurance company (in which case the member will execute the Bank's Advances and Security Agreement with delivery); or
- The member does not meet all statutory and regulatory capital standards; or
- The member is a credit union that does not meet the requirements for blanket lien status; or
- The financial condition or controls of the member or any commonly controlled insured depository are such that the Bank would be secure only if the collateral is in the Bank's possession; or
- The member otherwise fails to meet any of the Bank's underwriting standards for blanket lien status; or
- The borrower is a housing associate approved to do business with the Bank.

Members on custody status agree to inform the Bank within a designated time period of any event that materially reduces the principal amount of, or otherwise changes, collateral delivered to the Bank.

Custody members also agree to update information relating to such delivered collateral on a monthly basis, or as requested by the Bank. In all cases, the Bank in its sole discretion shall determine the market value of the member's collateral.

In the case of a loan of \$100,000 or less, the Bank requires that the member identify the type of property securing the loan. In the case of a loan greater than \$100,000 but less than \$250,000, the Bank requires that the member provide a valuation of the property securing the loan; the valuation can be produced by the member or by a third party appraiser. In the case of loan of \$250,000 or greater, the Bank requires that the member provide an appraisal that conforms to the Uniform Standards for Professional Appraisal Practice or the requirements under FIRREA and is dated within one year of the date of funding of such loan. The Bank, in its sole discretion, may assign lesser loan value percentages or decline to accept collateral that does not conform to the collateral characteristics anticipated by the percentages set forth above.

***Eligible Collateral and Maximum Collateral Values Under Custody Status for CFIs***

- First-lien mortgages, one- to four-family and multifamily (up to 90 percent)
- Small farm/agriculture loans (up to 40 percent)
- Small business loans (up to 60 percent)
- Commercial real estate collateral for completed properties with stabilized net operating incomes (up to 80 percent)
- With prior Bank authorization, the following commercial and multifamily real estate may also be accepted:
  - Completed properties that have not yet achieved stabilized net operating incomes, and have been evaluated by the Bank or its agents (up to 70 percent)
  - Incomplete properties and properties that have not been evaluated by the Bank or its agents (up to 60 percent).

***Eligible Collateral and Maximum Collateral Values Under Custody Status for LFIs***

- First-lien mortgages, one- to four-family and multifamily (up to 90 percent)
- Commercial real estate collateral for completed properties with stabilized net operating incomes (up to 80 percent)
- With prior Bank authorization, the following commercial and multifamily real estate may also be accepted:
  - Incomplete properties that have not yet achieved stabilized net operating incomes, and have been evaluated by the Bank or its agents (up to 70 percent)
  - Incomplete properties that have not yet achieved stabilized net operating incomes, and have not been evaluated by the Bank or its agents (up to 60 percent).

***Eligible Collateral and Maximum Collateral Values Under Custody Status for Credit Unions***

- First-lien mortgages, one- to four-family (up to 90 percent)
- First-lien mortgages, multifamily (up to 75 percent)
- Other real estate loans (up to 45 percent).

## **COLLATERAL MAINTENANCE LEVEL**

The level of collateral a member is required to maintain (Collateral Maintenance Level) and, in turn, its status as (a) receiving advances and other extensions of credit under a blanket lien, (b) receiving advances and other extensions of credit secured by delivery of collateral, or (c) receiving advances and other extensions of credit under a combination of any of the foregoing arrangements, is determined by the Bank's credit underwriting criteria (see Credit Underwriting). In addition to the verification of collateral at the member's expense as discussed below, the Bank reserves the right to verify the collateral of any member at any time at the member's expense. A satisfactory collateral verification of the member's collateral must be completed in accordance with the following guidelines:

### ***Collateral Verification***

These collateral verification guidelines apply to all members with advances or other extensions of credit secured by collateral under the blanket lien. Collateral verifications are not required for members that (i) have not obtained advances or other extensions of credit from the Bank, (2) are on custody status, or (3) are on blanket status but at all times have maintained at the Bank eligible loans, securities, and term deposits with a collateral maintenance level in excess of the member's advances and other extensions of credit.

The frequency and extent of the collateral verifications required for a member in a given calendar year is determined on the basis of the amount of that member's borrowings from the Bank in that calendar year.

Members with aggregate average borrowings secured by blanket lien collateral that are equal to or greater than \$35 million in a calendar year will undergo a full (Phases 1 and 2) collateral verification.

Members with aggregate average borrowings secured by blanket lien collateral that are \$5 million or greater but less than \$35 million in a calendar year will undergo a full (Phases 1 and 2) collateral verification every other year commencing in either the current or subsequent calendar year.

Members with aggregate average borrowings secured by blanket lien collateral that are less than \$5 million in a calendar year will undergo only Phase 1 of the collateral verification.

All collateral verifications will be conducted by Bank personnel and will consist of one or two phases as outlined above. Phase 1 will entail a review of a detailed trial balance of the member as of a date specified by the Bank. Phase 1 will identify ineligible collateral, such as loans past due more than 90 days. Phase 2 will take place on site at the member's place of business (or other place where the collateral is located) and will review in detail a representative sample of loans. As a part of Phase 2, the Bank will determine the member's documentation exception percentage that is used in determining a member's available eligible collateral from time to time. In the case of members that do not undergo Phase 2 of the collateral verification process, documentation exception percentages will be developed based on a composite of the Bank's experience with members. At any time a member not required to undergo Phase 2 of the collateral verification process may request that the Bank perform a Phase 2 review so as to establish for that member its own documentation exception rate (such member's rate of ineligible loans is in all cases based on the member's own portfolio), but the Bank shall have no obligation to perform such a collateral verification and will do so only if it has sufficient available human resources.

Members with no outstanding advances or other extensions of credit during the prior year will be assigned percentages for non-eligible loans and documentation exceptions that are based on composite percentages of members until such times as a collateral verification (Phase 1 or Phase 1 and 2, as applicable) is completed.

Members will be charged a fee for Phase 1 and Phase 2 collateral verifications in an amount as the management of the Bank may from time to time determine which determination management is hereby authorized to make.

## **COLLATERAL VALUATION METHODOLOGY**

All member obligations to the Bank will be secured with eligible collateral discounted to protect the Bank from default in adverse circumstances. Collateral discounts will be calculated so as to ensure that the market value of collateral securing each member's obligations exceeds the amount the member may borrow from the Bank with a 95% level of confidence. That is, collateral is discounted (haircut) to the point where its market value will exceed the amount that may be owed the Bank if any member defaults in all but the worst 5% of outcomes based on historical loss data from FDIC loan sales experience and other appropriate sources.

The collateral value of each type of collateral is its valuation basis multiplied by the complement of the discount (haircut) stated as a percentage (for example, if the hair cut is 0.25 or 25%, the compliment is 1 minus 0.25 = 0.75 or 75%). The valuation basis for a security is its market value. The valuation basis for loans under the blanket lien is the aggregate book value by type of loan reduced for ineligible and inadequately documented loans identified through collateral verifications. The valuation basis for loans in the Bank's custody or on listing is the least of the unpaid balance, the appraised value of the property securing the loan, or, in the case of fixed-rate single family mortgages, the estimated market value of the loan.

Collateral discounts and valuation bases will, in all cases, be determined by the Bank in its sole discretion and may vary from member to member based on the Bank's assessment of the relevant facts and circumstances.

## **GENERAL LIMITATIONS ON COLLATERAL AND CREDIT AVAILABILITY**

The maximum amount of advances or other extensions of credit available to a member is based upon several considerations, including the financial condition of the member and the adequacy of collateral to secure advances and other extensions of credit:

1. Credit will not be extended beyond 50 percent of a member's total assets without prior consent of the Bank's Board of Directors, except in the case of advances with original maturities of 30 days or less secured with eligible securities.
2. CIP and EDP advances may not exceed the lesser of 10 percent of a member's total assets or \$100 million at the time the advance is approved. The aggregate amount of the Bank's community development advances to all members may not exceed 5 percent of the Bank's total outstanding advances.
3. Housing associates are only eligible to deliver collateral as described in the "Eligible Collateral" section of this Policy (please see section entitled "Security for Advances and Other Indebtedness"). Housing associates are eligible to deliver collateral as outlined in #1, 2, 3, and 4 of that section.
4. For CFIs under blanket lien or custody status, combined small farm/agriculture/business and other real estate loans cannot exceed 300 percent of the member's Tier 1 capital.
5. For LFIs under blanket lien or custody status, other real estate related collateral cannot exceed 300 percent of the member's Tier 1 capital.

# **BORROWING PROCEDURES**

## **ADVANCES AGREEMENT & RELATED DOCUMENTATION**

Prior to the approval of any advance request and disbursement of advance funds, each member requesting an advance must have a fully executed Corporate Certificate of Authority, Signature Card for Advances, and a fully executed current borrowing agreement on file with the Bank. Only those officers whose names appear on the Corporate Certificate of Authority and Signature Card for Advances are authorized to request and sign for commitments and advances.

## **ADVANCES & FUNDING**

Members requesting funding other than CICA advances or Letters of Credit (which require written applications), do so by providing verbal instructions to the Bank's Member Sales Group or through SecureConnect. Instructions for executing advances are electronically recorded, stored and archived to provide for future review and verification. Members must verify the terms of the transactions to ensure that they are properly recorded for audit purposes. The Bank provides members with confirmations of advances, reflecting the terms of the associated advance and commitments.

All information provided to the Bank — including all regulatory reports submitted by members to the Bank, the FHFb, or a primary regulator — may be reviewed by the Bank when considering each request for an advance. Members should be aware of the representations and warranties in their borrowing agreements regarding the truth and accuracy of information submitted to the Bank, and the possible contractual consequences of the breach of such representations and warranties.

The Bank's obligation to release funds on advance commitments is subject to the continued eligibility of the member for advances as determined by the Bank under applicable law. Advance proceeds will be credited to the member's DDA.

## **INTEREST PAYMENTS**

Interest is due monthly and upon maturity of an advance unless otherwise agreed to at the time of borrowing. Interest payments on outstanding advances are debited monthly from the member's DDA, on the first business day of the month for the amount accrued through the last day of the previous month. Principal and accrued interest for short-term advances (35 days or less) is debited at maturity.

## **TRANSFERS OF ADVANCES**

While the Bank generally does not permit one member to assume an advance obligation of another member, in the case of mergers and acquisitions or when both parties are members of the same holding company, the Bank may allow the transfer of advances. The Bank, in its sole discretion, reserves the right to reject the transfer of any advance.

## PREPAYMENT OF ADVANCES

The following prepayment policy applies to advances granted or renewed on or after June 14, 2002. Members should consult prior credit policies or contact the Member Sales Group directly to obtain prepayment policies and fees applicable to advances made prior to that date. Prepayment fees are due and payable on the date the advance is prepaid. Advances associated with Helping Hand grant funds may not be prepaid unless the time period for calculating the Helping Hand grant amount has expired, in which case the standard prepayment fee will apply. Advances with maturities of six months or less are not prepayable unless they are Floating-Rate Advances designated as prepayable, which may be prepaid without prepayment fee on any reset date with two days' notice from the member.

- **Fixed-Rate Nonamortizing Advances** with an original term of more than six months may be prepaid for a fee at any time after the first six months with at least 24 hours' notification.

If the contract rate on the advance is greater than the yield on the prepayment date of a U.S. Treasury security of the same remaining maturity, and the member chooses to prepay the advance, the member shall pay the Bank a fee equal to the present value of the remaining advance cash flows discounted at the current market yield of the U.S. Treasury security, minus the principal amount outstanding on the advance (please see the following Example 1).

If the member chooses to prepay an advance when the contract rate on the advance is less than the yield on a U.S. Treasury security of the same remaining maturity, no prepayment fee is due on the advance.

- **Fixed-Rate Amortizing Advances** with an original term of more than six months may be prepaid for a fee after the first six months with at least 24 hours' notice. The prepayment fees on amortizing advances will be calculated according to the process described above, discounting the remaining advance cash flows at the yield on the U.S. Treasury security with duration equal to that of the remaining advance cash flows (please see the following Example 2).
- **Fixed-Rate Amortizing Advances** designated as prepayable may be prepaid for a fee at any time after six months and during the lockout period with at least 24 hours' notification. Because the rate on these advances includes an option to prepay after the lockout period, these advances may be prepaid after the lockout period without a prepayment fee. After the initial six months, but prior to the end of the lockout period, the prepayment fee will be calculated as described above for Fixed-Rate Amortizing Advances, using the end of the lockout period as the maturity date for the advance.
- **Floating-Rate Advances** with an original term of more than six months may be prepaid for a fee at any time after the first six months with at least 24 hours' notification. The prepayment fee will be calculated as follows:

Current interest rates will be used to determine a comparable fixed advance rate and the base prepayment fee will equal the present value of the cash flows on the comparable fixed-rate advance, discounted at a rate equal to 30 bps less than the yield on an equivalent-maturity interest rate swap. The comparable fixed advance rate will be determined by adding: (a) the floating-rate margin on the floating-rate advance to (b) the market yield for an interest rate swap with the same maturity as the floating-rate advance.

If the index rate in effect from the most recent reset date for the floating-rate advance exceeds the market rate for the index on the date of prepayment, an additional prepayment fee will equal the present value of the difference in interest due at the next reset date attributable to the change in the index rate. If the index rate in effect for the floating-rate advance does not exceed the rate for the index on the date of prepayment, there will not be an additional prepayment fee (please see the following Examples 3 and 4).

- **Callable Advances** are prepayable only in accordance with the specific terms of the advance. If the Bank terminates a Short Option Advance prior to the stated maturity date, the Bank will offer replacement funding for a period selected by the member up to the remaining term to maturity of the Short Option Advance. Replacement funding will be priced for the term to maturity of the replacement funding, at the posted rate and under the normal terms and conditions in effect for any of the Bank's advances products for the selected term to maturity of the replacement funding. The member shall make an election as to which maturity and type of advance will apply to replacement funding at the time the Short Option Advance is terminated and replacement funding is requested.
- **Non-Standard Advances**, which are created by means of the Bank entering into interest rate swaps the terms of which are passed through to the member, and for which a prepayment fee methodology is not otherwise defined in the Policy, may be prepaid for a fee at any time after the first six months with at least two business days' notification. The prepayment fee will equal the sum of: (a) the net cost incurred by (or paid to) the Bank to terminate the interest rate swap associated with the advance, and (b) the applicable prepayment fee a standard advance made at the synthetic rate the Bank receives on the associated interest rate swap (please see the following Example 5).

## PREPAYMENT FEE CALCULATION

Prepayment fees will be charged on advances as set forth above. The following examples illustrate how each prepayment fee is calculated:

### **Example 1:**

A \$2,000,000 fixed-rate, non-amortizing advance with an interest rate of 7.00 percent and an original term of eight years is prepaid after three years. The market yield for a U.S. Treasury security having a maturity equal to the remaining term of the advance (five years) is 6.00 percent.

Remaining term		= 5 years
Advance principal		= \$2,000,000
Monthly decreased earnings to Bank	= 2,000,000 x [7.00% - 6.00%] / 12	= \$1,667
Monthly discount rate	= 6.00% / 12	= 0.500%
Prepayment fee paid to Bank	= PV of decreased earnings	= \$86,209
Total amount paid to Bank		= \$2,086,209

**Example 2:**

A \$500,000 fixed-rate amortizing advance with an interest rate of 6.00 percent and an original term of 15 years is prepaid after two years. The market yield for a U.S. Treasury security having a duration equal to the remaining cash flow of the advance (4.5 years) is 5.00 percent.

Remaining term to maturity	= 13 years
Duration of remaining cash flow of advance	= 4.5 years
Advance original principal balance	= \$500,000
Advance payoff balance	= \$456,275
PV of remaining cash flows @ 5.00%	= \$483,275
Prepayment fee paid to Bank	= \$27,000
Total amount paid to Bank	= \$483,275

**Example 3:**

A \$2,000,000 floating-rate advance with a coupon that resets quarterly to 3-month LIBOR minus 10 bps and has an original term of eight years (96 months) is prepaid after three years and one month (37 months). The market yield for an interest rate swap having a maturity equal to the remaining term of the advance (59 months) is 5.10 percent, and 3-month LIBOR has increased from 2.75 percent to 3.00 percent since the advance's previous reset date.

Remaining term to maturity	= 59 months
Advance principal	= \$2,000,000
Advance spread to LIBOR	= -0.10%
Interest rate swap rate	= (59 months) = 5.10%
Comparable fixed advance rate	= (-0.10% + 5.10%) = 5.00%
Discount rate	= (5.10% - 0.30%) = 4.80%
Monthly discount rate	= (4.800% / 12) = 0.400%
Monthly decreased earnings to Bank	= (\$2,000,000 x [5.00% - 4.80%]) / 12 = \$333
Base prepayment fee paid to Bank	= PV of decreased earnings = \$17,487
Change in LIBOR	
since most recent reset date	= (3.00% - 2.75%) = 0.25%
Remaining term to reset date	= 2 months
Additional prepayment fee for LIBOR rate change	= \$0
Total prepayment fee paid to Bank	= \$17,487
Total amount paid to Bank	= \$2,017,487

**Example 4:**

A \$2,000,000 floating-rate advance with a coupon that resets quarterly to 3-month IBOR minus 10 bps and has an original term of eight years (96 months) is prepaid after three years and one month (37 months). The market yield for an interest rate swap having a maturity equal to the remaining term of the advance (59 months) is 5.10 percent, and 3-month LIBOR has decreased from 2.75 percent to 2.5 percent since the advance's previous reset date.

Remaining term to maturity		= 59 months
Advance principal		= \$2,000,000
Advance spread to LIBOR		= -0.10%
Interest rate swap rate	= (59 months)	= 5.10%
Comparable fixed advance rate	= (-0.10% + 5.10%)	= 5.00%
Discount rate	= (5.10% - 0.30%)	= 4.80%
Monthly discount rate	= (4.800% / 12)	= 0.400%
Monthly decreased earnings to Bank	= (\$2,000,000 x [5.00% - 4.80%]) / 12	= \$333
Base prepayment fee paid to Bank	= PV of decreased earnings	= \$17,487
Change in LIBOR		
since most recent reset date	= (2.50% - 2.75%)	= (0.25%)
Remaining term to reset date		= 2 months
Additional prepayment fee for LIBOR rate change		= \$828
Total prepayment fee paid to Bank		= \$18,315
Total amount paid to Bank		= \$2,018,315

**Example 5:**

A \$2,000,000 non-standard advance having an original term of eight years (96 months) with an effective borrowing rate to the Bank of 3-month LIBOR minus 10 bps is prepaid after three years and one month (37 months). The market yield for an interest rate swap having a maturity equal to the remaining term of the advance (59 months) is 5.10 percent, and 3-month LIBOR has increased from 2.75 percent to 3.00 percent since the previous reset date.

Remaining term to maturity		= 59 months
Advance principal		= \$2,000,000
Interest rate swap termination fee paid by Bank		= \$10,000
Prepayment fee for 3-month LIBOR minus 10 bps advance (See Ex. 4)		= \$17,487
Total prepayment fee paid to Bank		= \$27,487
Total amount paid to Bank		= \$2,027,487

## **SPECIAL PROVISIONS**

### **EXCEPTIONS**

Exceptions to this Policy may be made only by the Board or by management of the Bank under properly delegated authority from the Board.

### **DEFAULT**

In the event of a default on the payment of interest or principal on any advance, or in the event of any other default as defined in the Bank's borrowing agreements, the Bank is authorized to declare all debts owed to the Bank immediately due and payable, and subject to any and all prepayment fees and charges.

### **MEMBERSHIP TERMINATION & WITHDRAWAL**

As provided in the Bank's Capital Plan and applicable Regulations, membership may be terminated through voluntary withdrawal, through acquisition by another member or non-member institution, or through involuntary termination by action of the Dallas Bank's Board of Directors. An institution whose membership has been terminated for any reason will not be eligible to become a member of any FHLBank for a period of five years following the date membership was terminated and all of the member's stock was redeemed or repurchased. A member may voluntarily withdraw from membership in the Dallas Bank by providing five (5) years written notice, in which case the withdrawal notice will also serve as a stock redemption notice. Otherwise, the five-year stock redemption period will begin upon termination of membership.

### **MERGERS & ACQUISITIONS**

Any mergers or acquisitions involving Bank members or customers should be reported to the Bank so that appropriate changes can be made to Bank records, enabling the Bank to handle member and customer transactions in an expeditious manner. If a member institution acquires another member, the acquired institution's advances may be transferred to the acquiring member or prepaid, in accordance with the Bank's prepayment policy. In the case of acquisitions of a member by a non-member, the acquiring member may submit an application to become a Bank member and keep current advances outstanding; may prepay such advances in accordance with the Bank's prepayment policy; or may enter into an agreement with the Bank providing for the liquidation of the acquired institution's debt to the Bank. If the successor does not become a member of the Bank, the successor will be required to hold the stock of the Bank of which it is not a member so long as the successor has outstanding debt owed to the Bank.

## **MAINTENANCE OF OPERATIONS & SYSTEMS**

The Chief Executive Officer (CEO) is responsible for the maintenance of appropriate systems, procedures, internal controls and operational and personnel capacity to provide a safe and efficient member product delivery system. The CEO relies on experts from areas such as Banking Operations and Support Services, Corporate Administration and External Affairs, Member Sales and Capital Markets, Accounting, Research and Planning, and Risk Management. The Chief Risk Officer is responsible for the development of the methodology for measuring credit, market and operational risks. The Director of Internal Audit is responsible for determining the effectiveness and integrity of the controls, that the policies and delegated responsibilities are actually being followed, and the resulting processes are effective.

## **INFORMATION**

### **ADDITIONAL COPIES**

For additional copies of this Policy or related materials, please contact the Member Sales and Capital Markets Group at the Federal Home Loan Bank of Dallas.

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