

POLICY TITLE: ANTI-PREDATORY LENDING POLICY

APPROVED BY: BOARD OF DIRECTORS

APPROVAL DATE: September 30, 2020

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**I. INTRODUCTION**

The mission of the Federal Home Loan Bank of Chicago (“Bank”) is to partner with our member shareholders in Illinois and Wisconsin to provide competitively priced funding, a reasonable return on their investment in the Bank and support for community investment activities. This includes support for the expansion of affordable and equitable homeownership through products and services such as secured financing and mortgage purchases.

The Bank recognizes that predatory lending practices, including higher-priced mortgages, are inconsistent with advancing homeownership. To discourage predatory lending, the Bank has established this Anti-Predatory Lending Policy (“Policy”) that applies to both collateral pledged to the Bank and mortgage loans the Bank acquires through the MPF<sup>®</sup> Program.

**II. DEFINITIONS**

The following definitions apply to capitalized terms used in this Policy:

**Collateral:** Residential mortgage loans or mortgage-backed securities pledged by Members to the Bank.

**Higher-Priced Mortgage Loan:** A mortgage loan that is considered to be a higher-priced mortgage loan according to Regulation Z (12 CFR Part 1026) implementing the Truth in Lending Act.

**Interagency Guidance:** The *Interagency Guidance on Nontraditional Mortgage Product Risks* (issued October 4, 2006) and the *Statement on Subprime Mortgage Lending* (issued on July 10, 2007) (collectively, the “Interagency Guidance”) issued by the Office of the Comptroller of the Currency, Office of the Thrift Supervision, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and the National Credit Union Administration.

**Members:** Bank members and, if applicable, their affiliates pledging Collateral on their behalf to the Bank or Bank members that sell mortgage loans to the Bank under the MPF Program.

**MPF Loans:** Residential mortgage loans purchased by the Bank under the MPF Program.

**MPF Program:** Mortgage Partnership Finance<sup>®</sup> (MPF<sup>®</sup>) Program.

**Nontraditional Mortgage Loan:** A held for investment closed-end, first-lien or a simultaneous second-lien residential mortgage secured by a 1-4 family residential property that allows the borrower to defer the payment of principal and interest, such as, for example: interest-only mortgage, payment-option adjustable rate mortgage, and negative amortization mortgage.

**Predatory Mortgage Loan:** A mortgage loan that is considered to be predatory according to federal, state or local laws, rules and regulations (collectively, “Anti-Predatory Lending Laws”). This definition also includes any mortgage-backed securities that consist of Predatory Mortgage Loans.

### **Subprime Mortgage Loan:**

**For Collateral:** A held for investment, first-lien mortgage loan or simultaneous second-lien loan secured by a 1-4 family residential property made at the time of origination to a borrower with:

- A representative FICO score of 660 or below; or
- If a FICO score is not available, a total debt-to-income (DTI) ratio of 50% or greater; or
- Any loan where both a FICO and DTI ratio are not available.

Subprime Mortgage Loans do not include loans pledged by the member as held-for-sale or 1-4 family investor properties underwritten using a debt service coverage ratio (i.e., rental cash flows) rather than a DTI.

**For MPF Loans:** A first-lien mortgage loan or a simultaneous second-lien loan secured by a 1-4 family residential property made at the time of origination to a borrower with:

- A representative FICO score of 620 or below; or any mortgage loan with a representative FICO score between 620 and 660 that does not meet applicable laws and regulations, including Interagency Guidance, or conform to the “prime” underwriting standards set forth in the MPF Guides; or
- If a FICO score is not available:
  - A DTI ratio of 43% or greater for a conventional mortgage loan underwritten manually; or
  - Any DTI ratio for a conventional mortgage loan underwritten with Fannie Mae or

Freddie Mac's automated underwriting system ("AUS") that received a recommendation/decision that the loan is not acceptable and eligible for sale to the respective agency.

Subprime Mortgage Loan does not include MPF Loans originated under an affordable housing or government agency insured/guaranteed program (FHA, VA, HUD or RHS).

### **III. POLICY**

#### **A. PREDATORY MORTGAGE LOANS**

The Bank will not give collateral value for a Predatory Mortgage Loan or knowingly purchase a Predatory Mortgage Loan.

In addition to complying with Anti-Predatory Lending Laws, Collateral and MPF Loans **must not**:

- Require the borrower to obtain prepaid, single-premium credit life, credit disability, credit unemployment or other similar credit insurance as a condition of the loan;
- Contain a mandatory arbitration provision with respect to dispute resolution;
- Charge a prepayment penalty for paying off the loan;
- Violate the Home Ownership and Equity Protection Act of 1994 and its implementing regulations (collectively, "HOEPA Requirements");
- Violate the prohibited acts or practices in connection with Higher-priced Mortgage Loans set forth in Regulation Z (12 CFR Part 226) implementing the Truth in Lending Act;
- Violate the Ability to Repay requirements set forth in Regulation Z (12 CFR Part 1026) implementing the Truth in Lending Act;
- Violate the disclosure requirements set in forth in Regulation X (12 CFR Part 1024) implementing the Real Estate Settlement Procedures Act and Regulation Z (12 CFR Part 226) implementing the Truth in Lending Act;
- Be identified by a Member's primary regulator as having predatory lending characteristics;
- Be an MPF Loan that is ineligible for inclusion in a structured finance transaction due to a rating agency's determination that it cannot rate a transaction which includes such loan; and
- Be an MPF Loan that fails to comply with any requirement of the MPF Program relating to predatory lending, including without limitation, any requirements contained in the MPF Guides.

#### **B. SUBPRIME MORTGAGE LOANS, NONTRADITIONAL MORTGAGE LOANS AND HIGHER-PRICED MORTGAGE LOANS**

##### **1. Collateral**

Only mortgage loans and private label mortgage backed securities ("PLMBS") meeting the criteria below are eligible to be Collateral.

##### **a) Subprime and Nontraditional Mortgage Loans**

Subject to meeting the eligibility requirements set forth in the Collateral Guidelines, Subprime Mortgage Loans and Nontraditional Mortgage Loans are eligible to be pledged to the Bank as collateral if they meet one of the following criteria:

- The Subprime Mortgage Loan or Nontraditional Mortgage Loan was originated or acquired by the Member on or prior to July 10, 2007; or
- The Subprime Mortgage Loan or Nontraditional Mortgage Loan was originated or acquired by the Member after July 10, 2007 and the loan is in full compliance with the Interagency Guidance.

Members are required to certify to the Bank that all Subprime Mortgage Loans and Nontraditional Mortgage Loans pledged as Collateral comply with this Policy and all aspects of the Interagency Guidance.

Eligible first-lien Subprime Mortgage Loans will be subject to an additional discount factor as outlined in the Collateral Guidelines while eligible first-lien Nontraditional Mortgage Loans will be subject to an additional discount factor if the concentration exceeds 85% of a Member's total pledged 1-4 family residential mortgage unpaid principal balance.

For second-lien mortgages, the Bank's margin for all second-lien mortgages, regardless of the actual concentration level, already includes a discount factor for the additional risk of subprime and non-traditional mortgages loans.

b) Higher-Priced Mortgage Loans

Loans identified as Higher-Priced Mortgage Loans may be acceptable provided:

1. The Member is identified as exempt from escrow requirements for serving a rural or underserved area; or
2. Closing disclosures stipulate escrow accounts are established and maintained as follows:
  - a. Originations prior to January 1, 2014: One (1) year
  - b. Originations on or after January 1, 2014: Five (5) years

c) Private Label Mortgage Backed Securities (PLMBS)

PLMBS are eligible to be Collateral if they meet one of the following criteria:

1. The PLMBS was acquired by the Member on or prior to July 10, 2007; or
2. The PLMBS was acquired by the Member after July 10, 2007 and one of the following:
  - a. The issuer of the PLMBS provides representations and warranties to the Bank that the underlying mortgages comply with all aspects of the Interagency Guidance; or
  - b. The issuer of the PLMBS or the prospectus confirms that the underlying loans were underwritten evaluating the borrower's ability to repay on a fully indexed basis; or
  - c. The current unpaid principal balance of loans that meet any of the criteria below do not exceed 5% of the total current unpaid principal balance:
    - i. The FICO score of the borrower at origination was 660 or below;

- ii. If a FICO score is not available, the Debt-to-Income ratio at origination was above 50% unless the loan is seasoned greater than 5 years and is currently performing; or
- iii. The loans are comprised of closed end, adjustable-rate first-lien, or a simultaneous second-lien residential mortgage loan that allows the borrower to defer payment of principal or interest.

For any PLMBS that contain any loans meeting the criteria in 2.c above, the unpaid principal balance will be subtracted prior to calculating the Collateral Loan Value (as defined in the Collateral Guidelines).

## 2. MPF Loans

### a) Subprime Mortgage Loans

The MPF Program is an “A” quality or “prime” mortgage program, approved by the FHFA, meaning that Subprime Mortgage Loans are not eligible for sale or purchase through by the Bank.

### b) Nontraditional Mortgage Loans

Nontraditional Mortgage Loans are not eligible for sale or purchase by the Bank.

### c) Higher-priced Mortgage Loans

Higher-Priced Mortgage Loans are not eligible for sale or purchase by the Bank.

## IV. MONITORING

The Bank monitors Members’ compliance with this Policy through its Anti-Predatory Lending Monitoring Procedures as follows:

### For Collateral

1. Member Credit monitors Member regulator and government agency examination reports, supervisory agreements, memoranda of understanding, or cease and desist orders pertaining to predatory lending practices, subprime and nontraditional mortgages;
2. Collateral Operations requires Members to certify periodically that Collateral meets the requirements of this Policy;
3. Members reporting their pledged loans on a listing file may be subject to additional discounts based on the loan level data provided on a periodic basis. Loans where FICO and DTI information is not provided will be assessed the applicable discount of a Subprime Mortgage Loan;
4. Markets Credit monitors the levels of pledged Nontraditional Mortgage Loans Members have identified in periodic Collateral reporting and advises Collateral Operations of any change to Collateral discounts;
5. Collateral Verifications reviews Collateral as part of the CVR process to ensure compliance with this Policy and the Interagency Guidance, and gathers data during reviews that is used to identify Subprime Mortgage Loans and Nontraditional Mortgage Loans that may be subject to additional discounts as outlined in the Collateral Guidelines.

## **For MPF Loans**

1. On an annual basis, Seventh District Account Management reviews reporting by Members of any regulator and government agency examination findings pertaining to predatory lending practices, subprime and nontraditional mortgages;
2. Member Credit monitors Member regulator and government agency examination reports, supervisory agreements, memoranda of understanding, or cease and desist orders pertaining to predatory lending practices, subprime and nontraditional mortgages
3. MPF Risk Management requires Members to implement and maintain a quality control (“QC”) program to verify MPF Loans are in compliance with this Policy; and
4. MPF Operations performs QC reviews on sampled MPF Loans to verify compliance with this Policy.

## **V. NONCOMPLIANCE WITH POLICY**

In the event Collateral is found not to comply with this Policy, in addition to all available rights and remedies at law or in equity, the Bank will value such Collateral at zero and/or require the Member to substitute eligible Collateral and indemnify the Bank for any damage incurred by the Bank in connection with any ineligible Collateral.

In the event an MPF Loan is found not to comply with this Policy, the Bank will, in addition to all available rights and remedies at law or in equity, require the Member to immediately repurchase the MPF Loan and indemnify the Bank for any damages incurred by the Bank in connection with any ineligible MPF Loan.

In addition, the Bank may require the Member to undertake a review of its policies, practices and procedures for compliance with Anti-Predatory Lending Laws and this Policy.

## **VI. COMMUNICATION**

In order to ensure effective communication to all interested parties, this Policy is included in the Bank’s Member Products and Credit Policy and is posted on the Bank’s public website. Additionally, all new Members receive a copy of the Policy at the time of application to become a Member.

**VII. ROLES AND RESPONSIBILITIES**

The parties responsible for implementing, monitoring and managing this Policy are the Bank departments responsible for the monitoring duties stated in the Monitoring section of this Policy.

This Policy is reviewed and approved annually by the Board of Directors of the Bank.

APPROVED BY THE BOARD OF  
DIRECTORS THIS 30<sup>th</sup> DAY OF  
SEPTEMBER, 2020

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Its Corporate Secretary