Loan Collateral Eligibility: eNotes and Other Electronic Documents

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Members of FHLBank Topeka continue to transform their lending channels through the implementation of new and innovative technologies in pursuit of efficiencies, cost savings and an improved borrower experience. FHLBank is committed to supporting our members on this journey as we recently implemented the **Member Collateral Electronic Promissory Notes (eNotes) Acceptance Requirements and Guidelines**.

The purpose of this document is to address and answer questions that focus on the deployment of new technology and its impact on loan eligibility. Our goal is to ensure all members have the information they need to inform the best business decisions for their financial institution while also optimizing collateral capacity with FHLBank.

Commonly Used Terms

eNote: A promissory note that is originated, signed and stored electronically according to the standards for a transferable record. An authoritative electronic copy of the note exists in a file format known as a MISMO SMARTDoc and is registered with an eRegistry and stored in an eVault. In order to be acceptable as pledged collateral, an eNote must be a valid and enforceable transferable record pursuant to the Uniform Electronic Transactions Act ("UETA"), the Electronic Signatures in Global and National Commerce Act ("ESIGN") or otherwise applicable law. All eNotes must meet FHLBank's acceptance requirements and guidelines.

MERS eRegistry: The MERS® eRegistry is the mortgage industry's "system of record" for holders of eNotes. A national eNote registry is part of the industry's response to develop systems that can rely upon the UETA and ESIGN to establish legal effectiveness of electronic notes for mortgage loans. The registry identifies the current Controller (holder) and Location (custodian) of the authoritative copy of an eNote. The Controller of an eNote can have the equivalent rights as that of a "holder in due course" of a paper negotiable promissory note.

MISMO: MISMO® is the standards development body for the mortgage industry. MISMO developed a common language for exchanging information for the mortgage finance industry. MISMO is a subsidiary of the Mortgage Bankers Association and MISMO stands for *Mortgage Industry Standards Maintenance Organization*.

eVault: An eVault is a specialized document storage system, sometimes referred to as a data warehouse, that holds eNotes (and other digital loan documents) and manages their transfer across vaults. eVault technology works by permanently binding electronic signatures to a

document and creating a tamper-proof audit trail that demonstrates ownership and compliance.

Transferable Record: An electronic record as described in Section 16 of UETA and in Title II, Section 201 of ESIGN.

Hybrid Closing: A loan where some mortgage loan documents have been signed electronically, but a paper note and note-related items have been executed with a wet ink signature.

Wet Ink Signature: An original signature written on a piece of paper, as opposed to a fax copy or to an agreement offered verbally or electronically.

Imaged Note: Loan where a wet ink signature paper note had been executed and electronically scanned.

Questions and Answers

Q1: What eligible loan types will FHLBank accept as eNotes?

A1: Currently, FHLBank accepts eNotes as collateral on the following one-to-four family residential mortgage loan (one-to-four family) asset classes:

- Conventional One-to-Four Family Residential Real Property;
- Held-For-Sale Mortgages on One-to-Four Family Residential Real Property; and
- Second Mortgages on Residential One-to-Four Family Property

Q2: What is preventing FHLBank from accepting eNotes in other eligible asset classes?
A2: The infrastructure and market standards required to support eNotes in other asset classes is not yet established like it is for one-to-four family loans. There are many roadblocks to navigate including:

- The MERS eRegistry is an integral part of FHLBank's acceptance requirements as it allows FHLBank to control and perfect our security interest in one-to-four family loans . At this point in time, the MERS eRegistry does not accept eNotes for other asset classes and there is no other active industry registry that will accept eNotes for non-one-to-four family loans.
- The lack of defined and standardized documents prevents validation of the electronic record for other asset classes. The lack of standardized documentation creates interoperability issues between any potential registry and an eVault to validate the eNote record.

Q3: If as a lender I can legally foreclose on a promissory note executed with a digital signature that does not meet the eNote requirements, why will FHLBank not accept the loan as eligible collateral?

A3: FHLBank acknowledges that documents executed with a digital signature may be enforceable provided they comply with all applicable laws including ESIGN and UETA. However, pledging these types of loans as collateral to FHLBank present several issues:

- If the member is required to deliver loan documents to FHLBank, FHLBank would not be able to obtain control over the loan; and
- FHLBank's inability to liquidate the loans in the case of a default under the Advance, Pledge and Security Agreement.

Without the infrastructure, documents and technology embedding the required protections in the closing process used by members to originate eNotes, FHLBank has no way of confirming that they are holding the true original note and additionally that the note has not been altered. FHLBank would have no control or protection in the process as a secured lender.

Q4: For eligible one-to-four family eNotes, why does FHLBank require delivery of the authoritative copy of the eNote to their eVault? If I am a member who is not currently required to pledge on delivery for non-eNotes, why then do I have to deliver an eNote*?*
A4: FHLBank require eNotes to be delivered to our eVault for the following reasons:

- Delivery of the eNote provides absolute certainty that FHLBank is in control of the authoritative copy. FHLBank's requirements are heavily reliant upon the MERS eRegistry and designation as secured party. Possession of the eNote creates redundancy of control that protects FHLBank in the event of a MERS system failure; and
- It is impractical for FHLBank to perform due diligence, onboard and continually monitor every eVault vendor solution that is offered in the marketplace. By requiring delivery of the authoritative copy of the eNote, FHLBank avoids potential interoperability issues with our eVault and member technology solutions. We are hopeful that in the future the mortgage industry can create a designation or certification for vendors that potentially alleviates this issue.

Q5: Do eligible one-to-four family eNotes receive the same lending value as traditional papernotes?
A5: Yes, FHLBank will apply the same lending value for both traditional paper-executed notes and eNotes. FHLBank's lending values are published in the **Member Products and Services Guide** and lending values are subject to change in accordance with any future policy updates.

Q6: Will FHLBank accept hybrid closing loans for all loan types?
A6: Yes, FHLBank will accept hybrid closing loans, where all documents with the exception of the original promissory note can be executed electronically or imaged, for all eligible loan types.

Q7: Why does FHLBank need to be able to take possession of a physical note or eNote if we have an image?
A7: In order to protect the interests of the cooperative, FHLBank may require members to deliver loan collateral so that in the event of a liquidation or bankruptcy FHLBank's security

interest in the loan collateral is protected. Without being able to take possession of an original note or eNote, FHLBank runs the risk that its interest in the collateral may be compromised during the liquidation process.

Q8: When will FHLBank be able to accept imaged notes where the original is not retained?
A8: FHLBank has no plans to allow members to pledge loans where the original note has not been retained and only an imaged note is available. An imaged note does not meet FHLBank's requirements as an acceptable original note or eNote due to the fact that it fails to meet the requirements established by ESIGN and UETA as a transferrable record.

Q9: Will FHLBank accept modifications, renewals, extensions or any other change in terms to the original note if executed with a digital signature that is not in compliance with the Member Collateral Electronic Promissory Notes (eNotes) Acceptance Requirements and Guidelines?
A9: At this time, FHLBank does not accept digital signatures for original notes or modifications thereof unless they comply with the eNotes requirements and guidelines.

Q10: Who can I contact if I have questions about the eNote acceptance requirements?
A10: If you are evaluating changes to your lending channels to adopt eNotes or have already implemented eNotes and have questions about FHLBank's acceptance requirements, we encourage you to contact Financial Services at 800.905.2733. You can also contact your Regional Account Manager at any time for assistance. FHLBank's **eNotes Readiness Checklist** is available for additional information.