

## Section 5.07 - Loans Secured by Marketable Securities

**Introduction**

This section covers loans to consumer and business borrowers that are secured by marketable financial assets such as stocks, bonds and mutual funds.

**Policy**

Loans secured by properly margined, readily marketable securities are desirable loans. It is the responsibility of the relationship manager (RM) or Consumer Loan Portfolio Manager of the Retail Bank to understand the nature of the securities taken as collateral. The value of securities securing loans of this type will be monitored at least monthly to insure adequate margins. These loans require a high degree of commitment from the RM or Consumer Loan Portfolio Manager to service the account and to monitor the collateral in a timely and conscientious manner. Borrowers will be routinely informed that the pledge of additional collateral, principal reduction or retirement of the debt via collateral liquidation must promptly remedy margin shortfalls. Compass Bank will exercise control over the collateral through actual possession or a control agreement with a custodian.

If a loan secured by marketable securities cannot or will not be monitored in accordance with this policy, then the loan should be approved under the lender's unsecured lending authority.

Advance rate limitations of Federal Reserve Board Regulation 'U' will be observed in all cases.

Extensions of credit secured by marketable securities should be governed by either a loan agreement, letter agreement or collateral maintenance agreement that establishes, among other things, default and liquidation ratios and a provision for a cure period. An advance rate ratio level lower than the default ratio may be appropriate to allow for some market variance. Generally, a cure period of no more than five (5) business days is recommended with the exception of the liquidation ratio, where the cure period should be no greater than one (1) business day. These ratios should not be less than those reflected in the 'Required Margins' section of this policy.

**References**

Federal Reserve Board Regulation U: Credit by Banks of Persons other than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stocks

**Exhibits**

Exhibit "K" - Federal Reserve Board U-1 Form

Exhibit "N" - Restricted Stock Checklist

**Related Policies**

Section 5.01 - Consumer Loans - Common Considerations

**Regulation 'U'**

Regulation U sets out requirements for lenders who extend credit secured by margin stock. It restricts the amount of credit that may be extended for the purpose of purchasing or carrying margin securities

(purpose credit) to 50 percent of the current market value of the margin stock if the credit is secured directly or indirectly by that stock or any other margin stock. A financial institution may continue to maintain any credit initially extended in compliance with the regulation regardless of a reduction in the customer's equity resulting from a change in market price or a change in the status of the security securing the purpose credit.

Purpose credit loans that are unsecured are also covered by Regulation U. If an unsecured purpose credit loan is made to the same customer subsequent to a margin stock secured purpose credit loan, then the combined credit extended for both loans cannot exceed the 50 percent maximum loan value. If the unsecured purpose credit loan was made previous to the margin stock secured purpose credit loan, then upon extension of the margin stock secured purpose credit transaction, the credits are to be combined and treated as a single credit under Regulation U.

Covered loans include any transaction directly or indirectly secured by margin stock that allows the borrower to maintain, reduce, or retire debt originally incurred to purchase a security that is currently a margin stock. Indirectly secured transactions include transactions covered by non-encumbrance agreements rather than a direct pledge.

Margin stocks include the following:

- Any equity security trading on a national securities exchange including all issues traded on the New York Stock Exchange (NYSE), or the American Stock Exchange (ASE);
- Any over-the-counter (OTC) security trading in the National Market tier of the NASDAQ Stock Market;
- Any debt security convertible into a margin stock or carrying a warrant or right to subscribe to or purchase a margin stock;
- Shares of most mutual funds, unless 95 percent of the assets of the fund are continuously invested in U.S. government, agency, state, or municipal obligations.

Regulation U has two important requirements for the Bank and relationship managers:

- The relationship manager must obtain from the borrower, and complete, a purpose statement, form U-1 (see Exhibit "K"), for each loan secured by margin stock. Both the borrower and the relationship manager must sign the form. The form is not filed with the Federal Reserve, but must be retained for at least three years after the termination of the credit. A copy of the U-1 form should be retained with the collateral file for this purpose.
- The relationship manager must adhere to margin requirements of 50 percent for all purpose loans secured by margin stock. A purpose loan is any credit for the purpose, whether immediate, incidental, or ultimate, of buying or carrying margin stock.

A non-purpose loan is a loan made for any purpose other than purchasing or carrying margin stock. Regulation U places no restriction on the amount of credit that may be extended on non-

purpose loans secured by margin stock. See "Required Margins" section of this policy for the Bank's limits.

Penalties for non-compliance are severe. Requirements of Regulation U will be strictly observed.

#### Acceptable Securities

When debt or equity securities are held as collateral, the securities should have the following characteristics to be considered desirable collateral:

- Issued by a quality corporation or by a federal, state, or local government entity.
- Publicly priced and traded on one of the major national securities exchanges.
- Supported by a broad, active, liquid market where the securities value at the 52-week low is greater than \$10 per share.

The following types of stocks and securities have features that limit their value as collateral. Loans secured with this type of collateral should be underwritten with primary emphasis on the financial strength, repayment capacity and stability of the borrower:

- Debt and preferred stock with less than investment grade ratings.
- Securities that are restricted as to their marketability.
- Stock in a company that is not publicly traded.
- Closely held or unlisted stocks.
- Non-registered Securities.
- Stocks whose trading value reflects light trading and whose 52-week low is less than \$10 per share.
- Hedge Funds.
- Actively Traded Accounts not managed by Compass Brokerage

It is the responsibility of the relationship manager to fully understand the nature of the security taken as collateral.

Desirable securities include:

- Stocks traded on the NYSE, ASE and NASDAQ National Market System
- US Government obligations
- State, county and municipal obligations rated 'Baa' or better
- Corporate obligations rated 'A' or better

Over the counter stocks that are not traded on the NASDAQ National Market System should be evaluated on a case-by-case basis. Factors such as historical price volatility, average daily trading volume and the number of stockholders should be evaluated. This investigation should be documented in the underwriting memo. Over the counter stocks should be depended upon as collateral only if this investigation provides a high degree of certainty that the volume of stock taken as collateral can be readily liquidated over a short period of time.

Securities such as collateralized mortgage obligations, notes supported by securitized loans and similar asset backed securities are not generally acceptable as collateral. These securities generate unpredictable distributions to the owner as the underlying loans are repaid. This return of principal causes the value of the security to decline at an unpredictable and sometimes rapid rate.

Closely held or illiquid stocks, unrated debt instruments and annuities are not to be regarded as marketable securities within the context of this policy.

#### Restricted Stock

It is also important to investigate and understand any restrictions placed on the sale of stock owned by insiders of the issuer. Rule 144 of the Securities Act of 1933 covers the sale of control securities and restricted securities. These types of securities are not recommended as collateral and it is important to know that there are restrictions placed on the sale of these stocks.

If a situation arises where the Bank is considering taking this type of stock as collateral, the Bank's Legal Department should be consulted regarding these restrictions and the impact to the Bank in the event liquidation becomes necessary. If a decision is made to take this stock as collateral, the advance rate must not be greater than 50 percent; the default ratio 55 percent; and the liquidation ratio 60 percent.

Control securities are owned by directors, officers or individuals who own 10% or more of any type of outstanding securities of a company (or financially dependent relatives of such individuals). Individuals who have a control relationship with an issuer are considered affiliated persons. Restricted securities are those acquired through some means other than a registered public offering. A security purchased in a private placement is a restricted security. Exhibit "N" - Restricted Stock Checklist should be used to identify when stock may be a restricted or control stock.

Loans of more than \$500,000 secured by restricted stock must be approved by an individual with Class "B" or higher lending authority.

#### Required Margins

Maximum advance rates on loans secured by marketable securities will vary based on the quality and liquidity of the collateral.

All loans secured by certificated marketable securities will be set up for tracking on the Stock Margin System unless specifically exempted by an individual with adequate authority to approve the loan on an unsecured basis.

The RM or Consumer Loan Portfolio Manager is specifically responsible for reviewing and evaluating margins on any loan secured by marketable securities. This review should be performed no less than monthly and more frequently if circumstances warrant.

Unless further restricted by Regulation "U", maximum loan to value for the various types of securities are as follows:

Compass Bank Credit Policy Manual

Section 5.07 - Loans Secured by Marketable Securities

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	Advance Rate	Default Ratio	Liquidation Ratio
Compass Bancshares Stock	80%	85%	90%
NYSE, AMEX, NASDAQ listed stocks	75%	80%	85%
NASDAQ Small Capitalization Issues (OTC) - Non-investment grade	60% or less	70% or less	80% or less
US Government Obligations & securities Agencies	85%	90%	95%
State, County, & Municipal obligations with a rating of "Baa" or better	80%	85%	90%
Corporate obligations/bonds rated 'A' or better	80%	85%	90%
Corporate obligations/bonds rated below 'A'	60%	70%	80%
Mutual Funds	70%	75%	80%
Restricted or Limited Marketability (1)	50%	55%	60%
"Penny" Stocks (stocks valued at under \$10 per share on 52-week average) (3)	25%	35%	50%
Actively Traded Accounts (4)	50%	55%	60%
All Regulation 'U' Transactions	50%	(2)	(2)

(1) See 'Acceptable Securities' section of this policy regarding restrictions.

(2) Default and Liquidation Ratios of Regulation U transactions should be the consistent with the type of security and comply with the ratios indicated in the above table.

(3) Stocks valued at under \$5 per share on 52-week average are not eligible under this policy and should not be taken as collateral, unless loan is approved under unsecured lending authority.

(4) Actively Traded Accounts are defined as investment/brokerage accounts where trading is allowed and the stock/investment mix is subject to change at any time.

Loans that exceed these margin limitations due to price fluctuations are to be promptly brought back into margin. Remedies include a principal reduction, the pledge of additional collateral or liquidation of collateral to repay the loan.

The risks associated with actively traded accounts in which Compass exerts no control over trading should be carefully evaluated. Advance rates in excess of those outlined in this section require special approval. These types of exceptions will typically be made only on accounts that are professionally managed with a formally stated investment philosophy that provides a high degree of certainty with respect to the

types of assets that are likely to be held in the account. Loan Administration must approve all exceptions to the advance rate limitations on actively traded accounts.

### Control of Collateral

Perfection of a security interest in marketable securities requires the filing of an UCC-1 filing statement and the exercise of control over the securities. In the case of certificated securities, this control is achieved by physical possession of the securities.

When possible certificated marketable securities will be converted into a book entry transaction and held in an internal brokerage account. This will gain much efficiency and give the Bank greater control over the collateral to prevent loss due to fraud, stock splits, etc.

If physical securities are held, they must be held in the Safekeeping department. The decision to hold physical securities outside of the Safekeeping Department is an exception to this policy and must be approved by Loan Administration.

In the case of uncertificated securities, either of the following is required: a) the account is put in the Bank's name or b) a control agreement is executed by the Bank, the borrower and the brokerage firm. The Bank's control agreement should be used and executed by an officer of the Bank, the borrower and a representative of the brokerage firm. In the event that the brokerage firm insists that their control agreement be used, it will be considered an exception to this policy. The Bank's legal counsel should be consulted prior to execution of the third party control agreement and Loan Administration must approve the use of the third-party control agreement. A simple bailee letter is not sufficient to establish control.

Furthermore, loans of \$500,000 or more secured by actively traded accounts held at institutions other than Compass Brokerage must be approved by an individual with Class 'B' lending authority.

### Liquidation Process

It is the Bank's policy to allow market movement in stocks and securities valued as a collateral asset. Therefore, the Bank has put in place default and liquidation ratios to protect the bank from abnormal market declines. The relationship manager must monitor these ratios. Moreover, cure periods must be designated at each level prior to the liquidation ratio. No cure period beyond one (1) business day should be provided once a security has reached or exceeded the liquidation ratio. Further, if the liquidation ratio is met during a cure period actively underway (five (5) day cure period for default ratio), the liquidation ratio supercedes and the bank should have immediate rights (one (1) business day cure period) to sell the stock or securities with no further notice required.

In the event that a default or liquidation ratio has been met, the relationship manager must immediately review all documentation to ensure adequacy. The relationship manager must also notify Credit Administration and the Compass Bank Legal Department and immediately begin the process of liquidation. The liquidation process should include appropriate notification to the Borrower, as advised by

legal counsel, and consultation with Compass Brokerage as liquidation agent. Proceeds from the liquidation will be placed into a specifically designated Compass Bank account and debited for repayment of the subject loan within the most expedited timeframe possible. Any deviation from this policy requires the approval of Loan Administration.

If the securities are not held by Compass Bank, then the broker is to be notified and instructed in writing to sell the securities and wire the net proceeds into a specifically designated Compass Bank account to be debited for repayment of the subject loan.

#### Lost & Stolen Securities

The relationship manager shall determine whether or not securities taken as collateral have been reported as missing, lost, counterfeit or stolen, in all instances where the aggregate face value (in the case of bonds) or market value (in the case of stocks) of the securities to be used as collateral is greater than \$10,000. The inquiries are to be made to Securities Information Center ("SIC") or its designee and is to be documented in the bank's records/credit files.

The Securities and Exchange Commission requires that inquiries be made whenever a security is presented that is in bearer form, street name or registered to a third party. Inquiries are to be made to the Security Clearance area of the Safekeeping Department. Even when not required, an inquiry is recommended in any case where the borrower is not well known.

#### Exceptions

The requirements of Regulation U may not be waived. Any deviation from the "Liquidation Process" section of this policy requires at minimum the approval of Loan Administration. As indicated in the "Control of Collateral" section, Loan Administration must approve if physical securities are to be held and if the securities are held outside of the Safekeeping Department.

Individuals with Class 'C' or higher lending authority may make exceptions other than those indicated above to this policy within their unsecured dollar lending limits.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
Statement of Purpose for an Extension of Credit Secured by Margin Stock  
(Federal Reserve Form U-1)

\_\_\_\_\_  
Name of Bank

This report is required by law (15 U.S.C. §§ 78g and 78w; 12 CFR 221).

The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

Public reporting burden for this collection of information is estimated to average 10 minutes per response, including the time to gather and maintain data in the required form and to review instructions and complete the information collection. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100-0011), Washington, DC 20503.

**Instructions**

1. This form must be completed when a bank extends credit in excess of \$100,000 secured directly or indirectly, in whole or in part, by any margin stock.
2. The term "margin stock" is defined in Regulation U (12 CFR 221) and includes, principally: (1) stocks that are registered on a national securities exchange; (2) debt securities (bonds) that are convertible into margin stocks; (3) any over-the-counter security designated as qualified for trading in the National Market System under a designation plan approved by the Securities and Exchange Commission (NMS security); and (4) shares of most mutual funds, unless 95 per cent of the assets of the fund are continuously invested in U.S. government, agency, state, or municipal obligations.
3. Please print or type (if space is inadequate, attach separate sheet).

**Part I To be completed by borrower(s)**

1. What is the amount of the credit being extended? \_\_\_\_\_

2. Will any part of this credit be used to purchase or carry margin stock?  Yes  No

If the answer is "no," describe the specific purpose of the credit. \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

I (We) have read this form and certify that to the best of my (our) knowledge and belief the information given is true, accurate, and complete, and that the margin stock and any other securities collateralizing this credit are authentic, genuine, unaltered, and not stolen, forged, or counterfeit.

Signed:

Signed:

\_\_\_\_\_  
Borrower's signature Date

\_\_\_\_\_  
Borrower's signature Date

\_\_\_\_\_  
Print or type name

\_\_\_\_\_  
Print or type name

This form should not be signed if blank.

A borrower who falsely certifies the purpose of a credit on this form or otherwise willfully or intentionally evades the provisions of Regulation U will also violate Federal Reserve Regulation X, "Borrowers of Securities Credit."



**Part II** To be completed by bank only if the purpose of the credit is to purchase or carry margin securities (Part I(2) answered "yes")

1. List the margin stock securing this credit; do not include debt securities convertible into margin stock. The maximum loan value of margin stock is 50 per cent of its current market value under the current Supplement to Regulation U.

No. of shares	Issue	Market price per share	Date and source of valuation (See note below)	Total market value per issue

2. List the debt securities convertible into margin stock securing this credit. The maximum loan value of such debt securities is 50 per cent of the current market value under the current Supplement to Regulation U.

Principal amount	Issue	Market price	Date and source of valuation (See note below)	Total market value per issue

3. List other collateral including nonmargin stock securing this credit.

Describe briefly	Market price	Date and source of valuation (See note below)	Good faith loan value

Note: Bank need not complete "Date and source of valuation" if the market value was obtained from regularly published information in a journal of general circulation or an automated quotation system.

**Part III** To be signed by a bank officer in all instances.

I am a duly authorized representative of the bank and understand that this credit secured by margin stock may be subject to the credit restrictions of Regulation U. I have read this form and any attachments, and I have accepted the customer's statement in Part I in good faith as required by Regulation U\*: and I certify that to the best of my knowledge and belief, all the information given is true, accurate, and complete. I also certify that if any securities that directly secure the credit are not or will not be registered in the name of the borrower or its nominee, I have or will cause to have examined the written consent of the registered owner to pledge such securities. I further certify that any securities that have been or will be physically delivered to the bank in connection with this credit have been or will be examined, that all validation procedures required by bank policy and the Securities Exchange Act of 1934 (section 17(f), as amended) have been or will be performed, and that I am satisfied to the best of my knowledge and belief that such securities are genuine and not stolen or forged and their faces have not been altered.

Signed:

\_\_\_\_\_  
Date

\_\_\_\_\_  
Title

\_\_\_\_\_  
Bank officer's signature

\_\_\_\_\_  
Print or type name

\* To accept the customer's statement in good faith, the officer of the bank must be alert to the circumstances surrounding the credit and, if in possession of any information that would cause a prudent person not to accept the statement without inquiry, must have investigated and be satisfied that the statement is truthful. Among the facts which would require such investigation are receipt of the statement through the mail or from a third party.

**This form must be retained by the lender for three years after the credit is extinguished.**