

Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF[®] Program

Mortgage Partnership Finance Program[®]

Accounting and Regulatory Guidance for FFIEC Reporting Institutions

December 4, 2008

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Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF[®] Program

Today's Topics

- 1) Product Descriptions
- 2) Valuation of Mortgage Servicing Rights, Credit Enhancement Fees Receivable and Credit Enhancement Recourse Liabilities
- 3) Journal entries for recording the loan sale, including MSR, CE Fees Receivable and CE Recourse Liability
- 4) Regulatory Requirements

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MPF Closed Loan Product Descriptions

1. Original MPF

- FHLB provides the first loss account (FLA) which increases at 4 basis points per year
- PFI provides a Credit Enhancement (CE) Obligation to the FHLB
- PFI is paid a fixed Credit Enhancement Fee (CE Fee) for providing the CE Obligation

2. MPF 125

- FHLB provides the FLA which is equal to 100 basis points of the delivered amount
- PFI provides a minimum CE Obligation of 25 basis points based on the delivered amount
- PFI receives a performance based CE Fee for providing the CE Obligation

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MPF Closed Loan Product Descriptions - Continued

3. MPF Plus

- Master Commitments are set to achieve a the equivalent of a AA credit rating
- PFI purchases a supplemental mortgage insurance (SMI) policy that covers part or all of their CE Obligation for a pool of loans
- PFI receive a fixed CE fee to cover the SMI premium and a performance based fee that is accrued and begins payment on the 13th month following the loan sale

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MPF Flow Product Descriptions

1. MPF 100

- FHLB provides the FLA which is equal to 100 basis points of the delivered amount
- PFI provides a minimum CE Obligation of 20 basis points based on the delivered amount
- PFI receives a performance based CE Fee for providing the CE Obligation and the fee is guaranteed for at least two years

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How to Determine if an MSR Asset exists?

- Transfer of loan that meets “sale accounting” requirements – Original MPF, MPF 125 and MPF Plus
- Purchase or assumption of a servicing obligation that does not relate to the financial assets of the servicer – MPF 100

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FAS 156: Accounting for Servicing of Financial Assets

- Must initially recognize MSR at their fair value
- PFI can elect either the amortization method or the fair value method for future reporting of their MSRs
- FAS 156 became effective for fiscal years after September 15, 2006

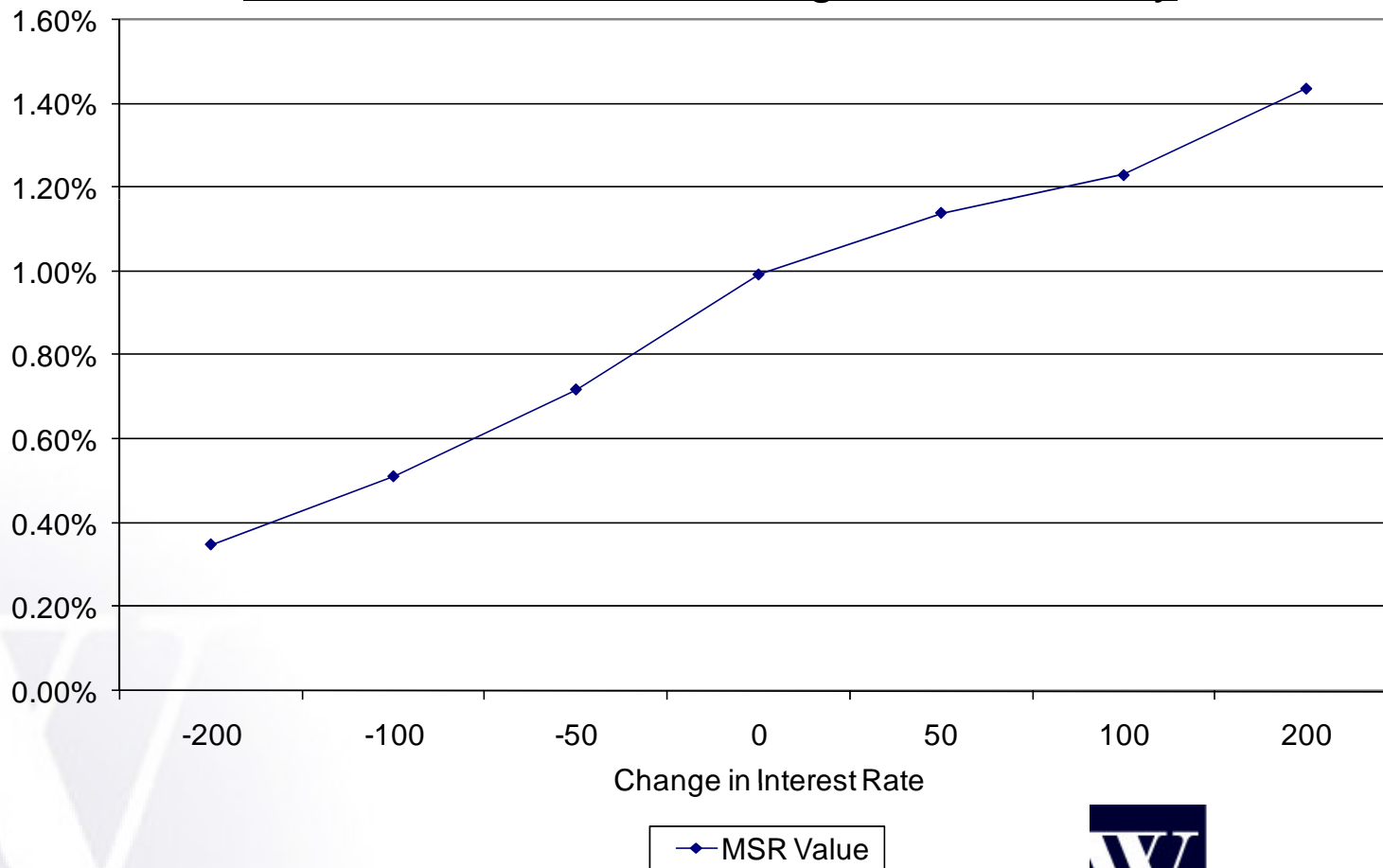
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Mortgage Servicing Right (MSR) Primary Valuation Components

1. The loan amount
2. Servicing fee percentage
3. Ancillary income
4. Expected loan life – prepayment
5. Discount rate
6. Costs to service – market costs
7. Delinquency rate and foreclosure losses
8. Remittance methodology – single vs. multiple
9. Escrow Payment (Tax & Insurance)

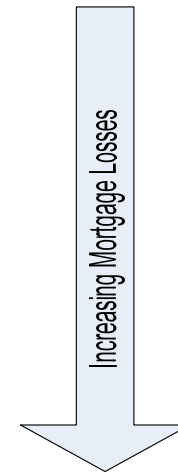
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MSR Yield Curve and Negative Convexity



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MPF Product Credit Structure



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MPF Credit Enhancement Fee

1. Paid to member for assuming credit risk (credit obligation) on mortgage defaults
2. Determined by the quality of the loans at the pool level and the MPF program selected
3. Fee paid monthly over the life of the loans
4. Sensitive to prepayments

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The Primary Valuation Factors of the CE Fees Receivable are:

1. The loan amount
2. The CE Fee percentage – depends upon the program selected
3. The expected life of the loan – sensitive to prepayments
4. The discount rate used to discount the cash flows

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Example: \$100,000 loan (assumptions as of September 30)

	CE Fee Value		
	30 Yr.	20 Yr.	15 Yr.
Original MPF CE Fee %	0.421%	0.390%	0.362%
Original MPF CE Fee \$	\$421.43	\$389.79	\$362.23
MPF 125 CE Fee %	0.199%	0.184%	0.171%
MPF 125 CE Fee \$	\$198.81	\$183.95	\$171.18

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The Primary Valuation Factors of the CE Recourse Liability are:

1. The loan amount
2. The CE Obligation amount – depends on quality of loans delivered
3. The expected life of the loan – sensitive to prepayments
4. The expected default rate
5. The expected severity of actual foreclosure losses
6. The level of credit risk assumed – depends on program selected
7. The discount rate used to discount the cash flows
8. The amount in the First Loss Account (FLA) – depends on program selected

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CE Recourse Liability vs. CE Obligation Amount

There is a difference between the CE Recourse Liability and the CE Obligation Amount

The CE Recourse Liability is related to properly accounting for the loans delivered under the program per Generally Accepted Accounting Principles

The CE Obligation amount is related to the amount of risk based capital that a PFI must hold for regulatory purposes for loans delivered under the program

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Example: \$100,000 loan (assumptions as of September 30)

	CE Recourse Liability		
	30 Yr.	20 Yr.	15 Yr.
Original MPF Recourse Liability Account	-0.057%	-0.053%	-0.049%
Original MPF Recourse Liability Account	-\$57.37	-\$53.17	-\$49.44
MPF 125 Recourse Liability Account	0.000%	0.000%	0.000%
MPF 125 Recourse Liability Account	\$0.00	\$0.00	\$0.00

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Accounting for Loans Sold Under the MPF Program

The discussion which follows are based on general examples. PFIs are strongly encouraged to review the accounting for the program with their external auditors and primary regulators before implementing the accounting described in the presentation, because the facts and circumstances for a particular institution may lead to different accounting and regulatory interpretations.

We further note that for purposes of simplicity, we have omitted the accounting requirements related to the Interest Rate Lock Commitments PFIs make to their borrowers and Forward Sales Commitments a PFI enters into with the FHLB, which are both derivatives.

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Credit Enhancement Recourse Liabilities

FAS Interpretation #45 (FIN #45) states that “when a guarantee is issued as part of a transaction with multiple elements, (such as in conjunction with selling an asset...), the liability recognized at the inception of the guarantee should be an estimate of the guarantee’s fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm’s length transaction with an unrelated party as a practical expedient.

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Recording of the CE Recourse Liability

1. Record the CE Recourse Liability at its Relative Fair Value
2. Record the CE Recourse Liability and the CE Fee receivable at their fair values – FAS 159 election – (Original MPF only)
3. Record the CE Recourse Liability in an amount equal to the CE Fee receivable

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Example: \$100,000 loan sold with an MSR of 1%

Fair Values

Cash proceeds	100,000
Servicing asset	1,000
CE Fees Receivable	400

Net Proceeds

Cash proceeds	100,000
Servicing asset	1,000
Net proceeds	<u>101,000</u>



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Example: MSR at Fair Value and CE Fees
Receivable at Relative Fair Value

	Fair Value	% of Total Fair Value	Allocated Carrying Amount
Loan Receivable	\$ 101,000	99.61%	\$ 100,602
CE Fee Receivable	\$ 400	0.39%	\$ 398
	<u>\$ 101,400</u>		<u>\$ 101,000</u>

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Example #1 – Original MPF: Journal Entries – Relative Fair Value

JE 1	Cash	\$	100,000	
	CE Fees Receivable	\$	398	
	Servicing Asset	\$	1,000	
	Loan Receivable	\$	602	
	CE Recourse Liability	\$		0
	Loan Receivable	\$		100,602
	Gain on Sale	\$		1,398
Record Loan Sale				

JE 2	CE Fees Receivable	\$	2	
	OCI	\$		2
Record CE Fees receivable at fair value				

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Example #2 Journal Entries – FAS 159 Fair Value

JE 1	Cash	\$	100,000	
	CE Fees Receivable	\$	400	
	CE Recourse Liability			\$ 40
	Loan Receivable			\$ 100,000
	Gain on Sale			\$ 360
Record Loan Sale with CE fees and CE obligation at fair value				

JE 2	Servicing Asset	\$	1,000	
	Gain on Sale			\$ 1,000
Record fair value of MSR				

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Fair Value Disclosures

PFIs that elect the fair value method are subject to the increased reporting requirements of FAS 157 and FAS 159

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Example #3 – Original MPF: Journal Entries – Liability = Receivable

JE 1	Cash	\$	100,000	
	CE Fees Receivable	\$	400	
	CE Recourse Liability			\$ 400
	Loan Receivable			\$ 100,000
Record Loan Sale				

JE 2	Servicing Asset	\$	1,000	
	Gain on Sale			\$ 1,000
Record fair value of MSR				

JE 3	Cash	\$	100	
	CE Fees Receivable			\$ 90
	Other Income			\$ 10
Record year one CE fees and amortize discount on liability				

JE 4	CE Recourse Liability	\$	90	
	Other Expense	\$	10	
	Other Income			\$ 100
Recognize fee income and amortize discount on liability				

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How to account for the MSR after initial recording?

FAS 156 allows the asset to be measured and reported in one of two ways:

- 1) Amortization Method
- 2) Fair Value Method

A PFI may select either method, but cannot switch methodologies unless it moves to the Fair Value method at the beginning of the fiscal year before interim financial statements have been released. A PFI cannot go back to the amortization method after it has elected Fair Value.

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Amortization Method

Amortize the MSR in proportion and over the period of estimated net servicing income (level yield method) and assess servicing assets for impairment based on fair value at each reporting date.

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Fair Value Method

- The fair value is determined at each reporting period
- The asset is adjusted to equal its fair value
- The difference is taken into income or expense for that reporting period
- PFIs that hedge their servicing rights portfolios can benefit from the fair value method because the accounting is less complex than under FAS #133. PFIs that do not hedge their portfolios and that elect the fair value method could experience earnings volatility.

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Regulatory Reporting Requirements

FFIEC – Federal Financial Institutions Examination Council

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Federal Home Loan Bank of Chicago
Active Master Commitments - Summary
 funded through 9/30/2008

PFI Number: **XXXX**

ABC Bank

MC Number:

XXXX

Totals for MC Number: **XXXX**

<i>Original (Contracted) C/E:</i>	\$1,500,000.00	<i>MC Pool Amount:</i>	\$45,000,000.00
<i>Pool (Total Used) C/E:</i>	\$1,149,173.68	<i>Delivery Commitment Amounts:</i>	\$39,425,000.00
<i>Balance (Available) C/E:</i>	\$350,826.32	<i>Amount Funded to Date:</i>	\$39,425,000.00
		<i>Outstanding Delivery Commitment Amount Available:</i>	\$0.00
 <i>Highest Zip Code Concentration</i>	 XXXX 15.128%	<i>Number of Loans to Date:</i>	316
<i>Average Loan Level CE</i>	2.915%	<i>Total PairOff Fees by MC:</i>	\$5.01
		<i>Total Extension Fees by MC:</i>	\$129.34
		<i>MC Expiration Date:</i>	12/31/2009
		<i>MC Program:</i>	Original
		<i>Remaining MC Available:</i>	\$5,575,000.00

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FFIEC Call Report Requirements for Mortgage Servicing Rights

- 1) Total volume of loans sold - Schedule RC-S, item 11A and RC-S, Memoranda, item 2a
- 2) Book value of retained servicing – RC-M, Memoranda, item 2a
- 3) Estimated fair value of retained servicing – RC-M, Memoranda, item 2a(1)
- 4) Gain or Loss for the quarter should be reported on Schedule RI, item 5i
- 5) Servicing fees for the quarter should be reported on Schedule RI, item 5f

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FFIEC Call Report Requirements for CE Fees Receivable and CE Recourse Liabilities – Original MPF

- 1) The recourse obligation amount (less any recourse liability recorded) is reported in Schedule RC-S, item 12A and RC-R, item 50A
- 2) The amount in RC-R, 50A is multiplied by the Credit Conversion Factor of 12.5 (gross-up method) or the institution-specific factor for the PFI (direct reduction method)
- 3) The resulting multiplicand is reported as the Credit Equivalent Amount in RC-R, Item 50F
- 4) The CE Fees receivable is to be reported on RC-F, item 3a as an interest only strip
- 5) The CE recourse liability is reported on RC-G, item 4

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Regulatory Reporting Example - FFIEC

ABC Bank - FFIEC Call Report Summary 9/30/2008 Valuation - Client Uses Amortization Method

Item	Amount to Report	Location to Report
Outstanding Prin. Bal. of Sold Loans	37,165,653.46	Schedule RC-S, item 11A
Outstanding Prin. Bal. of Sold Loans	37,165,653.46	Schedule RC-S, Memoranda, item 2a
Book Value of Retained Servicing	329,203.91	Schedule RC-M, Memoranda, item 2a
Estimated Fair Value of Retained Servicing	334,831.91	Schedule RC-M, Memoranda, item 2a (1)
Recourse Obligation Amount	1,149,173.68	Schedule RC-S, item 12A
Recourse Obligation Amount	1,149,173.68	Schedule RC-R, item 50A
Recourse * 12.5 (gross up method)	14,364,671.00	Schedule RC-R, item 50F
CE Fees Receivable	124,556.24	Schedule RC-F, item 3a
Gain or Loss on Sale (for the quarter)	27,027.53	Schedule RI, item 5i
Servicing Fees (for the quarter)	N/A	* Schedule RI, item 5f
Recourse Liability (actual liability reported on G/L)	124,556.24	Schedule RC-G, item 4

* This information is internal to the Bank and can not be provided by Wilary Winn.

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FFIEC Call Report Requirements for CE Fees Receivable and CE Recourse Liabilities for MPF 125 and MPF Plus

- 1) The recourse obligation amount (less any recourse liability recorded) is reported in Schedule RC-S, item 12A and RC-R, item 50A
- 2) The amount in RC-R, 50A is multiplied by the Credit Conversion Factor of 12.5 (gross-up method) or the institution-specific factor for the PFI (direct reduction method).
- 3) The resulting multiplicand is reported as the Credit Equivalent Amount in RC-R, Item 50F
- 4) The performance-based CE Fees receivable amount is to be reported on RC-F 3a as an interest only strip and RC-S 2a column A.
- 5) The value of the CE Fees receivable recorded is limited to 25 percent of Tier 1 Capital. The disallowed portion is to be recorded in RC-R 10g.
- 6) The CE recourse liability is reported on RC-G, item 4



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FFIEC Call Report Reporting Requirements for CE Fees Receivable and CE Obligation Liabilities for MPF 100

- 1) The recourse obligation amount (less any recourse liability recorded) is reported in Schedule RC-S, item 9A and RC-R, item 52A
- 2) The amount in RC-R, 52A is multiplied by the Credit Conversion Factor of 1.00 for Column B of Item 52A.
- 3) The resulting multiplicand is reported as the Credit Equivalent Amount in RC-R, Item 52F
- 4) The performance-based CE Fees receivable amount is to be reported on RC-F 3a as an interest only strip and RC-S 2a column A.
- 5) In addition, the value of the CE Fees receivable recorded is limited to 25 percent of Tier 1 Capital. The disallowed portion is to be recorded on RC-R 10g.
- 6) The CE recourse liability is reported on RC-G, item 4

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Implementation

1. Discuss with Wilary Winn the options for accounting for the MSR Asset, CE Fees Receivable and the CE Recourse Liability. The PFI will need to choose whether or not they will account for the MSR asset using the amortization method or the fair value method.
2. The PFI will also need to decide (after discussions with their external auditor/primary regulator) how to recognize the CE Recourse Liability.

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How Wilary Winn Can Help

1. Wilary Winn can determine the **values** of the MSR, the CE Fees Receivable, the CE Recourse Liability and Gain on Sale at the Loan Level and summarize the information needed to record the journal entry to book the loan sales for the reporting period.
2. For those electing the amortization method for MSRs, Wilary Winn will incorporate the MSR, CE Fees Receivable and CE Recourse Liability into a **loan level basis roll forward file**, which will provide information necessary to produce the amortization **journal entries** going forward.
3. At quarter end Wilary Winn will provide the PFI with a summary spreadsheet that details the entries they will need to make on their **call report** related to their MPF activities.

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Background on Wilary Winn LLC

Wilary Winn provides independent, fee-based advice to financial intermediaries, including banks, savings and loans, credit unions, finance companies, and mortgage bankers. Founded in 2003, we have grown to over 150 clients in 26 states and the District of Columbia.

Our services include assessments and valuation of complex financial assets, including mortgage servicing rights, credit enhancement fees receivable and credit enhancement obligation liabilities, as well as the development and implementation of interest rate risk management programs.

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