

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

Mortgage Partnership Finance Program[®]

MPF Accounting and Regulatory Guidance

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Wilary Winn LLC

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 Reporting 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 Xtra
 - Loans sold to the FHLB Des Moines are concurrently sold to a third party investor
 - No credit enhancement obligation or benefit
 - Must be sold servicing retained

4. Original MPF for FHA/VA loans
 - Includes USDA rural development loans
 - No credit enhancement obligation or benefit

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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 Xtra
- Wilary Winn notes to check with your external auditors with regard to the changes set for in FAS 166, which becomes effective for reporting periods after November 15, 2009 – which could affect true sale for Original MPF and MPF 125

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Accounting for Servicing of Financial Assets

- Must initially recognize MSR's at their fair value
- PFI can elect either the amortization method or the fair value method for future reporting of their MSR's

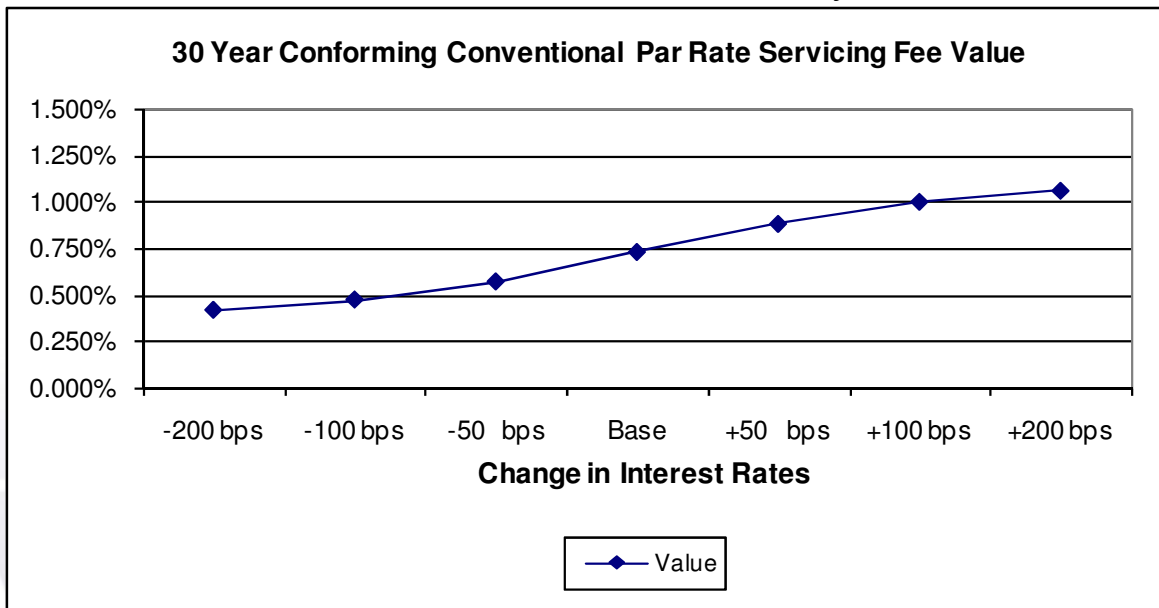
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Mortgage Servicing Right (MSR) Primary Valuation Components

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)

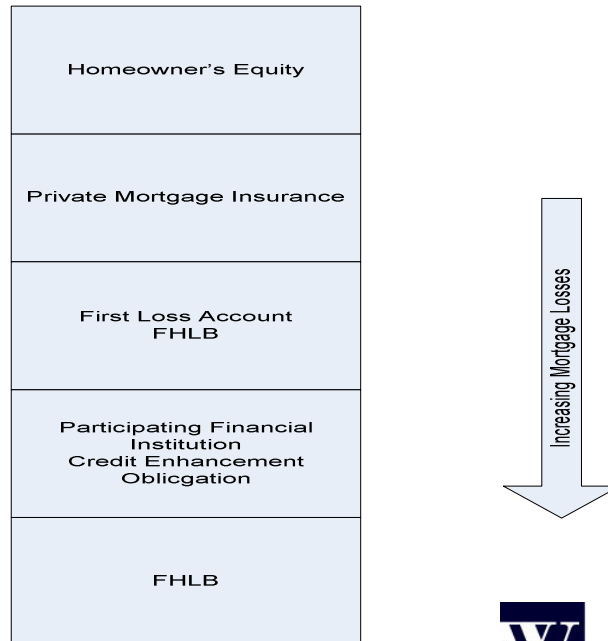
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MSR Yield Curve and Convexity



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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

	CE Fee Value		
	30 Yr.	20 Yr.	15 Yr.
Original MPF CE Fee %	0.337%	0.320%	0.277%
Original MPF CE Fee \$	\$337.41	\$320.15	\$277.04
MPF 125 CE Fee %	0.155%	0.147%	0.127%
MPF 125 CE Fee \$	\$155.06	\$147.15	\$127.40

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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

	CE Recourse Liability		
	30 Yr.	20 Yr.	15 Yr.
Original MPF Recourse Liability Account	-0.053%	-0.050%	-0.044%
Original MPF Recourse Liability Account	-\$52.63	-\$50.10	-\$43.82
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
4. We note that FAS 166 is effective for reporting periods after November 15, 2009. It will require fair value of assets transferred and liabilities incurred and does away with relative fair value

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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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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 on loan sales 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 Mortgage Banking Activities

Schedule RC-P – 1-4 Family Residential Mortgage needs to be completed if the following is true:

- 1.The Bank has over \$1 Billion in Total Assets.
- 2.The Bank has less than \$1 Billion in Total Assets at which either 1-4 family residential mortgage loan originations and purchases for resale from all sources, loan sales, or quarter-end loans held for sale exceed \$10 Million for two consecutive quarters.

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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 3

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Regulatory Reporting Example - FFIEC

ABC Bank - FFIEC Call Report Summary 12/31/2008 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)
CE Obligation Amount (less recorded liability)	1,024,617.44	Schedule RC-S, item 12A
CE Obligation Amount (less recorded liability)	1,024,617.44	Schedule RC-R, item 50A
Recourse * 12.5 (gross up method)	12,807,718.02	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
CE Recourse Liability (actual liability reported on G/L)	124,556.24	Schedule RC-G, item 3

* 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

- 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 9a.
- 6) The CE recourse liability is reported on RC-G, item 3

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TFR Reporting Requirements for Mortgage Servicing Rights

- 1) MSR asset amount is reported on SC 642
- 2) MSR liability amount is included on SC 796 and also SC 791-792, 794-795, or 797-798 – item 15
- 3) Custodial accounts for loan servicing are reported on SC 712
- 4) Loan servicing fees are reported on SO 410
- 5) Loan servicing impairments are reported on SO 411
- 6) Amortization of the MSR asset or Fair Value write-up / write-down is reported on SO 411
- 7) Additional information regarding the loans serviced is reported on CMR 401 through CMR 450

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TFR Reporting Requirements for Mortgage Servicing Rights (Continued)

In addition, the amount of servicing assets that can be included in Tier 1 capital is limited to the lesser of 100 percent of the amount of servicing assets reported, 100 percent of Tier 1 capital or 90 percent of the servicing asset's fair value. The amount "disallowed" servicing is to be reported on CCR 270.

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TFR Reporting Requirements for CE Fees Receivable and CE Recourse Liabilities for Original MPF, and MPF 125

- 1) The outstanding principal balance amount of loans sold is reported on CC 455
- 2) The amount of the recourse obligation is reported on CC 468
- 3) The CE Fees receivable is reported on SC 665
- 4) The CE Recourse Liability is reported on SC 796
- 5) If the direct reduction method is elected, the recourse obligation amount should be reported on CCR 375. Alternatively, the recourse obligation may be reported on CCR 605 where it will be multiplied by 12.5 or the reciprocal of the 8 percent risk-based capital requirement.

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Additional TFR Reporting Requirements for CE Fees Receivable and CE Recourse Liabilities for MPF 125 and MPF Plus

- 1) The performance-based CE Fees receivable is reported on SI 402
- 2) The balances of the performance-based CE Fees receivable reported on SI 402 that exceeds 25 percent of Tier 1 Capital is reported on CCR 133 in accordance with 12 CFR part 567. The disallowed portion is reported on CCR 270.
- 3) OTS-regulated PFIs that elect the direct reduction method will report the recourse obligation amount on CCR 375. (We note that the amount of CE Fees receivable reported on CCR 270 may be deducted from the amount to be reported on CCR 375).

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Regulatory Reporting Example - OTS

ABC Bank - OTS Call Report Summary
12/31/2008 Valuation - Client Uses Amortization Method

Item	Amount to Report	Location to Report
Book Value of Retained Servicing Assets	329,345.58	SC 642
Book Value of Retained Servicing Liabilities	(141.67) **	SC 796
Custodial account balances for loan servicing	N/A *	SC 712
Loan Servicing Fees (for the quarter)	N/A *	SO 410
Loan Servicing Impairments	(359.00) ****	SO 411
MSR Asset Amortization (for the quarter)	13,722.73	SO 411 (for PFIs who elect the amortization method)
Write Up or Write Down of Asset (Fair Value)	N/A ****	SO 411 (for PFIs who elect the fair value method)
Servicing Portfolio Statistics		**** CMR 401 through CMR 450
Outstanding Prin. Bal. of Sold Loans	37,165,653.46	CC 455
CE Obligation Amount (less recorded liability)	1,024,617.44	CC 468
CE Fees Receivable	124,556.24	SC 665
Recourse Liability	124,556.24 ***	SC 796
Recourse Obligation Amount	1,149,173.68	CCR 375 (if "direct deduction" method is chosen)
Recourse Obligation Amount	1,149,173.68	CCR 605 (if "super risk weighting" method is chosen)

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

** If this is one of the three largest liabilities it also needs to be reported on SC 791, 794 or 797 as a code 15 with the dollar amount reported on SC 792, SC 795 or SC 798.

*** If this is one of the three largest liabilities it also needs to be reported on SC 791, 794 or 797 as a code 16 with the dollar amount reported on SC 792, SC 795 or SC 798.

**** Will be provided for PFIs who also choose to have Wilary Winn value the portfolio quarterly, semi annually or annually.



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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 250 clients located throughout the U.S.

Our services include assessments and valuation of complex financial assets, including mortgage servicing rights, credit enhancement fees receivable and credit enhancement obligation liabilities, non-Agency MBS and Pooled Trust Preferred Securities.

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