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## SECONDARY MORTGAGE OPERATIONS CONFERENCE

October 23, 2008 | 8 am - 4 pm



## Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF<sup>®</sup> Program

Mortgage Partnership Finance Program<sup>®</sup>

Accounting and Regulatory Guidance

October 23, 2008

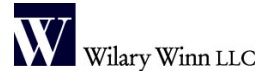
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# Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF® Program

## Today's Topics

1. Product Descriptions
2. Valuation of Mortgage Servicing Rights, Credit Enhancement Fees and Credit Enhancement Obligation Liabilities
3. Journal Entries for booking loan sale including MSR, CE Fees Receivable and CE Obligation Liability
4. Regulatory Reporting Requirements

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

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

## MPF FHLBank Funded Product Descriptions

3. 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 fixed CE Fee for the first two years (or other period specified in the Master Commitment) and a performance based CE Fee thereafter

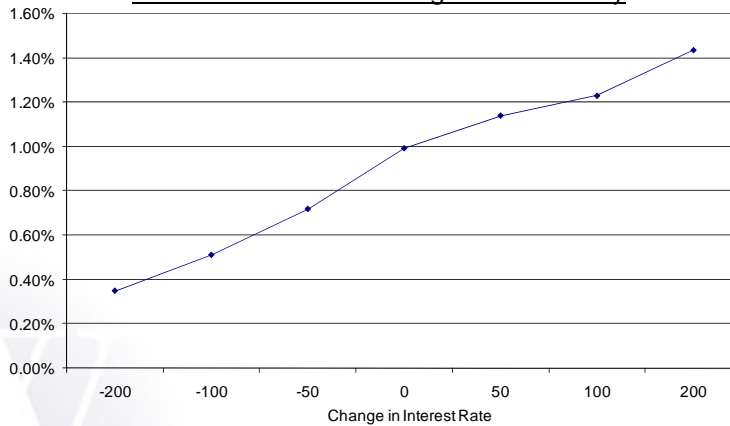
# Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF® Program

## Mortgage Servicing Right (MSR) Primary Valuation Components

- Servicing fee percentage
- Ancillary income
- Expected loan life – prepayment
- Discount rate
- Costs to service – market costs
- Delinquency rate and foreclosure losses
- Remittance methodology

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

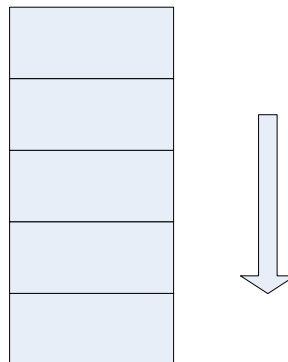
MSR Yield Curve and Negative Convexity



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

MPF Product Credit Structure



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

### The primary valuation factors of the CE Fees Receivable are:

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

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

Example: \$100,000 loan with escrow and multiple remittance (assumptions as of September 30)

	CE Fee Value		
	30 Yr.	20 Yr.	15 Yr.
MPF Original CE Fee %	0.421%	0.390%	0.362%
MPF Original CE Fee \$	\$421.43	\$389.79	\$362.23
MPF 125 CE Fee %	0.421%	0.390%	0.362%
MPF 125 CE Fee \$	\$421.43	\$389.79	\$362.23

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

## The primary valuation factors of the CE Obligation Liability are:

1. The loan amount
2. The CE Obligation percentage – 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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# Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF® Program

## E Obligation Liability vs. CE Obligation Amount

here is a difference between the CE Obligation Liability and the CE Obligation Amount

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

he 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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## Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF® Program

Example: \$100,000 loan with escrow and multiple remittance (assumptions as of September 30)

	CE Obligation Liability		
	30 Yr.	20 Yr.	15 Yr.
MPF Original CE Obligation %	-0.057%	-0.053%	-0.049%
MPF Original CE Obligation \$	-\$57.37	-\$53.17	-\$49.44
MPF 125 CE Obligation %	-0.223%	-0.206%	-0.191%
MPF 125 CE Obligation \$	-\$222.62	-\$205.84	-\$191.05

The CE Obligation Liability for the MPF 125 product represents the reduction of CE Fees due to estimated losses. PFIs could also elect to the decrease as a reduction of the CE Fee Receivable

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

### ABC Bank of Colorado MPF Portfolio

Sample Data as of 9/30/2008

#### Colorado Data - MPF Orig. - Act./Act. Multiple Remittance

Portfolio Stats <sup>1</sup>	Loan Count	Unpaid Principal Balance	Average Loan Size	Interest Rate	Service Fee	CE Fee
30 Yr.	180	27,024,765	150,138	6.214%	0.25%	0.10%
20 Yr.	26	2,621,440	100,825	5.767%	0.25%	0.10%
15 Yr.	86	7,064,841	82,149	5.593%	0.25%	0.10%
10 Yr. & Balloons	14	454,606	32,472	5.862%	0.25%	0.10%
Total	306	37,165,653	121,456	6.060%	0.25%	0.10%

<sup>1</sup> Portfolio details were provided by the Federal Home Loan Bank of Topeka.

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

**ABC Bank of Colorado  
MPF Portfolio  
Sample Data as of 9/30/2008  
Colorado Data - MPF Orig. - Act./Act. Multiple Remittance**

Estimate of Mortgage Servicing Rights <sup>2</sup>	Basis Point Value if loans have Escrow	Dollar Value if loans have Escrow	Basis Point Value if loans do not have Escrow	Dollar Value if loans do not have Escrow
30 Yr.	0.946%	255,628	0.790%	213,380
20 Yr.	0.913%	23,925	0.729%	19,121
15 Yr.	0.761%	53,780	0.573%	40,478
10 Yr. & Balloons	0.330%	1,499	0.166%	756
<b>Total</b>	<b>0.901%</b>	<b>334,832</b>	<b>0.737%</b>	<b>273,735</b>

<sup>2</sup> All values are high level estimates. Actual values will be provided if PFI enrolls in the accounting program. These values should not be used as a source for any entries made to the PFI's general ledger or for use comparing a PFI's current book value of mortgage servicing rights and credit enhancement liabilities.

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

**ABC Bank of Colorado  
MPF Portfolio  
Sample Data as of 9/30/2008  
Colorado Data - MPF Orig. - Act./Act. Multiple Remittance**

Estimate of CE Fee Receivable <sup>2</sup>	Basis Point Value	Dollar Value
30 Yr.	0.345%	93,229
20 Yr.	0.348%	9,115
15 Yr.	0.300%	21,175
10 Yr. & Balloons	0.228%	1,037
<b>Total</b>	<b>0.335%</b>	<b>124,556</b>

<sup>2</sup> All values are high level estimates. Actual values will be provided if PFI enrolls in the accounting program. These values should not be used as a source for any entries made to the PFI's general ledger or for use comparing a PFI's current book value of mortgage servicing rights and credit enhancement liabilities.

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

### 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.

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

### Recording of the Credit Enhancement Obligation Liability

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

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

### Example #1: Journal Entries – Liability = Receivable

JE 1	Cash	\$	100,000	
	CE Fees Receivable	\$	400	
	CE Obligation			\$ 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 receivable

JE 4	CE Obligation Liability	\$	90	
	Other Expense	\$	10	
	Other Income			\$ 100

Recognize fee income and amortize discount on liability



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

### Example #2 Journal Entries – FAS 159 Fair Value

JE 1	Cash	\$	100,000	
	CE Fees Receivable	\$	400	
	CE Obligation			\$ 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



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

## Fair Value Disclosures

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

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

Example #3: Recording of MSR at fair value and CE Fee Receivable at relative fair value (the CE Obligation Liability is valued and recorded at \$0)

	<b>Fair Value</b>	<b>% of Total Fair Value</b>	<b>Allocated Carrying Amount</b>
Loan Receivable	\$ 101,000	99.61%	\$ 99,610
CE Fee Receivable	\$ 400	0.39%	\$ 390
	<u>\$ 101,400</u>		<u>\$ 100,000</u>

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

### Example #3: Journal Entries – Relative Fair Value

JE 1	Cash	\$	100,000	
	CE Fees Receivable	\$	390	
	CE Obligation			\$ 0
	Loan Receivable			\$ 100,000
	Gain on Sale			\$ 390
Record Loan Sale				

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

JE 3	CE Fees Receivable	\$	10	
	OCI			\$ 10
Record CE Fees receivable at fair value				

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

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

### 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.

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

### 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.

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

## Regulatory Reporting Requirements

- FFIEC – Federal Financial Institutions Examination Council
- TFR – Thrift Financial Reports
- NCUA – National Credit Union Association

The examples which follow are for the Original MPF Product

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

## Regulatory Reporting Example - FFIEC

ABC Bank of Colorado - 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 credit union and can not be provided by Wilary Winn.

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

## Regulatory Reporting Example - OTS

ABC Bank of Colorado - FFIEC Call Report Summary  
9/30/2008 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
Recourse Obligation Amount	1,149,173.68	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 credit union 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.

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

## Regulatory Reporting Example - NCUA

ABC Credit Union of Colorado - NCUA Call Report Summary  
9/30/2008 Valuation - Client Uses Amortization Method

Item	Amount to Report	Location to Report
Loan Servicing Fees (for the quarter)	N/A	* Page 7, Line 12
Loan Servicing Costs (for the quarter)	N/A	* Page 7, Line 23
Item 7b and 8c must be checked		Page 8
Determine whether 7a and 8f need to be checked		Page 8
Total amount of loans sold in secondary market Year-to-Date	5,897,315.00	Schedule A, Line 18
Total amount of first mortgage loans sold but serviced by the credit union	37,165,653.46	Schedule A, Line 20
CE Fees Receivable	93,228.52	Page 4, Line 29C
Recourse Liability	93,228.52	Page 5, Line 8
Book Value of Mortgage Servicing Assets	329,203.91	Schedule A, Line 21
Outstanding Principal Amount of Loans Sold	37,165,653.46 **	Page 11, Line 4

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

\*\* The principal amount sold is then subject to the Risk Based Net Worth requirement, equal to the lesser of the actual CE Obligation percent or 6 percent (NCUA 702.107 (d)).

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

## Implementation

- 1) Discuss with Wilary Winn the options for accounting for the MSR Asset, CE Fees Receivable and the CE Obligation 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 Obligation Liability.

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

## How Wilary Winn Can Help

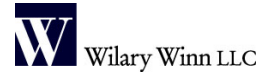
1. Wilary Winn will determine the **values** of the MSR, the CE Fees Receivable, the CE Obligation Liability and Gain on Sale at the Loan Level and summarize the information needed to record the journal entry to book the loan sales for the reporting period.
2. For those electing the amortization method for MSRs, Wilary Winn will incorporate the MSR, CE Fees Receivable and CE Obligation 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.

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

## Information Flow

The PFI has the option of either having the Federal Home Loan Bank of Topeka provide a loan level file to Wilary Winn that includes all of the data needed to properly account for the loans sold during the reporting period, or the PFI can elect to provide the information directly. (PFIs selling loans to institutions other than FHLB Topeka will have to provide the information directly).

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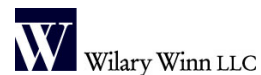


# Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF® Program

## Pricing

<b>Monthly Accounting</b>	<b>Monthly Fee</b>	<b>Annual Cost</b>
Less than 10 loans	\$100	\$1,200
10 - 25 loans	\$150	\$1,800
25 - 50 loans	\$250	\$3,000
Greater than 50 loans	\$350	\$4,200

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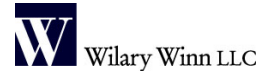
## Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF® Program

### 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 125 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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## Accounting and Regulatory Guidance for the Federal Home Loan Banks' MPF® Program

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