



STRENGTHENING FINANCIAL INSTITUTIONS

Mortgage Partnership Finance® Program Accounting & Regulatory Guidance

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Introduction

This guide is designed to provide Participating Financial Institutions (“PFIs”) with assistance in complying with the accounting and regulatory requirements resulting from delivering loans to the Federal Home Loan Banks (“FHLBanks”) under the Mortgage Partnership Finance® (“MPF”) Program. It begins with a brief description of the FHLBanks and the MPF Program; summarizes the products offered under the MPF Program; provides guidance on accounting for interest rate lock commitments and forward sales commitments; addresses the accounting and regulatory requirements for mortgage servicing rights (“MSRs”); and finally provides accounting and regulatory advice on the MPF credit enhancement by type of product.

The handbook was written by Wilary Winn, LLC, which is solely responsible for its content. Wilary Winn was formed in 2003 as a limited liability company (LLC) to provide independent fee-based advice to financial institutions. We have more than 670 clients located across the country, including 75 publicly traded banks and 40 of the top 100 credit unions.

The guidance herein has not been approved by any of the FHLBanks. It is not intended for use with the Mortgage Purchase Program or the Mortgage Asset Program. The “MPF Mortgage Partnership Finance” logo, “Mortgage Partnership Finance,” “MPF,” and “MPF Xtra” are registered trademarks of the FHLBank of Chicago.

References to call report schedules are current as of the publication date and may change as reporting forms are periodically revised. See the [Call Report References for Loans Sold with Servicing Retained \[White Paper\]](#) on the Wilary Winn website for additional details related to the FFIEC 041, FFIEC 051, and NCUA call report requirements and references.

THE ISSUES ADDRESSED IN THE HANDBOOK ARE COMPLEX AND ARE BASED ON GENERAL EXAMPLES. READERS ARE STRONGLY ENCOURAGED TO REVIEW THE RECOMMENDATIONS SET FORTH IN THIS HANDBOOK WITH THEIR INDEPENDENT ACCOUNTANTS AND PRIMARY REGULATORS TO OBTAIN THEIR INPUT AND COMMENTS BEFORE IMPLEMENTING THESE PROCEDURES. THE SPECIFIC FACTS AND CIRCUMSTANCES FOR A PARTICULAR INSTITUTION MAY LEAD TO DIFFERENT ACCOUNTING AND REGULATORY INTERPRETATIONS THAN THOSE DESCRIBED HEREIN.

Definitions of Terms

Actual/Actual

A remittance type that requires the Servicer to remit to the investor only the actual interest and the actual principal payments collected from borrower.

Best Efforts Delivery Commitment

A sales agreement in which a PFI commits to delivering a mortgage of a specified principal amount and quality to an investor if and when the loan closes.

Credit Enhancement ("CE")

A risk-sharing structure under the MPF Program whereby the PFI agrees to absorb a defined layer of mortgage credit losses in exchange for ongoing CE income. Credit loss layers generally consist of borrower equity, private mortgage insurance ("PMI"), a First Loss Account, and a PFI recourse layer.

Credit Enhancement Income (formerly known as Credit Enhancement Fee)

Income payable monthly by the FHLBank to a PFI in consideration of the PFI's CE Recourse Obligation to cover losses incurred for a Master Commitment arising from the default of a loan. The amount paid is based on the agreed rate subject to the terms of the Master Commitment and applicable MPF Program, which may include performance and risk participation features.

Credit Enhancement Obligation Liability

The required CE Obligation liability is often calculated at the loan level using specialized credit risk models, and is based on the loan's risk profile, expected default rate, and foreclosure loss severity. The contingent liability is determined by calculating the present value of expected losses not covered by borrower equity or PMI. Loan-level CE Obligation liabilities are aggregated at the Master Commitment level to determine the credit risk exposure not covered by the First Loss Account.

Credit Enhancement Recourse Obligation

The contractual obligation of the PFI to absorb credit losses up to a defined amount for each Master Commitment. This term broadly refers to the total recourse exposure retained by the PFI (CE Recourse Obligation maximum).

First Loss Account ("FLA")

A contingent liability memorandum account established by the FHLBank for each Master Commitment based on and in the amount required under the applicable MPF Program product description. This account is the liability of the FHLBank with respect to the loss incurred arising from the default of a loan (after any applicable borrower equity and PMI).

Forward Sales Commitments

Contracts between a PFI and the FHLBank that obligates the PFI to deliver mortgage loans at specified prices and parameters in the future. These commitments economically hedge IRLCs and closed loans held for sale.

Interest Rate Lock Commitments ("IRLCs")

Agreements between a PFI and a borrower under which the PFI commits to originate a mortgage loan at a specified interest rate and loan amount for a defined period, subject to underwriting approval. In the MPF context, IRLCs for loans intended for sale are treated as derivative instruments and measured at fair value, incorporating expected secondary-market execution, servicing value, and anticipated CE economics.

Mandatory Delivery Commitment

A sales agreement that requires the PFI to deliver eligible mortgage loans equal to at least a minimum required delivery amount. If the minimum required delivery amount is not met, the commitment must be settled via a "pair-off" fee.

Master Commitment Agreement

A document (including any addenda or attachments thereto) executed by a PFI and a FHLBank, which provides the terms under which the PFI will deliver Mortgage Loans to the FHLBank.

PFI Agreement

An agreement between a FHLBank and a PFI which sets out the terms, under which the PFI originates, sells, and/or services mortgages.

Scheduled/Scheduled

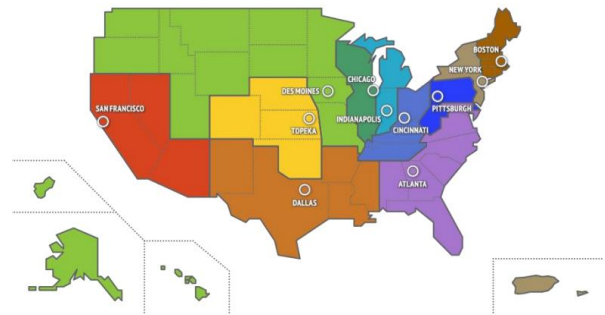
A remittance type that requires the servicer to remit to the investor the scheduled interest due and the scheduled principal due (whether or not payment is collected from the borrower).

Background

DESCRIPTION OF THE FEDERAL HOME LOAN BANKS

The FHLBanks are wholesale banks serving and owned by their members. They are government-sponsored enterprises, federally chartered, but privately capitalized and independently managed. Each FHLBank is governed by a board of directors made up of industry directors elected by member institutions and public-interest directors. Each FHLBank is capitalized by the capital-stock investments of its members and its retained earnings. Members purchase stock in proportion to their product usage with the FHLBank, their holdings of mortgages and mortgage securities, and their assets. Lenders eligible for FHLBank membership include savings banks, savings and loan associations, cooperative banks, commercial banks, credit unions, and insurance companies that are active in housing finance.

Through the 11 FHLBanks, located in Atlanta, Boston, Chicago, Cincinnati, Dallas, Des Moines, Indianapolis, New York, Pittsburgh, San Francisco and Topeka, the FHLBank System has nearly 6,500 member PFIs. As of December 31, 2025, the System had total assets of \$1.25 trillion.



The FHLBanks offer three mortgage products to their members: the Mortgage Partnership Finance (“MPF”) Program, the Mortgage Purchase Program (“MPP”), and the Mortgage Asset Program (“MAP”). Mortgage programs have been a part of the FHLBank System since 1997 and are another way the FHLBanks provide liquidity to their members.

DESCRIPTION OF THE MPF PROGRAM

The MPF Program, pioneered by the FHLBank Chicago, is currently offered by the majority of FHLBanks. The program is a unique secondary market alternative for fixed rate mortgage loans available to FHLBank members who apply and are approved to become a PFI. A PFI in the MPF Program enters into a Master Commitment Agreement with the FHLBank of which it is a member. This agreement specifies the dollar amount of loans to be delivered under the commitment and details the terms and conditions for the particular MPF product offered, including the CE that governs the loans delivered under the Master Commitment.

The FHLBanks offer a variety of MPF products which are further described in the next section, some of which are premised on the concept of risk-sharing. Different member institutions need different types of structures for their secondary market sales. Various MPF Program product offerings are available to meet the specific needs of PFIs. With each product, the PFI originates, closes, and then sells the loan to the FHLBank. Regardless of which MPF product is used, members retain all typical origination, closing, and miscellaneous fees.

The FHLBank purchases first lien, conforming, conventional and government one-to-four family residential mortgage loans from the PFI. The FHLBanks purchase the liquidity risk and manage the interest rate and prepayment risks of the fixed-rate mortgages because of their expertise in properly

hedging such risks and their ability as GSEs to raise low-cost, long-term funds in the global capital markets. The PFI manages the credit risk of the loans they sell to the FHLBank while keeping the customer relationship local. In an MPF transaction, because the mortgage lender manages credit risk, the FHLBanks do not charge loan level price adjustments.

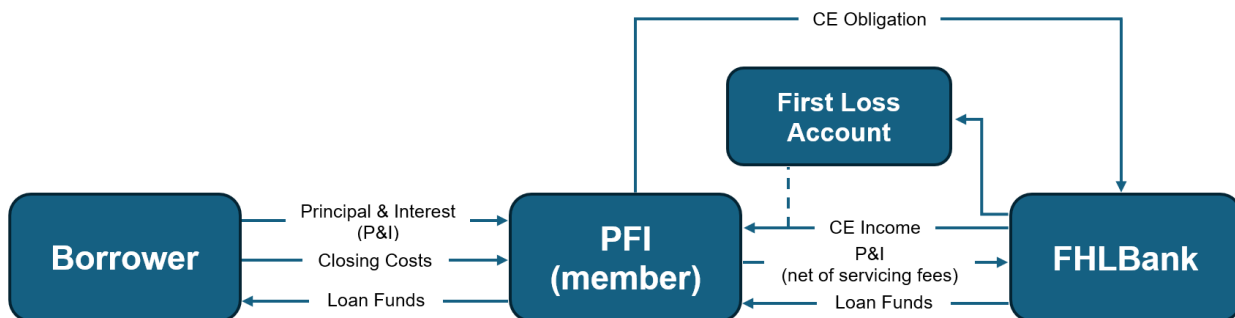
A key insight of the MPF Program is to view a fixed-rate mortgage as a bundle of risks which can be split into its component parts. Each risk can be assigned to the institution which is best situated to manage it. For example, experience has demonstrated that local lenders know their customers best. The MPF Program recognizes this fact and assigns the mortgage lender with the primary responsibility for managing the credit risk (the risk that the homebuyer will be unable to repay the loan) of the loans it originates. Similarly, the local lender is better situated to handle all functions involving the customer relationship, including servicing the loan. The MPF Program provides both servicing retained and servicing released options.

Credit Enhancement

The credit risks of traditional MPF Program products are managed by structuring possible losses into three layers. As is customary for conventional mortgage loans sold to Fannie Mae or Freddie Mac, PMI is required for MPF loans with down payments of less than 20 percent of the original purchase price. Foreclosure losses following any PMI coverage¹ are applied to a “first loss” account (“FLA”) provided by the FHLBank. If “second losses” beyond this first layer are incurred, they are absorbed by the PFI through a CE Recourse Obligation (not to exceed a specific amount) provided for each Master Commitment. The CE layer ensures that the lender retains a credit stake in the loans it originates. Losses beyond the first and second loss layers are absorbed by the FHLBank. For managing this risk, the PFI is paid monthly CE Income from the FHLBank. CE Income is either fixed or performance based. Performance based CE income is reduced by deducting an amount equivalent to the realized losses of the Master Commitment, up to the maximum of fully refunding the FLA. To date, nearly 1,600 PFIs have received over \$1.1 billion in CE income.

MPF Program Flow Chart

The following diagram represents a simplified and general version of how the MPF Program works.



¹ The value of the homeowner’s remaining equity and any PMI insurance coverage thus provide initial CE. Only losses which exceed these amounts are allocated to the FLA.

Summary Descriptions of Specific MPF Products

As part of the FHLB MPF program, credit-enhanced loans require the member to provide a credit enhancement (recourse) layer that absorbs a defined portion of credit losses in exchange for CE income, while non-credit-enhanced loans transfer all credit risk to the FHLBank with no member recourse or loss-sharing obligation.

CREDIT ENHANCED PRODUCTS

The traditional MPF Program product differences are primarily related to the amount initially allocated to the FLA, the resulting differences in the PFI's CE Recourse Obligation percentage, and whether the CE Income is fixed or performance based.

We note that some FHLBanks offer mortgages with lower-than-market interest rates to members that meet certain income thresholds.

MPF Original

Under the MPF Original product, the FLA is zero upfront and accumulates monthly at the rate of 4 basis points per year against the unpaid principal balance of loans in the Master Commitment². The PFI is paid fixed CE Income for providing the CE Recourse Obligation. See Loss Absorption Profile #1.

MPF 125

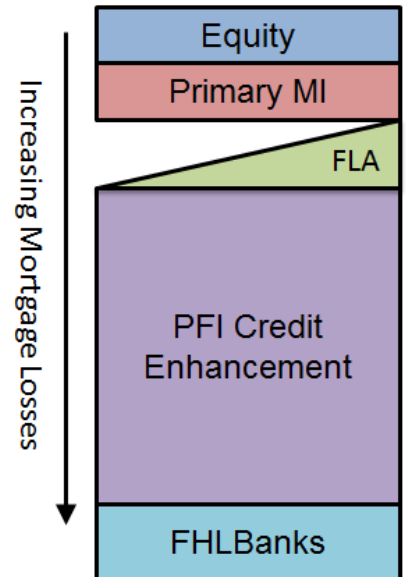
Under the MPF 125 product, the FLA is funded up front at 100 basis points of the delivered principal balance. The PFI is paid performance-based CE Income for providing the CE Recourse Obligation. See Loss Absorption Profile #2.

The differences between the MPF Original and MPF 125 products are primarily related to the underlying economics of the products themselves. Under MPF 125, the FLA is larger, the maximum potential CE Recourse Obligation is smaller, and the amount of CE Income to be received is generally less given the CE Income is performance-based.

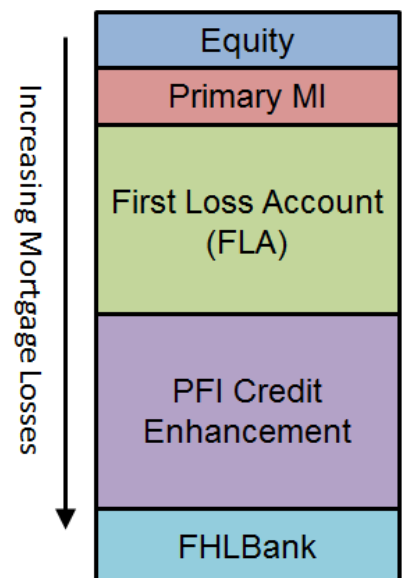
MPF 35

Under the MPF 35 product, the FLA is funded up front at a percentage of the delivered principal balance specified in each Master Commitment, typically 35 basis points. The PFI is paid fixed and/or performance-based CE Income as specified in the Master Commitment. The performance-based income begins accruing in month one and is paid to the PFI commencing with the thirteenth month following the delivery of the loan. See Loss Absorption Profile #2.

Loss Absorption Profile #1



Loss Absorption Profile #2



² The rate specified in current Master Commitments is 4 basis points, but actual rates range from 3 to 5 basis points

The differences between the MPF 125 and MPF 35 products are primarily related to the underlying economics of the products themselves. Under MPF 35, the FLA is smaller and the amount of CE Income to be received is generally more.

NON-CREDIT ENHANCED PRODUCTS

As in all secondary market sales, the financial accounting and reporting for mortgage banking derivatives and mortgage servicing apply to these products. However, the accounting treatment for CE does not apply.

MPF Xtra

Under the MPF Xtra product, the PFI sells the loan to the FHLBank, which sells it concurrently to another investor. The PFI does not retain credit risk for loans sold under this product. As a result, while the PFI continues to retain the normal loan origination representations and warranties of a secondary market sale, there are no risk-based capital or additional CE requirements.

MPF Government

The MPF Government product provides an alternative to holding loans insured or guaranteed by government agencies in portfolio or selling them to other secondary market investors. With the MPF Government product, PFIs market to borrowers and obtain the insurance or guarantee for FHA, VA, HUD 184, and RHS Section 502 loans. The MPF Government Program provides both servicing retained and servicing released options for FHA, VA, and RHS Section 502 loans. Wilary Winn notes that the PFI bears the cost of any disallowed or unreimbursed servicing costs incurred under the government insurance or guarantee as it would servicing these loans under sales to other secondary market investors.

MPF Government MBS

The MPF Government MBS product allows PFIs to sell closed FHA, VA or RHS Section 502 loans to the FHLBank. The FHLBank will hold these loans with the purpose of selling these loans into GNMA MBS pools. The servicing fee for GNMA MBS loans will fluctuate between 19 basis points and 56.5 basis points depending on the note rate of the loan and the MBS coupon for the pool in which that loan is sold. Wilary Winn notes that the PFI bears the cost of any disallowed or unreimbursed servicing costs incurred under the government insurance or guarantee as it would servicing these loans under sales to other secondary market investors.

DISCONTINUED PRODUCTS

Wilary Winn notes that there are several discontinued products no longer offered for new loan originations. These products include MPF Direct, MPF Plus, and MPF 100. Additional information related to these products is attached as [Appendix F](#).

Financial Accounting & Reporting

The accounting and financial reporting varies by MPF product. The closed loan products offered by the FHLBanks include: MPF Original, MPF 125, MPF 35, MPF Government, MPF Government MBS, and MPF Xtra. For all six products, a PFI originates residential mortgages; closes the loans in its own name (or acquires loans from third party originators); and then sells them to the FHLBank in a manner similar to any secondary market sale. Financial reporting is based on valuing and properly accounting for the MSR asset and CE Income receivable as well as the CE Obligation liability to absorb credit losses. The sales are accounted for under FASB Accounting Standards Codification (“FASB ASC”) Topic 860 Transfers and Servicing.

SALES TREATMENT

The first step is to determine whether or not the delivery of the loans to FHLBank qualifies as a sale.

In general, if the transaction qualifies as a sale, then the PFI removes the loans sold from its balance sheet, records the fair value of the retained MSR, records the CE Income receivable at its fair value, records the value of the CE Obligation liability, and records a gain or loss on the sale of the loan based on the amount remaining. See the [Accounting for the Guarantee](#) section for detailed examples.

If transfer of the loans does not qualify for “sales treatment”, the transfer of the loans to the FHLBank is accounted for and recorded as a secured borrowing. In this case, the loans remain on the books as loans, and the cash received is accounted for as debt.

Loan sales accounting is very complex, and readers are strongly encouraged to discuss the issue with their independent accountant or primary regulator. FAS ASC 860-10-40-5 sets the criteria that must be met in order to record a sale. It provides that a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale if and only if all of the following conditions are met:

- a. The transferred financial assets have been isolated from the transferor – put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other [receivership].
- b. Each [transferee] has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor.
- c. The [transferor] does not maintain effective control over the transferred financial [assets].

We believe the sale of loans to the FHLBank meets the requirements of FAS ASC 860-10-40-5a. The requirements related to 860-10-40-5b and c are more complex. FASB has indicated that when determining whether control has been surrendered over transferred financial assets, the [transferor] must consider its continuing involvement in the transferred financial assets and all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer, even if they were not entered into at the time of the transfer. The PFI will receive CE Income (which resembles an interest

only strip) and a servicing fee from the transaction. **The first question is whether or not the CE Income or the servicing fee would be considered a participating interest in order to ensure sales treatment.**

If either meets the definition of a participating interest, then further analysis is required.

Servicing rights are explicitly listed in the definition of “continuing involvement” and must therefore be examined for sales treatment viability. FAS ASC paragraph 860-10-40-6A b 1 provides direct guidance “cash flows allocated as compensation for services performed, if any, shall not be included in that determination of participating interest provided those cash flows meet both of the following conditions - they are not subordinate to the proportionate cash flows of the participating interest and they are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, which includes the profit that would be demanded in the marketplace.” Since the PFI would be compensated for servicing at market rates (e.g. 25bp for conventional loans), and this compensation is senior (instead of junior) to all other cash flows of the mortgages, the presence of the servicing rights would not preclude sales treatment.

The next question concerns the CE Income. Wilary Winn notes that under the MPF Program, a PFI sells a 100% interest in the loan to the FHLBank. It enters into a separate contract to provide a CE Recourse Obligation and to receive CE Income. Wilary Winn believes that because the CE Income is a separate obligation and that it is not a pro-rata interest in the loan, it is therefore not a participating interest.

This conclusion is supported by FASB ASC 860-20-25-6, which indicates that a separate liability rather than a beneficial interest (i.e. interest only strip) should be recognized when the underlying payment source of the cash flows resulting from a credit loss claim by an FHLBank on an MPF loan is not derived from the underlying MPF loans. The cash flow payment source in the event of a credit loss claim by an FHLBank on an MPF loan is either from the general assets of the PFI or in the case of performance-based CE Income, the FHLBank withholding payment of the performance-based CE Income to the PFI. In the latter case, the PFI is effectively paying the FHLBank from its general assets – that is, if the PFI were paid its performance-based CE Income by the FHLBank, it would need to immediately send back that cash payment to the FHLBank. The FHLBank’s withholding of the performance-based CE Income is done as an operational convenience.

FAS ASC 860-20-25-6 provides – “In determining whether credit risk is a separate liability or part of a beneficial interest that has been obtained by the transferor, the transferor should focus on the source of cash flows in the event of a claim by the transferee. If the transferee can only look to cash flows from the underlying financial assets, the transferor has obtained a portion of the credit risk only through the interest it obtained, and a separate obligation shall not be recognized. Credit losses from the underlying assets would affect the measurement of the interest that the transferor obtained. In contrast, if the transferor could be obligated for more than the cash flows provided by the interest it obtained and, therefore, could be required to reimburse the transferee for credit-related losses on the underlying assets, the transferor shall record a separate liability. It is not appropriate for the transferor to defer any portion of a resulting gain or loss (or to eliminate gain on sale accounting, as it is sometimes described in practice).” Thus, Wilary Winn believes the transfer of the loan to the FHLBank should be accounted for as a sale because the PFI has sold a 100% interest in the loan and entered into a separate transaction to provide CE. We note that the transfer of an entire financial asset with limited recourse can be accounted for as a sale under FAS ASC 860-20-55-24A. We further believe

the CE transaction should be accounted for as a guarantee. See the [Accounting for the Guarantee](#) section for more details.

The financial accounting and reporting which follows is designed to correspond to the operational flow of originating loans. The discussion begins with the accounting for the interest rate lock commitment to the applicant; then addresses the accounting for the commitments giving the PFI the right to sell loans to the FHLBank; next discusses accounting for the MSR; and concludes with a description of the accounting practices relating to the CE.

INTEREST RATE LOCK COMMITMENTS

IRLCs are agreements under which a PFI agrees to extend credit to a borrower under certain specified terms and conditions in which the interest rate and the maximum amount of the loan are set prior to funding. Under the agreement, the PFI commits to lend funds to a potential borrower (subject to the PFI's approval of the loan) on a fixed or adjustable-rate basis, regardless of whether interest rates change in the market, or on a floating rate basis. The types of mortgage loan IRLCs are:

- Lock ins for fixed-rate loans. The borrower can lock in the current market rate for a fixed-rate loan.
- Floating rate loan commitments. The interest rate is allowed to “float” with market interest rates until a future date when the rate is set.

IRLCs on mortgage loans that will be held for resale are derivatives and must be accounted for at fair value on the balance sheet.^{3,4} However, commitments to originate mortgage loans to be held for investment and other types of loans are generally not derivatives.

Initial Valuation of IRLCs

The fair value of IRLCs is conceptually related to the fair value that can be generated when the underlying loan is sold in the secondary market. The value of the loan to the originating institution is based on many components, including:

- The loan amount
- The interest rate
- The price at which the loan can be sold
- Discount points and fees to be collected from the borrower
- Direct fees and costs associated with the origination of the loan (processing, underwriting, commissions, closing, etc.)
- The value of the servicing to be retained or the servicing released premium to be received⁵
- CE Income receivable
- CE Obligation liability

³ FAS ASC paragraphs 815-10-15-71

⁴ See also SEC Staff Accounting Bulletin No. 105 - Application of Accounting Principles to Loan Commitments

⁵ See SEC Staff Accounting Bulletin No. 109 - Update to SAB 105

Fair value is defined by FASB ASC Topic 820 which provides a framework for measuring fair value and expands required disclosures related to fair value measurements. FASB ASC Topic 820 defines fair value as an exit price that would be received to sell an asset or paid to transfer a liability in orderly transactions between market participants at the measurement date.⁶ The statement goes on to provide that a fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability, or, in the absence of a principal market, the most advantageous market for the asset or liability.⁷ The most advantageous market is the market in which the reporting entity would receive the highest selling price for an asset, or pay the lowest price to transfer the liability. The determination of the principal market is a key step in applying FASB ASC Topic 820 because if there is a principal market, the fair value should be based on the price in that market, even if the price in a different market is potentially more advantageous at the measurement date.⁸ As a practical matter, we believe that most institutions that aren't doing broader pipeline hedging lock in with an investor at the time they offer the lock to the mortgage applicant and that the secondary market price used to value the IRLC should be based on the prices available from this same investor as this would represent the principal market. Thus, if a PFI locks a loan in with the FHLBank at the time it locks the loan in with its customer, or if the PFI sells most of its production to the FHLBank, then it should use the FHLBank pricing to value the IRLC.

FASB ASC paragraph 820-10-50-2 also establishes a fair value hierarchy for reporting purposes. The hierarchy ranks the quality and reliability of the information used to determine fair values with Level 1 being the most certain and Level 3 being the least certain. The levels are:

- **Level 1:** Quoted market prices for identical assets or liabilities in active markets
- **Level 2:** Observable market-based inputs other than Level 1 quoted prices or unobservable inputs that are corroborated by market data
- **Level 3:** Unobservable inputs that are not corroborated by observable market data; valuation assumptions that are based on management's best estimates of market participants' assumptions

We believe lock in price from the investor represents a Level 2 input because the value of the derivative is based on an observable price in the marketplace. We note that the MSR value is an element of the IRLC value and that it contains both level 2 and level 3 inputs. When estimating the fair value of the IRLC, PFIs should consider predicted "pull-through" rates. A pull-through rate is the probability that an IRLC will ultimately result in an originated loan.

Following is an example of how to value the IRLC based on the following assumptions:

- Loan amount: \$300,000
- Price to borrower or lock-in price: 100
- Lock-in interest rate: 6.375%
- Market interest rate at inception: 6.000%
- Sales price: 101.50 at inception – servicing retained and locked in with an investor
- Value of the servicing: 1.00%
- Value of the CE Income receivable: 0.35%

⁶ FASB ASC paragraph 820-10-35-3

⁷ FASB ASC paragraph 820-10-35-5

⁸ FASB ASC paragraph 820-10-35-6

- Value of the CE Obligation liability: 0.00%
- Projected origination costs: \$3,000 or 1.00%
- The originating institution thus has an expected gain of \$5,550 or 1.85% (101.50 {sales price} + 1.00 {value of servicing} + 0.35% {value of CE Income receivable} - 100.0 {price to borrower} - 1.00 {projected origination costs})

The following table shows the change in the value of the IRLC as market interest rates and estimated pull through percentages change over time. The differences are highlighted in blue.

Change in Value of the IRLC	Inception	Rates up 50 bp	Loan at Processing	Rates down 100 bp	Loan Approved	Loan at Close
Loan amount	\$300,000	\$300,000	\$300,000	\$300,000	\$300,000	\$300,000
Lock in interest rate	6.375%	6.375%	6.375%	6.375%	6.375%	6.375%
Market interest rate	6.000%	6.500%	6.500%	5.500%	5.500%	5.500%
Market value without servicing	101.50%	99.50%	99.50%	103.50%	103.50%	103.50%
Servicing value	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
Origination costs to be incurred	-1.00%	-1.00%	-0.50%	-0.50%	0.00%	0.00%
CE Income receivable	0.35%	0.35%	0.35%	0.35%	0.35%	0.35%
CE Obligation liability	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Price to borrower	-100.00%	-100.00%	-100.00%	-100.00%	-100.00%	-100.00%
Value as a percent of the loan amount	1.85%	-0.15%	0.35%	4.35%	4.85%	4.85%
Dollar value	\$ 5,550.00	\$ (450.00)	\$ 1,050.00	\$ 13,050.00	\$ 14,550.00	\$ 14,550.00
Pull through percentage	30.00%	45.00%	60.00%	60.00%	80.00%	100.00%
Derivative value	\$ 1,665.00	\$ (202.50)	\$ 630.00	\$ 7,830.00	\$ 11,640.00	\$ 14,550.00
Value recorded	\$ 1,665.00	\$ (1,867.50)	\$ 832.50	\$ 7,200.00	\$ 3,810.00	\$ 2,910.00

As the example shows, the value of the IRLC changes as market interest rates change and as the anticipated pull-through rate changes based on updates in the status of the loan. Essentially, there are four components to consider when determining the subsequent changes in fair value:

1. The projected sale price of the loan based on changes in market interest rates
2. The projected pull-through rate - the probability that an IRLC will ultimately result in an originated loan
3. The decay in the value of the applicant's option due to the passage of time
4. The remaining origination costs to be incurred based on management's estimate of market costs (Level 3 input)

Additional Valuation Considerations for IRLCs

The example above is highly simplified. Changes in interest rates can affect the value of the servicing asset, the CE Income receivable, the CE Obligation liability, as well as the value of the loan. In addition, pull through assumptions in the marketplace can be complex. Factors that may be considered in arriving at appropriate pull-through rates include the origination channel, current mortgage interest rates in the market versus the interest rate incorporated in the IRLC, the purpose of the mortgage (purchase versus refinancing), the stage of completion of the underlying application and underwriting process, and the time remaining until the IRLC expires. We believe these pull-through estimates are Level 3 inputs.

To account for the time decay in the option, one should calculate the market price based on the number of days remaining in the IRLC at the end of the reporting period. For example, if PFI locks in a rate with a borrower for 60 days on January 1 and is calculating the change in the value of the IRLC at January 31, the market rate should be based on a 30-day lock and not a 60-day lock. This is necessary to properly account for the marketplace risk adjustment. (In general, commitments with shorter lock lengths have higher prices than longer lock lengths because the buyer is subject to changes in market interest rates {volatility} for a shorter time period.) If the PFI needs to extend a commitment, then it should use the new commitment price in its determination of sales price.

The sales price in our example is simplified. PFIs should include the effect of loan level price adjustments in their determination of sales price.

We further note that institutions should consider the risk of nonperformance on their IRLC liabilities based on the institution's own credit risk.⁹

Accounting for IRLCs

Changes in the fair value of an IRLC must be measured and reported in financial statements and regulatory reports. The carrying value of the IRLC, based on its fair value, should be accounted for as an adjustment to the basis of the loan when the loan is funded. The amount is not amortized under FAS ASC paragraph 948-310-25-3 (Financial Services - Mortgage Banking). Therefore, the value of the IRLC at closing directly affects the gain (loss) realized upon the sale of the loan.

FAS ASC 948-310-25-3 also requires that the direct loan origination costs for a loan held for resale be deferred. However, the value of the IRLC in our example is increasing as origination costs are incurred because we are considering only costs to be incurred in the future. **Therefore, we recommend that PFIs expense origination costs for IRLCs as incurred.** Otherwise, the PFI would be double counting the effect of incurring the origination cost, once as a deferral and again in the increased value of the IRLC.

Institutions should report each fixed, adjustable, and floating rate IRLC as an other asset or as an other liability based on whether the IRLC has a positive (asset) or negative (liability) value, with the offset recorded as non-interest income or non-interest expense.

Following is an accounting example for the \$300,000 loan from inception to closing or funding.

⁹ FASB ASC 820-10-55-56

Description		Journal Entries		Income Statement	IRLC	Cash	Warehouse
		Debit	Credit				
JE 1	Derivative Asset	A	\$ 1,665		\$ 1,665		
	Origination income			\$ 1,665	(1,665)		
	Record initial value						
JE 2	Origination expenses	B	\$ 1,500	\$ 1,500			
	Cash		\$ 1,500			(1,500)	
	Record origination costs						
JE 3	Derivative Asset	C	\$ 12,885		\$ 12,885		
	Gain on IRLC		\$ 12,885	(12,885)			
	Record change in Value						
JE 4	Origination expenses	D	\$ 1,500	\$ 1,500			
	Cash		\$ 1,500			(1,500)	
	Record origination costs						
JE 5	Warehouse Loan	E	\$ 314,550				\$ 314,550
	IRLC		\$ 14,550		(14,550)		
	Cash		\$ 300,000			(300,000)	
	Record Loan Funding						
	Totals		\$ 332,100	\$ 332,100	(11,550)	\$ (303,000)	\$ 314,550

A - Record value at inception
 B - Record processing costs of \$500
 C - Record changes in fair value of IRLC

D- Record commission expense of \$500
 E- Record loan funding at 100.0 or par

In addition, IRLCs with positive values may not be offset against the IRLCs with negative values when presenting assets and liabilities on the statement of financial condition.¹⁰

The servicing asset, CE Income receivable, and CE Obligation liability are not recorded as separate assets and liabilities until the loan is sold, and thus, affect the sale gain or loss. We believe the value of the IRLC is Level 3 as it contains material Level 3 inputs.

Regulatory Reporting

Information regarding IRLCs must be included in the PFI's required regulatory reports (Call Report or 5300). The following table indicates where the information is to be reported. The National Credit Union Administration's ("NCUA") also requires credit unions to report additional information regarding the use of derivatives on Schedule F of the 5300. See [Appendix D](#) of this guide for details.

Interest Rate Lock Commitments	FFIEC	NCUA
	RC-L	
Notional amount of "Over-the-counter written options"	12d.(1) Column A	Schedule F 1.a.ii.
Derivatives with a positive fair value held for purposes other than trading (asset)	15.b.(1) Column A	Other Assets 23. f. & Schedule F
Derivatives with a negative fair value held for purposes other than trading (liability)	15.b.(2) Column A	Liabilities 1. & Schedule F

The total amount of loans for which the PFI has issued commitments, including floating rate commitments, are to be reported as over-the-counter written options. The derivative assets and liabilities are to be reported as indicated.

¹⁰ FASB ASC paragraph 815-10-45-2

A simplified example of the valuation and accounting for IRLCs is attached as [Appendix A](#).

MORTGAGE LOAN SALES COMMITMENTS

The MPF Program includes two kinds of mortgage loan sales commitments (Delivery Commitments): the agreement to deliver loans meeting specified parameters on a mandatory basis and commitments to deliver loans on a “best efforts” basis. The mandatory commitments provide that the loan must be delivered or the commitment be “paired off.” Conversely, the best efforts commitments provide that the loan be delivered if and when it closes. The mortgage loan sales commitments are also known as forward loan sales commitments.

In addition, the program also includes Master Commitments, which set the overall parameters (level of CE Income and CE Recourse Obligations) of the contractual relationship between the PFI and the FHLBank. The discussion that follows does not apply to the Master Commitments themselves, only to the mortgage loan sales commitments issued under their terms.

The mandatory sales commitments are considered to be derivatives under FASB ASC Topic 815 Derivatives and Hedging because they meet all of the following criteria they:

- Have a specified underlying (the contractually specified price for the loans)
- Have a notional amount (the committed loan principal amount)
- Require little or no initial net investment
- Require or permit net settlement as the PFI is obligated under the contract to either deliver mortgage loans or pay a pair-off fee (based on then-current market prices) on any shortfall on the delivery of the committed loan principal amount

Because the mandatory sales commitments are derivatives, they must be accounted for and reported at their fair value. We believe the fair value determination should be based on the gain or loss that would occur if the institution were to pair-off the transaction with the FHLBank at the measurement date. We note that mandatory commitments with the FHLBanks are one-way commitments and the FHLBanks are not required to pay the PFI a pair-off fee if the PFI cancels a commitment which is in a gain position. The accounting examples that follow are based on standard two-way mandatory commitment agreements.

Conversely, the best efforts commitments are not considered to be derivatives because they do not require a pair-off. As a result, they cannot be marked to fair value as a derivative to offset the changes in the IRLCs. However, FASB ASC paragraph 825-10-15-4(b) (Financial Instruments - Overall), provides that a PFI can elect to account for and report at fair value a firm commitment that would not otherwise be recognized at inception and that involves only financial instruments. The statement goes on to say “(An example is a forward purchase contract that is not convertible to cash. That commitment involves only financial instruments – a loan and cash – and would not otherwise be recognized because it is not a derivative instrument.)” Wilary Winn believes a PFI can thus elect to account for its best efforts commitments at fair value.

We further note that institutions should consider the risk of nonperformance on their forward commitment liabilities based on the institution’s own credit risk.¹¹

Accounting for Mortgage Loan Sales Commitments

The mandatory delivery commitments are to be accounted for at their fair value on the balance sheet. PFIs should report each forward loans sales commitment as an other asset or as an other liability based on whether it has a positive (asset) or negative (liability) value, with the offset recorded as non-interest income or non-interest expense.

The accounting treatment is similar for the “best efforts” commitments that a PFI elects to account for at fair value.

Below is a continuation of our previous example from funding to sale (see [Accounting for IRLCs](#) section). The income of \$14,550 related to the value of the IRLC is net of the \$3,000 of origination costs that were expensed and by the \$6,000 decrease in the value of the forward commitment derivative shown below. (This is caused by a net ½ percent fall in market interest rates at a 4 to 1 tradeoff between interest rate and discount points.) Thus, the institution earned its targeted margin of \$5,550 or 1.85 percent.

Description	Journal Entries		Income Statement	Cash	MSR	Derivative	Warehouse
	Debit	Credit					
JE 1 Hedging loss	\$ 6,000		\$ 6,000				
Derivative Liability		\$ 6,000				\$ (6,000)	
Record loss on forward							
JE 2 Cash	\$ 304,500			\$ 304,500			
Mortgage servicing right	\$ 3,000				\$ 3,000		
CE Income receivable	\$ 1,050						
CE Obligation liability	\$ -						
Derivative Liability	\$ 6,000					\$ 6,000	
Warehouse loan		\$ 314,550					\$ 314,550
Record loan sale							
Totals	\$ 320,550	\$ 320,550	\$ 6,000	\$ 304,500	\$ 3,000	\$ -	\$ 314,550

A simplified example of the valuation and accounting for forward contracts is attached as [Appendix B](#).

Regulatory Reporting

Information regarding forward contracts must be included in the PFI’s required regulatory reports as detailed in the following table:

¹¹ FASB ASC paragraphs 820-10-35-17 and 820-10-35-18

Forward Loan Sales Commitments	FFIEC RC-L Item	NCUA
Notional amounts of "Forward contracts"	12.b Column A	Schedule F 2.
Derivatives with a positive fair value held for purposes other than trading (asset)	15.b.(1) Column A	Other Assets 23. f. & Schedule F
Derivatives with a negative fair value held for purposes other than trading (liability)	15.b.(2) Column A	Liabilities 1. & Schedule F
Derivative loan commitments and forward loan sales	14 Column A	Schedule F 2.

The entire gross notional amount of the forward loans sales commitments, mandatory and best efforts, must be included in the PFI's call report as "forward contracts" including those hedging IRLCs and those covering the closed loan inventory. The derivative assets and liabilities are to be reported as indicated. Finally, the total of IRLCs and forward contracts are to be reported as shown below.

Two other requirements should be noted:

1. PFIs may offset derivatives with negative fair values (liabilities) against those with positive fair values (assets) only if the criteria for "netting" under generally accepted accounting principles (GAAP) have been satisfied, which is essentially the right of legal offset.
2. In addition, PFIs may not offset the fair value of forward loan sales commitments against the fair value of the IRLCs.

The NCUA also requires credit unions to report additional information regarding the use of derivatives on Schedule F of the 5300. See [Appendix D](#) of this guide for details.

Best Efforts Commitments

In the case where a PFI has elected to account for its best efforts commitments at fair value, it must also report the following:

Best Efforts Commitments	FFIEC RC-L Item	NCUA
Commitments with a positive fair value held for purposes other than trading (asset)	9.	Other Assets 23. f. & Schedule F
Commitments with a negative fair value held for purposes other than trading (liability)	10.	Liabilities 1. & Schedule F

The required reporting under RC-L for best efforts commitments reported at fair value is subject to a dollar limitation generally equal to 25 percent of the bank's total equity capital. Amounts below the equity threshold need not be reported. If the asset exceeds the equity threshold, then it must be reported on RC-L and potentially RC-Q 6 Column A and RC-Q Memoranda 1b Column A. The reporting for RC-Q Memoranda is subject to another threshold. The asset must exceed \$100,000 and 25 percent

of the total amount reported on RC-Q 6. If the liability exceeds the equity threshold, it must be reported on RC-L and potentially RC-Q 13 Column A and RC-Q Memoranda 2.c. Column A. The RC-Q Memoranda threshold for other liabilities is \$100,000 and 25 percent of the total amount reported on RC-Q 13.

MORTGAGE LOANS HELD FOR SALE

A PFI must account for its inventory of closed loans awaiting purchase by the FHLBank at the lower of cost or fair value, unless the PFI elects to account for the loans at fair value, which Wilary Winn recommends. The election of fair value accounting ensures that the PFI benefits from the economic hedge provided by the forward sales commitments. A PFI could also elect to account for closed loans held for sale under hedge accounting FAS-ASC 815-25. However, we do not recommend this because of the additional complexity involved.

Fair Value

Wilary Winn recommends that PFIs elect to value the closed loans awaiting purchase at their fair value in accordance with FASB ASC paragraph 825-10-15-4(b). We believe the fair value of the committed loans is the price at which it could be sold to the FHLBank on the measurement date, referred to as the “exit price” and the price is a Level 2 input. Similarly, we believe the fair value of the forward sales commitments should be based on the gain or loss that would occur if the PFI were to pair-off the transaction with the FHLBank at the measurement date. We further believe this is a Level 2 input. Changes in the fair value of the loans should be offset by the changes in the fair value of the forward sales commitments and thus, there should be no overall gain or loss from changes in market interest rates on committed loans.

Similarly, we believe the appropriate uncommitted loan prices are Level 2 inputs as well. There could be an overall gain or loss depending on the economic effectiveness of the forward sales contracts as a hedge, since both the loans and the forward sales commitments are marked to market separately.

FASB ASC paragraph 820-10-50 requires the following disclosures:

- The fair value measurements at the reporting date;
- The level in the fair value hierarchy – Level 1, 2 or 3. We believe loans held for sale and forward loan sales commitments are level 2 and that IRLCs are level 3.

FAS-ASC-850-10-1C provides “the objective of the disclosure requirements in this Subtopic is to provide users of financial statements with information about assets and liabilities measured at fair value in the statement of financial position or disclosed in the notes to financial statements:

- a. The valuation techniques and inputs that a reporting entity uses to arrive at its measures of fair value, including judgments and assumptions that the entity makes
- b. The uncertainty in the fair value measurements as of the reporting date
- c. How changes in fair value measurements affect an entity’s performance and cash flows.”

FAS-ASC-10-1D continues “when complying with the disclosure requirements of this Subtopic, a reporting entity shall consider all of the following:

- a. The level of detail necessary to satisfy the disclosure requirements
- b. How much emphasis to place on each of the various requirements
- c. How much aggregation or disaggregation to undertake
- d. Whether users of financial statements need additional information to evaluate the quantitative information disclosed.”

FAS-ASC- 850-10-2c requires for fair value measurements categorized within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:

1. Total gains or losses for the period recognized in earnings and the line item(s) in the statement of income (or activities) in which those gains or losses are recognized;
2. Total gains or losses for the period recognized in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognized;
3. Purchases, sales, issues, and settlements (each of those types of changes disclosed separately), and;
4. The amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers, and the reporting entity’s policy for determining when transfers between levels are deemed to have occurred (see paragraph 820-10-50-2C). Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

FAS-ASC-10-2d requires for recurring fair value measurements categorized within Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period in (c)(1) included in earnings that is attributable to the change in unrealized gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in the statement of income in which those unrealized gains or losses are recognized.

FAS-ASC-10-2f requires for recurring and nonrecurring fair value measurements categorized within Level 3 of the fair value hierarchy, a description of the valuation processes used by the reporting entity (including, for example, how an entity decides its valuation policies and procedures and analyzes changes in fair value measurements from period to period).

FAS-ASC-50-2G requires for recurring fair value measurements categorized within Level 3 of the fair value hierarchy, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, a reporting entity shall also provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs shall include, at a minimum, the unobservable inputs disclosed when complying with paragraph FAS-ASC 820-10-50-2(bbb).

Lower of Cost or Fair Value

If an institution does not elect “fair value” or “hedge” accounting, the closed loans awaiting purchase (warehouse loans) are accounted for at the lower of cost or fair value.¹²

FASB ASC paragraph 948-310-35 provides that the fair value for loans subject to investor purchase commitments (committed loans) and loans held on a speculative basis (uncommitted loans) are to be determined separately as follows:

Committed loans – Mortgage loans covered by investor commitments shall be based on the fair values of the loans.

Uncommitted loans – Fair value for uncommitted loans shall be based on the market in which the mortgage banking enterprise normally operates. That determination would include consideration of the following:

- Market prices and yields sought by the mortgage banking enterprise’s normal market outlets (FHLBank)
- Quoted Government National Mortgage Association (GNMA) security prices or other public market quotations for long-term mortgage loan rates
- Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) current delivery prices (Wilary Winn believes this should include FHLBank prices as well.)

We believe the forward sales commitments used to hedge the closed loan inventory and allocated to loans at the loan level (resulting in “committed loans”) can be used to determine the loans’ fair value. The fair value for uncommitted loans is calculated as described earlier.

The accounting then varies if market interest rates have increased or decreased since the loan was closed and whether or not the loan is committed or uncommitted. Following are the four possible scenarios when accounting for the loans at the lower of cost or fair value.

Committed Loan – Market Rates Increase

If market rates have increased, the fair value of the mandatory forward loan sales commitment has increased and should be recorded. The loan has decreased in value by a similar amount and the PFI should record a corresponding loss on the value of the loan. The result is no overall gain or loss to the PFI.

Committed Loan – Market Rates Decrease

If market rates have decreased, the fair value of the mandatory forward loan sales commitment has decreased and the economic value of the loan has increased. However, the loan cannot be “written up” above cost, resulting in an overall loss.

¹² FASB ASC 948-310-35-1

Uncommitted Loan – Market Rates Increase

If market rates increase, the fair value of the mandatory forward sales contracts has increased and the value of the loan has decreased. The fair value of the loan and the contract are based on market prices. The result is an overall gain or loss depending on the economic effectiveness of the forward sales contract as a hedge.

Uncommitted Loan – Market Rates Decrease

If market rates have decreased the fair value of the mandatory forward loan sales commitment has decreased and the economic value of the loan has increased. However, the loan cannot be “written up” above cost, resulting in an overall loss.

This asymmetrical result is the reason Wilary Winn recommends that PFIs account for their mortgage loans held for sale at fair value.

Regulatory Implications

If a PFI is accounting for its closed loan inventory at the lower of cost or fair value, then the forward loan sales commitments used to hedge them for economic purposes are treated as “non-hedging” derivatives for regulatory purposes. The following disclosures are required if a PFI elects to account for its closed loan inventory at fair value.

FFIEC

The total gains and losses must be reported on RI-5i and RI Memoranda 13a and 13b.

The outstanding principal balance of the loans held for sale reported at fair value must be reported on RC-C Part I line 1 c (2) (a).

Mortgage Banking Activities

Banks with that engage in significant mortgage banking activities - defined as more than \$10 million of loan originations and purchases for resale from all sources, loan sales, or loans held for sale inventory at quarter-end for two consecutive quarters must complete Schedule RC-P – 1 - 4 Family Residential Mortgage Banking Activities in Domestic Offices. The schedule requires the following reporting:

- Retail originations during the quarter of 1 - 4 family residential loans for sale are reported on 1.
- Wholesale originations and purchases during the quarter of 1 - 4 family residential loans for sale are reported on 2.
- 1 - 4 family residential mortgage loans sold during the quarter are reported on 3.
- 1 - 4 family residential mortgage loans held for sale or trading at quarter-end are reported on 4.
- Noninterest income for the quarter from the sale, securitizations and servicing of 1 - 4 family residential mortgage loans is reported on 5.
- Repurchases and indemnifications of 1 - 4 family residential mortgage loans during the quarter are reported on 6.
- Representation and warranty reserves for 1 - 4 family residential mortgage loans sold are reported on 7.a. through 7.c.

In our previous simplified gain on sale example, the MSR's were recorded at their estimated initial fair value. The subsequent accounting and reporting requirements for MSR's are relatively complex and are described in the following sections.

MORTGAGE SERVICING RIGHTS

Given their complexity and volatility, MSR's require documented valuation, appropriate accounting treatment, and comprehensive governance over modeling and regulatory compliance. This section discusses the value of retained MSR's, the applicable accounting methods for MSR's, and key regulatory implications.

Value of Retained Mortgage Servicing Rights

An MSR is the right to service a loan on behalf of an investor and collect a servicing fee. Loan servicing consists of collecting and processing loan payments during the life of a loan. Servicing activities also include billing the borrower; collecting payments of principal, interest, taxes and insurance; disbursing property taxes and insurance premiums; accounting for these activities at the loan and investor level; and forwarding funds to an investor in the secondary market.

MSR's are a modified interest-only strip. The expected life of the loan is calculated based on its expected prepayment rate and is a key valuation variable. The servicing fee is paid monthly based on the outstanding principal balance of the loan and is another significant determinant of value.

Other important components include the expected ancillary income, the current and future servicing costs, the current and expected delinquency rate and related incremental servicing costs, interest income from float, as well as whether the servicing is non-recourse, recourse, or has a limited form of credit risk exposure. The final key element in valuing the MSR is the interest rate used to discount the future cash flows to present value.

Servicing fees vary by type of investor - 25 basis points for conventional loans, 44 basis points for MPF government loans, and between 19 and 56.5 basis points for MPF Government MBS loans. Ancillary income includes late fees, credit life insurance commissions and other insurance income, and other fees earned from soliciting the portfolio. The amount of ancillary income generated varies significantly based on a PFI's ability to cross-sell its servicing customers. Servicing costs are best expressed in dollars per loan as they are more closely related to units versus loan size. Valuations based on servicing costs expressed in basis points imply that the cost to service a \$300,000 loan is three times that of a \$100,000 loan, which is decidedly untrue.

The method a PFI selects to remit the cash due to the FHLBank affects the value of the servicing asset. The choices include actual/actual, actual/actual single, or scheduled/scheduled remittance. The method selected affects the frequency and timing with which the cash is remitted and the value of future float earnings. Under actual/actual remittance, servicers transfer funds to the FHLBank whenever the balance of the P&I Custodial Account (excluding Servicing Fees) exceeds \$2,500 and then any remaining account balance on the first business day of the month after the accounting cut-off date. Under actual/actual single remittance and scheduled/scheduled remittance, servicers remit payments on the 18th calendar day of the month following the accounting cut-off. If the 18th falls on a weekend or holiday the remittance day is the business day prior to the 18th.

The interest rate used to discount projected future cash flows is also a significant driver of value. Valuations should be based on marketplace assumptions regarding discount rates.

Wilary Winn believes that the fair value of the servicing rights asset is based in Level 2 and Level 3 inputs and is therefore classified as a Level 3 asset. According to FAS ASC paragraph 820-10-35-48 inputs include the following:

- **Level 1:** Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.
- **Level 2:** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs would include, for example, quoted prices for similar assets or liabilities.
- **Level 3:** Unobservable inputs for the asset or liability. Unobservable inputs should be used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective should remain the same; that is, an exit price from the perspective of a market participant that holds the asset or owes the liability.

The inputs used to value servicing rights are either observable (prepayment speeds, servicing costs, forward curves, default rates, and loss severities) or can be corroborated (discount rates).

Accounting for MSRs

The proper accounting and reporting for mortgage servicing assets is set forth in FASB ASC 860-50. FAS ASC paragraph 860-50-25-1 - Transfers and Servicing - Servicing Assets and Liabilities provides that an entity shall recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in any of the following situations:

- a. A servicer's transfer of any of the following, if that meets the requirements for sale accounting - an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset, in which circumstance the transferor shall recognize a servicing asset or a servicing liability only related to the participating interest sold.
- b. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer or its consolidated affiliates.

The institution as loan servicer receives the benefits of the servicing, including the contractually specified servicing fees, a portion of the interest from the financial assets, late charges, and ancillary income, and incurs the costs of servicing the assets. The benefits of servicing are expected to exceed "adequate compensation". If they do not, an institution has a servicing liability. Servicing assets and liabilities must be reported separately. FAS ASC 860-50-30-2 states that, "adequate compensation is

determined by the marketplace.” Entities shall consider the nature of the assets being serviced as a factor in determining the fair value of a servicing asset or servicing liability. The types of assets being serviced affect the amount required to adequately compensate the servicer.¹³

The servicing asset is to be initially reported at its fair value. Following is an example of how to record the servicing asset at fair value assuming that the estimated fair value of the MSR is one percent on a \$300,000 loan.

Journal Entries			
	Description	Debit	Credit
JE 1	Servicing Asset	\$ 3,000	
	Gain on Sale		\$ 3,000
Record initial MSR value			

The asset is to be subsequently measured and accounted for using one of the following two methods:

1. **Amortization method:** Amortize the servicing asset in proportion to 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.
2. **Fair value measurement method:** Measure the servicing asset at fair value at each reporting date and report changes in fair value of servicing assets in earnings in the period in which the changes occur.

For more details, see FASB ASC paragraph 860-50-35-1.

Wilary Winn recommends that PFIs that do not financially hedge their portfolios remain on the amortization method in order to minimize earnings volatility.

We note that different elections can be made for different classes of servicing and that a PFI may make an irrevocable decision to subsequently measure a class of servicing assets at fair value at the beginning of any fiscal year.¹⁴

A simplified monthly income statement for the \$300,000 loan the month after it is sold is below. The servicing fee is 25 basis points, the ancillary income is \$25.00 per loan per year, the value of the float is estimated to be \$4.45 (average escrow balance of \$1,525 at 3.5 percent interest), and the servicing costs are \$70 per loan per year. The servicing asset is being amortized on the level yield methodology. FASB ASC paragraph 860-50- 50- 2 sets forth increased required disclosures for servicing assets and liabilities.

Income Statement	Value	Methodology
Servicing Income	\$ 62.50	300,000 * .25% / 12
Amortization Expense	\$ (45.51)	
Ancillary Income	\$ 2.08	25.00 / 12
Value of Escrows	\$ 4.45	1,525 * 3.5% / 12
Servicing Costs	\$ (5.83)	-70 / 12
Profit	\$ 17.69	

¹³ FAS ASC 860-50-30-7

¹⁴ FAS ASC 860-50-35-3d

Regardless of the method selected, institutions must disclose:

1. Management's basis for determining the classes of servicing assets and liabilities.
2. A description of the risks inherent in the servicing assets and liabilities, and if applicable, the instruments used to mitigate the income statement effect of changes in fair value of the servicing assets and liabilities.
3. The amount of contractually specified servicing fees, late fees, and ancillary fees earned for each period for which results are presented, including a description of where each item is reported in the statement of income.
4. Quantitative and qualitative information about the assumptions used to estimate fair value (for example, discount rates, anticipated credit losses, and prepayment speeds).

Amortization Method

FASB ASC paragraph 860-50-35-9 requires that MSRs be stratified and reported by one or more predominant risk characteristics which include "interest rate, type of loan, loan size, date of origination, term, and geographic location." PFIs should be deliberate in their selection of stratification bands, as a gain in one band cannot be used to offset an impairment loss in another. Moreover, making changes to the bands once they are established is strongly discouraged.

Impairment is best measured at the loan level and is reported at the predominant risk characteristic stratum. There is a difference between temporary impairment, which is accounted for through an allowance, and "other than temporary" or permanent impairment, which requires a direct write off. We note that the temporary impairment reserve can be reduced to a floor of zero if the asset recovers and the reserve is no longer required.

The disclosures required when PFIs elect the amortization method are as follows:

1. For each class of servicing assets and liabilities, the activity in the balance of the servicing assets and the activity in the balance of the servicing liabilities (including a description of where changes in the carrying amount are reported in the statement of income for each period for which results of operations are presented) including, but not limited to, the following:
 - The beginning and ending balances
 - Additions (through purchases of servicing assets, assumptions of servicing obligations, and servicing obligations that result from transfers of financial assets)
 - Disposals
 - Amortization
 - Application of valuation allowance to adjust carrying value of servicing assets
 - Other-than-temporary impairments
 - Other changes that affect the balance and a description of those changes
2. For each class of servicing assets and liabilities, the fair value of recognized servicing assets and liabilities at the beginning and end of the period.
3. The risk characteristics of the underlying financial assets used to stratify recognized servicing assets for purposes of measuring impairment in accordance with FASB ASC paragraph 860-50-35-9. An example of risk characteristics for MSRs is attached as [Appendix C](#).

4. The activity by class in any valuation allowance for impairment of servicing assets – including beginning and ending balances, aggregate additions charged and recoveries credited to operations, and aggregate write-downs charged against the allowance – for each period for which results of operations are presented.

Fair Value Measurement Method

Alternatively, PFIs may elect to subsequently measure the servicing asset using the fair value method. Using this method, an institution measures the servicing asset at fair value at each reporting date and reports the changes in the fair value of servicing assets in earnings in the period in which the changes occur. The disclosures required when institutions elect the fair value method are as follows:

1. For each class of servicing assets and liabilities, the activity in the balance of the servicing assets and the activity in the balance of the servicing liabilities (including a description of where changes in the fair value are reported in the statement of income for each period for which results of operations are presented) including, but not limited to, the following:
 - The beginning and ending balances
 - Additions (through purchases of servicing assets, assumptions of servicing obligations, and servicing obligations that result from transfers of financial assets)
 - Disposals
 - Changes in fair value during the period resulting from:
 - Changes in valuation inputs or assumptions used in the valuation model
 - Other changes in fair value and a description of those changes
2. Other changes that affect the balance and a description of those changes

Loan Servicing Regulatory Implications

The banking agencies expect institutions involved in the mortgage-servicing operations to use market-based assumptions that are reasonable and supportable in estimating the fair value of servicing assets.¹⁵ PFIs should compare their estimates of fair value to bulk, flow, and daily servicing released prices to ensure that the PFI's valuation assumptions are reasonable and consistent with those used in the marketplace. The Interagency Advisory on Mortgage Banking also indicates that PFIs should ensure that the following items are addressed.

Valuation and Modeling Processes

The advisory requires comprehensive documentation standards for all aspects of mortgage banking, including mortgage servicing assets. PFIs should substantiate and validate the initial carrying amounts assigned to MSRs and the underlying valuation assumptions. The validation process should compare actual to predicted performance.

Valuation models should be based on realistic estimates of adequate compensation, future revenues, prepayment speeds, market servicing costs, mortgage default rates, and discount rates. Fair values should be based upon market prices and market-based valuation assumptions.

¹⁵ The Interagency Advisory on Mortgage Banking Activities - February 2003, Examination Concerns paragraph 1

The agencies encourage institutions to obtain periodic third-party valuations by qualified market professionals to support the fair values of their MSRs and to update internal models.

Institutions should compare the actual gross monthly cash flows to modeled cash flows in order to better understand the economic value of their servicing rights.

Changes in valuation assumptions should be reviewed and approved by management and, where appropriate, by the board of directors. Institutions should ensure that financial models used throughout the company for mortgage servicing including valuation, hedging, and pricing be compared and that differences between the values obtained be identified, supported, and reconciled.

There are two more modeling recommendations for PFIs remaining on the amortization method. PFIs should ensure that:

1. Amortization of the cost basis is based on the estimated remaining net servicing income period as adjusted for prepayments; and
2. Impairment is recognized timely.

There are also requirements for mortgage banking hedging activities, management information systems, and internal audit.

In addition, there are four FFIEC Call Report reporting requirements associated with MSRs arising under the MPF closed loan products:

1. The outstanding principal balance of the loans delivered under the MPF Original, MPF 125, and MPF 35 products is to be reported on Schedule RC-S, item 11A and RC-S, Memoranda, item 2a.
2. The outstanding principal balance of the loans delivered under the MPF Government, MPF Government MBS, and MPF Xtra programs is to be reported on Schedule RC-S Memoranda, item 2b.
3. The book value of the retained servicing is reported in RC-M, Memoranda, item 2a.
4. The estimated fair value of the retained servicing is reported in RC-M, Memoranda, item 2a(1).

For regulatory capital purposes, MSRs are limited to 10 percent of Common Equity Tier One. Amounts in excess of the 10 percent threshold do not count toward Common Equity Tier One and the eligible portion is risk weighted at 250 percent. The amount of MSRs deducted from Common Equity Tier One reduces total risk weighted assets. MSRs are also included in the 15 percent limitation test, so while they could be less than 10 percent of Common Equity Tier One, they could be subject to deduction as a component of the 15 percent test items, which also include eligible deferred tax credits and significant investments in unconsolidated financial institutions.

The requirements for the NCUA 5300 are as follows:

- The servicing fees are included in Non-Interest Income – page 5, line 13 – Fee Income.
- Loan servicing expenses are included in Non-Interest Expense – page 5, line 29 – Loan Servicing Expense.
- The total number and amount of loans sold is reported on Schedule A, Section 6:
 - Item 3.a. First mortgage loans sold on the secondary market

- Item 3.b. Loans Transferred with Limited Recourse Qualifying for Sales Accounting
- Item 3.c. Real Estate Loans Sold with Servicing Retained (year-to-date and outstanding)
- The MSR book value is reported on page 2 - Other Assets, line 23.b. Mortgage servicing assets

CREDIT ENHANCEMENT

THERE IS A DIVERSITY OF PRACTICE IN THE RECORDING OF THE CE OBLIGATION LIABILITY AND THE CE INCOME TO BE RECEIVED. READERS ARE THEREFORE STRONGLY ENCOURAGED TO DISCUSS THE ACCOUNTING FOR THESE ITEMS WITH THEIR INDEPENDENT ACCOUNTANTS AND PRIMARY REGULATORS TO OBTAIN THEIR INPUT AND COMMENTS BEFORE MAKING ANY ACCOUNTING DECISIONS.

To account for the MPF Program CE a PFI must differentiate the accounting for the CE Recourse Obligation amount – the maximum loss amount it could incur versus the Contingent Liability Amount – the actual losses it could likely incur. The CE Recourse Obligation amount is accounted for as a guarantee under FAS ASC 326-20.¹⁶ The CE Obligation liability amount is within the scope of CECL because it is an off-balance sheet exposure not accounted for as insurance.¹⁷

Following is a discussion of the accounting for CE Recourse Obligation – the guarantee followed by an analysis of the Contingent Liability or Recourse Liability Amount – the potential actual losses.

Accounting for the Guarantee

The required CE Obligation liability is determined by using a credit risk model's assessment of loan, borrower, and property attributes and is calculated for each loan originated under the Master Commitment. Loan level CE Obligation liabilities are accumulated at the pool level to determine maximum credit risk exposure for a given commitment.

The present value of the CE Obligation liability is determined by discounting the expected losses at an appropriate discount rate. The primary valuation factors are:

- The loan amount
- The CE Recourse Obligation percentage
- The expected life of the loan
- The expected default rate
- The expected severity of actual foreclosure losses
- The level of credit risk assumed
- The discount rate used to discount the cash flows
- The net amount in the FLA

The severity of the actual losses is dependent on the amount of equity the homeowner has in the loan at the time of the default and the amount of PMI in place, if any. The actual losses flowing through to

¹⁶ FAS ASC 460-10-30-5

¹⁷ FAS ASC 326-20-10-15-2c

the PFI are dependent on the percentage level of CE Recourse Obligation assumed and the amount of the FLA at the time of default.

The CE Obligation liability is a recourse liability that arises from the sale of the loans to the FHLBank. The accounting guidance for the recourse liability can be found in FAS ASC 460-10 - Guarantees. FAS ASC 460-10-25-4 requires a guarantor to “recognize at the inception of the guarantee, a liability for that guarantee.” Because the guarantee is issued as a part of a transaction with multiple elements (sale of the loan, recording of the servicing, incurring the liability) the guarantee liability at inception should be recorded at its estimated fair value and will affect the proceeds from the sale.¹⁸ FAS ASC 460-10-30-2b goes on to state that in estimating fair value, the “guarantor 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.”

In both cases, the CE Income receivable is set equal to its fair value. The recognition of the CE Obligation liability associated with the guarantee is subject to diversity in practice. In the first case, the CE Obligation liability is set to its respective fair value. In the second case, the CE Obligation liability is set equal to the CE Income receivable – the practical expedient.

Accounting Practices – Example Number One

Accounting Practices Example Number One is based on our interpretation of guidance regarding accounting for the MPF program that the FDIC released in its Supervisory Insights News Winter 2004 – Accounting News. In this interpretation of FAS ASC 460, the CE Obligation liability and the CE Income receivable are each initially recorded at their estimated fair value, and both are part of the sale proceeds. The fair value of the CE Income receivable increases sales proceeds, while the fair value of the CE Obligation liability reduces sales proceeds.

The value of the CE Income receivable under this accounting practice is based on the outstanding loan amount, the CE Income percentage, the expected loan life (based on prepayments and defaults), and the rate used to discount the future payments. Wilary Winn believes PFIs should calculate potential credit losses under CECL using the same methodologies and models used to assess credit risk on residential real estate loans held in portfolio. Ideally, we believe calculations are performed at the loan level and that the pools used to determine losses should be at the Master Commitment level. This will ensure that a PFI considers the benefit of the funded FLA and the FHLBank covering losses in excess of the CE Recourse Obligation maximum amount.

Following is an example of how to record the sale of the loan, the servicing asset at fair value, and the CE Income receivable and CE Obligation liability at their fair values (assuming that the value of the CE Obligation liability at the time of the sale is zero). The basis of the loan is \$300,000, its face amount is \$300,000 and it can be sold for a price of 101.50. The fair value of the MSR is \$3,000 and the estimated fair value of the CE Income receivable is 35 basis points or \$1,050.

¹⁸ FAS ASC 460-10-30-2b

Journal Entries			
Description		Debit	Credit
JE 1	Cash	\$ 304,500	
	CE Income Receivable	\$ 1,050	
	CE Obligation Liability		\$0
	Loan Receivable		\$ 300,000
	Gain on Sale		\$ 5,550
Record initial loan sale			
JE 2	Servicing Asset	\$ 3,000	
	Gain on Sale		\$ 3,000
Record initial MSR value			
JE 3	Cash	\$ 120	
	CE Income Receivable		\$ 108
	Other Income		\$ 12
Record CE Income and amortize the receivable			

Because the mortgages in the Master Commitment can be contractually prepaid and the CE Income receivable is a function of the principal amount outstanding on the mortgage loans, Wilary Winn believes the CE Income receivable should be subsequently measured and accounted for in accordance with the accounting for interest only strips.¹⁹ The receivable is to be measured at its fair market value as an available-for-sale security under FAS ASC 860-20-55-33, with changes in fair value recorded to other comprehensive income. Additionally, the discount on the CE Income receivable amortizes as the cash is received. Because the amount recorded at inception is the present value of the CE Income estimated to be collected, a portion of the cash received represents the value arising from discounting the receivable.

We further note that the interest only strip analogy referenced above in no way affects the fact that transfers of loans to the FHLBanks under the MPF Program are true sales for accounting purposes. See the [Sales Treatment](#) section.

Accounting Practices – Example Number Two

Under this accounting practice (the FAS 460- 10 Practical Expedient), the fair value of the CE Obligation liability at inception is equal to the present value of the CE Income expected to be received. PFIs can subsequently account for their release from risk over the term of the guarantee using one of the following three methods:

1. Upon expiration or settlement of the CE Recourse Obligation;
2. By a systematic and rational amortization method; or
3. As the fair value of the guarantee changes.

We note that the fair value method cannot be used for the CE Obligation liability unless it can be justified under GAAP. For example, if the guarantee is accounted for as a derivative.²⁰

Following is an example of how to record the sale of the loan, the servicing asset at fair value, and the CE Income receivable and CE Obligation liability at their fair values (assuming that the value of the CE

¹⁹ FAS ASC 860-20-35-2

²⁰ FAS ASC 460-10-35-2

Obligation liability at the time of the sale is equal to the value of the CE Income receivable). The basis of the loan is \$300,000, its face amount is \$300,000 and it can be sold for a price of 101.50. The fair value of the MSR is \$3,000 and the estimated fair value of the CE Income receivable is 35 basis points or \$1,050.

Journal Entries			
	Description	Debit	Credit
JE 1	Cash	\$ 304,500	
	CE Income Receivable	\$ 1,050	
	CE Obligation Liability		\$ 1,050
	Loan Receivable		\$300,000
	Gain on Sale		\$ 4,500
Record initial loan sale			
JE 2	Servicing Asset	\$ 3,000	
	Gain on Sale		\$ 3,000
Record initial MSR value			
JE 3	Cash	\$ 120	
	CE Income Receivable		\$ 108
	Other Income		\$ 12
Record CE Income and amortize the receivable			
JE 4	CE Obligation Liability	\$ 108	
	Other Expense	\$ 12	
	Other Income		\$ 120
Record CE Income and amortize the liability			

Similar to Accounting Practices Example Number One, the discount on the CE Income receivable is amortized as the cash is received. The entry for the CE Obligation liability is similar in this respect. Wilary Winn recommends the CE Obligation liability be amortized in proportion to and over the period of its estimated life. This method results in a “level yield” over the estimated life of the guarantee and the amortization amount would largely offset the income received.

We note that many organizations that believe Accounting Practices Example Number Two is the correct interpretation simply account for the CE Income on a cash basis as received because this methodology closely matches the accounting required under the example.

Credit Enhancement Regulatory Implications

The CE Income receivable and CE Obligation liability are similar to, and therefore subject to, many of the standards contained in the December 1999 Inter-Agency Guidance on Asset Securitization Activities. The key assumptions used to value the asset and the liability include prepayment rates, default rates, loss severity percentages, and discount rates. As with MSRs, the Guidance requires comprehensive documentation of the valuation process; that the valuation be based on reasonable and supportable assumptions; and that assumptions be compared to actual results.

In addition, there are rules regarding required capital for insured institutions that sell loans under the MPF Program. The specifics are set forth in the Financial Institution Letter 99-21, Final Rule to Amend

Regulatory Capital Treatment of Recourse Arrangements, Direct Credit Substitutes, Residual interests, Residual Interests in Asset Securitizations, and Asset-Backed and Mortgage-Backed Securities.

In general, the MPF Original product requires the most risk-based capital because the other MPF products have larger FLAs from inception. Following is a summary of the current regulatory reporting requirements by type of financial institution.

Banks

Under BASEL III, the CE Recourse Obligation amount is treated as a securitization. The Banking Agencies believe that exposures that tranche credit risk meet the definition of a synthetic securitization and that the risk of such exposures would be appropriately captured under the securitization framework. Although Basel III establishes detailed risk-based capital and securitization standards, the Community Bank Leverage Ratio (“CBLR”) framework offers a streamlined approach, provided that securitization activities and retained exposures remain within regulatory thresholds.

Community Bank Leverage Ratio

The CBLR final rule was adopted by the federal banking agencies and became effective on January 1, 2020. The rule is optional and designed to simplify the calculation of regulatory capital. It allows community banks to calculate a leverage ratio based on total assets. Thus, qualifying banks no longer have to calculate risk-weighted assets. The CBLR is calculated as the ratio of Tier 1 Equity to average total consolidated assets.

We note that the final rule was modified April 6, 2020, by two interim final rules under Section 4012 of the Coronavirus Aid, Relief and Economic Security Act. Furthermore, beginning July 1, 2026, revised rule changes to the CBLR framework take effect. The modifications are included below.

Qualifying Community Banking Organization

Beginning July 1, 2026, a qualifying community banking organization is defined as a depository institution, or depository institution holding company, that is not an advanced approaches banking organization and that meets the following criteria:

- CBLR greater than 8 percent;
- Total consolidated assets of less than \$10 billion;
- Total off-balance sheet exposures (excluding derivatives other than credit derivatives and unconditionally cancelable commitments) of 25 percent or less of total consolidated assets;
- Total trading assets and trading liabilities of 5 percent or less of total consolidated assets.

If a community bank falls below the required minimum CBLR threshold because of growth in total assets and/or declines in Tier One equity, it could revert to use of the existing rules. If a community bank elects to remain in the CBLR framework, the rule provides a four-quarter grace period to restore the ratio, subject to a maximum of eight out of the prior twenty quarters. During the grace period, the bank’s leverage ratio must not fall below 8 percent.

When the FDIC originally released the CBLR framework in 2020:

- The CBLR requirement was 9 percent, not 8 percent.

- The grace period was two quarters, not four quarters.

Off-Balance Sheet Exposures

While most of the qualifying criteria are relatively straightforward, off-balance sheet exposures require further explanation. Under the proposal, total off-balance sheet exposures would be calculated as the sum of the notional amounts of certain off-balance sheet items as of the end of the most recent calendar quarter. Total off-balance sheet exposures would include:

- The unused portions of commitments (except for unconditionally cancellable commitments);
- Self-liquidating, trade-related contingent items that arise from the movement of goods;
- Transaction-related contingent items including performance bonds, bid bonds, warranties and performance standby letters of credit;
- Sold credit protection through:
 - Guaranties
 - Credit derivatives
 - Credit enhancing representations and warranties
- Securities lent and borrowed, calculated according to Call Report reporting instructions;
- Financial Standby Letters of credit;
- Forward agreements that are not derivative contracts; and
- Off-balance sheet securitization exposures.

Total off-balance sheet exposures would not include derivatives (such as foreign exchange swaps and interest rate swaps) but would include credit derivatives.

The off-balance sheet exposure limitation has a direct effect on the FHLBank MPF participating financial institutions. PFIs opting into the CBLR would no longer have to calculate the risk-weighted assets arising from the CE Recourse Obligation amount in accordance with BASEL III. It simply reports the total net CE Recourse Obligation amount under Tier I leverage ratio calculation as an off-balance sheet securitization exposure. The total net CE Recourse Obligation amount, combined with other off-balance sheet exposures, cannot exceed 25 percent of total assets.

The table below shows a simplified example assuming the PFI has \$7,000 of net CE Recourse Obligations and no other off-balance sheet exposures.

Current Tier 1 Leverage Ratio		9.38%
Qualifying Criteria for Using the CBLR Framework:		
Total Consolidated Assets < \$10 billion		\$ 450,000
Trading Assets and Trading Liabilities as a % of Total Consolidated Assets (5% limit)	0.00%	\$ -
Off-Balance Sheet Exposures:		
Unused Portion of Conditionally Cancellable Commitments	\$ -	
Securities Lent or Borrowed	\$ -	
Other Off-Balance Sheet Exposures	\$ 7,000	
Total Off-Balance Sheet Exposures as a % of Total Consolidated Assets (25% limit)	1.56%	\$ 7,000

Before Adopting the Rule

Even at 8 percent, the CBLR capital threshold is well in excess of the 5 percent considered to be well-capitalized under the risk-based capital rules. Wilary Winn therefore strongly encourages PFIs to evaluate how adopting the CBLR framework would affect the amount of capital required to be held in bank. If the amount of capital restricted under the CBLR is substantially greater than the amount required under the existing rules, and the PFI has plans or needs to deploy it, we recommend the PFI consider reporting under the existing regulations.

Basel III

Under the securitization framework, a PFI can calculate the risk-weighted amount for a securitization exposure by applying either the Simplified Supervisory Formula Approach (“SSFA”) or a Gross-up approach under the general risk-based capital rules. However, a PFI must apply the SSFA or the Gross-up approach consistently across all of its securitization exposures. The question that arises is whether a bank can switch from the SSFA to the Gross-up approach or vice versa from quarter to quarter so long as it uses only one approach for the quarter. The rules here are silent. Based on our conversations with the banking regulators, Wilary Winn believes that a PFI can switch from one approach to the other and that a PFI did not make an irrevocable decision at the initial reporting. However, we believe the changes should be made infrequently and for a sound reason. We believe that frequently switching between the two approaches will invite regulatory scrutiny.

We note that a PFI can also elect to assign a 1,250 percent risk weight to any securitization exposure at any time - which is essentially a dollar-for-dollar required capital treatment.

SSFA Approach

Under the SSFA approach, risk-weighting is determined using a relatively complex set of calculations. For a step-by-step description of the calculation details, please see [Appendix E](#).

Wilary Winn has a BASEL III risk weighting tool (“[MPF SSFA Calculator](#)”) and a “[Guide to reporting under BASEL III for FHLBank MPF Program participants](#)” available on our website at <https://wilwinn.com/resources/>.

Gross-Up Approach

Under the Gross-up approach, a bank is required to calculate the credit equivalent amount which equals the amount of loans sold and outstanding less the balance in the FLA. The credit equivalent amount is then risk weighted at 50 percent for loans that are current and 100 percent for non-current loans (as defined under the SSFA approach). The minimum risk weight is 20 percent of the CE Recourse Obligation amount.

Regulatory Reporting

To complete the Call Report, on RC-R, Part II, Risk-Weighted Assets Line 10, PFIs need to sum the CE Recourse Obligation amounts and report:

- Column A: the total of all obligations
- Column Q: the total amounts that are to be reported by multiplying by 12.5
- Column B*: the total amounts to be risk-weighted under the SSFA or Gross-up approach

- Column T: the total calculated risk-weighted assets (not the total CE Recourse Obligation amount).
- Column U: the total calculated risk-weighted assets (not the total CE Recourse Obligation amount).

*A PFI cannot select to report certain CE Recourse Obligation amounts under the SSFA method and others under the Gross-up approach. A PFI must select one method or the other. Either Column T or Column U will be N/A.

In addition, we note that the CE Recourse Obligation amount net of any CE Obligation liability already recorded is reported in Schedule RC-S, item 12A. For a complete example, see our [Guide to Reporting Under BASEL III for FHLB MPF Program Participants](#) on the Wilary Winn website.

Credit Unions

Under the NCUA 5300 call report, federally insured credit unions classified as complex—those with more than \$500 million in total assets—must comply with the NCUA risk-based capital rule unless they qualify for and elect the Complex Credit Union Leverage Ratio (“CCULR”) framework.

Risk-Based Capital

Loans sold to the FHLBanks with limited recourse are reported in total risk-based assets as follows – the outstanding principal amount of the loans is reported on page 10, Schedule A, Section 6 – Loans Sold, item 3. b. - Loans Transferred with Limited Recourse Qualifying for Sales Accounting. For credit union’s using the standard risk-based net worth calculation, the amount reported on Schedule A will flow to page 27, Schedule I – Part III, item 35 – Federal Home Loan Bank under the MPF Program. The balance of loans sold and outstanding (net of any valuation allowances) would be multiplied by a 20% credit conversion factor and then risk-weighted at 50%. In other words, 10% of the balance of the loans sold and outstanding would be included in total risk-weighted assets.

For credit unions with more than \$500 million in total assets and loans sold under the FHLB MPF program, additional reporting is required related to the balances of loans sold with recourse and the credit exposure amount. The total outstanding principal balance of closed-end 1-to-4 family residential mortgage loans are also reported on Schedule C, Section 2 Off-balance sheet exposures, item 4 – Loans Transferred under the FHLB MPF program.

Complex Credit Union Leverage Ratio

The Complex Credit Union Leverage Ratio (“CCULR”) framework is an option for complex credit unions to meet their risk-based net worth requirement without calculating a risk-based capital ratio. To opt into the CCULR framework, complex credit unions must meet the following qualifying criteria as of the measurement date:

- CCULR (net worth ratio) of 9 percent or greater (Initial Opt-in)
- Total off-balance sheet exposures of 25 percent or less of total assets
- Sum of total trading assets and total trading liabilities of 5 percent or less of total assets
- Sum of total goodwill and total other intangible assets of 2 percent or less of total assets

Conclusion

Participation in the FHLBank MPF Program offers PFIs a strategically important secondary market alternative that enables the retention of customer relationships, servicing income, and, in many cases, credit-related economics. However, these benefits introduce meaningful accounting, valuation, capital, and regulatory complexities that must be carefully managed.

This guidance has outlined the key accounting and regulatory considerations associated with MPF loan deliveries, including the proper treatment of IRLCs, forward loan sales commitments, MSR, CE Income receivable, and CE Obligation liabilities. Particular emphasis has been placed on fair value measurement, the use of market-based and supportable assumptions, and the need for disciplined model governance and documentation. As demonstrated throughout this handbook, MSR, CE Income, and CE Obligation liabilities are highly sensitive to changes in interest rates, borrower behavior, and economic conditions, underscoring the importance of robust valuation methodologies and ongoing performance validation.

From a regulatory perspective, institutions must understand how MPF-related exposures interact with capital frameworks, including risk-based capital requirements and alternative leverage ratio regimes. Decisions regarding accounting elections, valuation approaches, and capital framework participation can materially affect reported earnings, regulatory capital, and balance sheet flexibility. Accordingly, these decisions should be made deliberately, consistently applied, and revisited as institutional strategies, regulatory expectations, and market conditions evolve.

Given the inherent complexity and diversity of practice in several areas addressed herein, PFIs are strongly encouraged to maintain open and ongoing dialogue with their independent accountants and primary regulators. Sound governance, transparent disclosures, and well-supported assumptions are critical to ensuring that MPF participation remains both economically beneficial and compliant with applicable accounting standards and regulatory requirements.

Appendix A

12/31/2025

Loan ID	Status	Program	Term	Rate	Estimated Close Date	Loan Amount	Discount Points	Basis in Loan ¹	Lock Expiration Date	Days until Lock Expiration	Investor	Secondary Investor Net Price	Origination Fee	Doc. & Underwriting Fee	Commissions	Other Remaining Origination Costs	Accounting Net Gain on Sale (BPS)	Rate Sheet Price Adjustment			Interest Rate Lock-in Commitments												
																		Investor Price at 12/31/2025 based on actual lock days ²	SRP / Servicing Asset	Adjusted Investor Price at 12/31/2025	Investor Price at 12/31/2025 less Basis in Loan	Remaining Origination Benefits	Remaining Origination Costs	Value at 12/31/2025 before Pull-Through	Pull-Through Rate	Value at 12/31/2025 Adjusted for Pull-Through	Gain	Loss					
XXXX1	Approved	Conv.	360	5.875%	1/15/2026	816,000	16,320	98,000	2/4/2026	34	FHLB	100.939	-	775	3,019	1,750	245	100.688	0.800	101.488	3,488	775	(4,769)	24,468	95%	23,244.49	23,244.49	-					
XXXX2	Underwriting	Conv.	180	5.625%	1/20/2026	251,000	-	100,000	1/30/2026	30	FHLB	101.638	-	-	929	2,150	41	101.722	0.700	102.422	2,422	-	(3,079)	3,001	90%	2,700.69	2,700.69	-					
XXXX3	Approved	Conv.	360	6.125%	1/16/2026	250,665	1,880	99,250	2/2/2026	32	FHLB	102.590	-	775	927	1,750	258	101.527	0.850	102.377	3,127	775	(2,677)	5,935	95%	5,638.56	5,638.56	-					
XXXX4	Underwriting	FHA	360	6.750%	1/21/2026	237,650	-	100,000	2/6/2026	36	FHLB	102.500	-	775	879	2,150	155	101.477	2.500	103.977	3,977	775	(3,029)	7,197	90%	6,477.33	6,477.33	-					
XXXX5	Approved	Conv.	360	6.125%	1/19/2026	832,750	-	100,000	2/19/2026	49	FHLB	101.793	8,328	675	3,081	1,750	229	101.545	0.800	102.345	2,345	9,003	(4,831)	23,699	95%	22,514.35	22,514.35	-					
Total						\$ 2,388,065	\$ 18,200	99,238				101.639	\$ 8,328	\$ 3,000	\$ 8,836	\$ 9,550	211																
						Number of Loans:	5																										

Weighted Average Rate: 6.049%

¹ The Basis in Loan is calculated by taking Par minus Discount plus Credit.

² Market prices were pulled from investor rate sheets as of the valuation date.

IRLCs		
	DR	CR
Derivative Asset		60,575.42
Other Non-Interest Income		60,575.42
Other Non-Interest Expense		-
Derivative Liability		-

Appendix B

12/31/2025																	Rate Sheet Price Adjustment			Mandatory Forward Loan Sales Commitments						
Loan ID	Status	Program	Term	Rate	Estimated Close Date	Loan Amount	Discount Points	Basis in Loan ¹	Lock Expiration Date	Days until Lock Expiration	Investor	Secondary Investor Net Price	Origination Fee	Doc. & Underwriting Fees	Commissions	Other Remaining Origination Costs	Accounting Net Gain on Sale (BPS)	Investor Price at 12/31/2025 based on actual lock days ²	SRP / Servicing Asset	Adjusted Investor Price at 12/31/2025	Original Investor Price less 12/31/2025 Investor Price	Value at 12/31/2025 before Pull-Through	Pull-Through Rate	Value at 12/31/2025 Adjusted for Pull-Through	Gain	Loss
XXXX1	Approved	Conv.	360	5.875%	1/15/2026	816,000	16,320	98.000	2/4/2026	34	FHLB	100.939	-	775	3,019	1,750	245	100.688	0.800	101.488	(0,549)	(4,480)	100%	(4,479.84)	-	4,479.84
XXXX2	Underwriting	Conv.	180	5.625%	1/20/2026	251,000	-	100.000	1/30/2026	30	FHLB	101.638	-	-	929	2,150	41	101.722	0.700	102.422	(0,784)	(1,968)	100%	(1,968.09)	-	1,968.09
XXXX3	Approved	Conv.	360	6.125%	1/16/2026	250,665	1,880	99.250	2/2/2026	32	FHLB	102.590	-	775	927	1,750	258	101.527	0.850	102.377	0.213	534	100%	534.42	534.42	-
XXXX4	Underwriting	FHA	360	6.750%	1/21/2026	237,650	-	100.000	2/6/2026	36	FHLB	102.500	-	775	879	2,150	155	101.477	2.500	103.977	(1,477)	(3,510)	100%	(3,510.09)	-	3,510.09
XXXX5	Approved	Conv.	360	6.125%	1/19/2026	832,750	-	100.000	2/19/2026	49	FHLB	101.793	8,328	675	3,081	1,750	229	101.545	0.800	102.345	(0,552)	(4,597)	100%	(4,596.78)	-	4,596.78
Total						\$ 2,388,065	\$ 18,200	99.238				101.639	\$ 8,328	\$ 3,000	\$ 8,836	\$ 9,550	211					(14,020)	\$ (14,020.38)	\$ 534.42	\$ 14,554.80	
Number of Loans:						5																				

Weighted Average Rate: 6.049%

¹ The Basis in Loan is calculated by taking Par minus Discount plus Credit.

² Market prices were pulled from investor rate sheets as of the valuation date.

Mandatory Commitments		
	DR	CR
Other Asset	534.42	
Other Non-Interest Income		534.42
Other Non-Interest Expense	14,554.80	
Other Liability		14,554.80

Appendix C

ABC Bank - \$84.2 MM Servicing Portfolio Valuation as of March 31, 2026

		Principal Balance	# of Loans	Avg. Loan Size	WAC	WAM	Age	Avg Life	Service Fee	T&I Total	Prepayment PSA	Lifetime CRR%	Servicing Multiple	MSR			CE Income			
														Fair Value %	Fair Value \$	Book Value \$	Fair Value - Book Value	Bal. Sheet Impact	Fair Value %	Fair Value \$
40, 30, & 25 year	less than 4.875%	37,797,168	371	101,879	3.348%	287	74	7.84	0.250%	136,211	114	6.868%	4.4	1.109%	419,178	238,058	181,120	-	0.240%	90,588
	4.875% - 6.875%	22,300,907	216	103,245	6.277%	337	23	5.75	0.250%	79,570	255	13.928%	3.5	0.877%	195,565	171,058	24,507	-	0.265%	59,076
	greater than 6.875%	3,588,906	20	179,445	7.127%	343	17	3.51	0.250%	8,476	436	23.678%	2.6	0.654%	23,466	18,958	4,508	-	0.183%	6,563
	Total 40, 30, & 25 year	63,686,981	607	104,921	4.586%	308	53	6.86	0.250%	224,257	182	10.288%	4.0	1.002%	638,209	428,074	210,135	-	0.245%	156,228
20 year	less than 4.750%	6,337,055	79	80,216	3.124%	161	79	5.29	0.250%	23,210	110	6.595%	3.3	0.815%	51,673	24,648	27,026	-	0.161%	10,189
	4.750% - 6.750%	466,731	11	42,430	5.708%	186	54	4.85	0.250%	2,120	193	11.401%	2.3	0.582%	2,715	1,931	784	-	0.267%	1,244
	greater than 6.750%	62,355	2	31,177	6.875%	211	29	4.19	0.250%	273	292	17.371%	0.6	0.149%	93	85	8	-	0.229%	143
	Total 20 year	6,866,141	92	74,632	3.334%	163	77	5.25	0.250%	25,603	117	7.019%	3.2	0.793%	54,482	26,664	27,818	-	0.169%	11,576
15 year	less than 4.500%	10,110,241	233	43,392	2.692%	102	78	3.20	0.250%	56,932	188	11.300%	2.0	0.501%	50,631	18,535	32,096	-	0.090%	9,129
	4.500% - 6.500%	2,582,537	21	122,978	6.043%	166	14	4.24	0.250%	4,880	260	13.501%	2.7	0.679%	17,543	14,896	2,647	-	0.273%	7,059
	greater than 6.500%	231,350	2	115,675	6.750%	153	27	4.36	0.250%	943	205	12.266%	3.1	0.776%	1,796	2,042	(246)	(246)	0.269%	622
	Total 15 year	12,924,128	256	50,485	3.435%	116	64	3.42	0.250%	62,756	203	11.757%	2.2	0.541%	69,970	35,473	34,497	(246)	0.130%	16,810
10 year	less than 4.250%	693,392	14	49,528	2.518%	61	59	2.20	0.250%	2,853	140	8.387%	1.3	0.326%	2,263	655	1,608	-	0.015%	105
	4.250% - 6.250%	8,463	1	8,463	4.500%	30	90	1.11	0.250%	-	277	16.631%	-3.9	-0.977%	(83)	-	(83)	(83)	0.000%	-
	greater than 6.250%	22,576	1	22,576	7.000%	110	10	2.94	0.250%	-	373	18.740%	-1.1	-0.265%	(60)	215	(274)	(274)	0.000%	-
	Total 10 year	724,431	16	45,277	2.681%	62	58	2.21	0.250%	2,853	149	8.806%	1.2	0.293%	2,120	870	1,251	(357)	0.015%	105
Grand Total	84,201,682	971	86,716	4.291%	264	56	6.17	0.250%	315,469	180	10.234%	3.6	0.908%	764,781	491,080	273,701	(603)	0.219%	184,718	

Existing Impairment Reserve (127)

(Additional) / Excess Impairment (476)

Appendix D

Credit Union Name: _____

Federal Charter/Certificate Number: _____

**SCHEDULE F
DERIVATIVE TRANSACTIONS REPORT AS OF: _____**

Total Derivative Transactions Outstanding		Total Notional Amount	Account	Net Fair Value Gain (Loss)	Account
1. Interest Rate Derivatives	a. Options				
	i. Purchased Options		DT0001		DT0002
	ii. Written Options		DT0003		DT0004
	b. Swaps		DT0005		DT0006
	c. Futures		DT0007		DT0008
	d. Other Interest Rate Derivatives		DT0009		DT0010
2. Loan Pipeline Management Derivatives			DT0011		DT0012
3. European Equity Call Options			DT0013		DT0014
4. All Other Derivatives			DT0015		DT0016
5. Total Derivatives (Sum of each column)			1030		1030C

Appendix E

Following is a step-by-step description of the detailed SSFA approach calculations.

The calculation begins with an analysis of the capital requirements that apply to all exposures underlying the securitization. Risk weights are assigned based on the subordination level of an exposure. The formula assigns relatively higher capital requirements to the riskier junior tranches in a securitization which are designed to absorb losses first, while the senior tranches benefit from the subordination provided by the junior tranches. For the MPF Program, the CE Recourse Obligation amount is treated as a subordinate tranche in a securitization. The baseline capital requirement for the CE Recourse Obligation is four percent for the loans sold and outstanding under the Master Commitment that are current, and 8 percent for loans that are past due. The four percent is based on a required capital level of 8 percent multiplied by the risk weight for current first lien single family residential mortgage loans of 50 percent. Similarly, the risk weighting for non-current (defined as the balance of loans in the Master Commitment that are 90 days or more past due, subject to bankruptcy, in the process of foreclosure, held as OREO, which have contractually deferred interest payments of 90 days or more, or are in default) first lien single family residential mortgage loans is 100 percent. The result of this analysis is an SSFA formula input K_G . In effect, K_G is the capital charge the PFI would incur if it held the loans on its balance sheet instead of selling them under the MPF Program.

The banking agencies wanted to further tune the model to account for delinquent loans by adjusting K_G . The percentage of the non-current (as defined above) loans to the total loans sold and outstanding results in an input W . K_G is adjusted by W , resulting in K_A according to the following formula:

$$K_A = (1-W) * K_G + (0.5 * W)$$

The next calculation is to determine the level of subordination or when the PFI will begin incurring losses and when it will cease incurring losses under the Master Commitment. The beginning is called the attachment point (input A) and the ending is called the detachment point (input D). For the MPF Program, input A is equal to the FLA percentage, and input D is equal to the FLA percentage plus the CE percentage.

Wilary Winn has a BASEL III risk weighting tool (“[MPF SSFA Calculator](#)”) and a “[Guide to reporting under BASEL III for FHLBank MPF Program participants](#)” available on our website at <https://wilwinn.com/resources/>.

Begin with the calculation of K_G .

K_G is equal to the weighted-average risk weight of the underlying exposures - which in this case is 4 percent for current loans and 8 percent for loans which are 90+ days delinquent or in non-accrual.

Adjust K_G for delinquent loans to derive K_A according to the following formula:

$$K_A = (1-W)*K_G + (0.5*W)$$

W = The proportion of the loans sold and outstanding that meet the following criteria:

- i. ninety days or more past due;
- ii. subject to a bankruptcy or insolvency proceeding;
- iii. in the process of foreclosure
- iv. held as real estate owned
- v. has contractually deferred interest payments for 90 days or more
- vi. is in default

Next, determine the attachment and detachment points for the loans sold and outstanding.

A is the attachment point and is equal to the FLA as a percentage of the loans sold and outstanding.

D is the detachment point and is equal to the FLA percentage plus the CE amount as a percentage of the loans sold and outstanding.

Essentially A represents the point at which the PFI begins incurring losses and D represents the point at which the PFI would no longer be incurring losses. If the detachment point percentage D (FLA percentage plus CE Recourse Obligation percentage) is less than or equal to K_A , the risk weighting is 1,250 percent. This is because the resulting calculation will result in an increase to risk-weighted assets of less than 50 percent – the baseline capital requirement. In this circumstance, the regulation essentially requires dollar-for-dollar capital treatment.

If A (FLA percentage) is greater than or equal to K_A , the risk weight is equal to K_{SSFA} times 1,250 percent, subject to a minimum supervisory floor of 20 percent of the CE Recourse Obligation amount. The K_{SSFA} formula is determined as follows:

$$\frac{e^{\alpha^* \mu} - e^{\alpha^* \iota}}{\alpha(\mu - \iota)} \text{ where,}$$

- i. $\alpha = \frac{1}{\rho^* K_A}$

- ii. $\rho =$ An indicator variable that is equal to 0.5

- iii. $\mu = D - K_A$

- iv. $\iota = \max(A - K_A, 0)$

- v. $e = 2.71828$, the base of natural logarithms

The K_{SSFA} formula calculates the theoretical losses a PFI could incur over the life of the underlying loans based on its CE Recourse Obligation percentage and the balance in the FLA account. The formula essentially fully recognizes the benefit of the FLA up to the required baseline capital percentage of K_A . The calculation is then based on the losses that a PFI could incur by comparing the CE Recourse Obligation percentage to the balance in the FLA in excess of the baseline capital requirement.

If A is less than K_A and D is greater than K_A the applicable risk weight is a weighted average of 1,250 percent and K_{SSFA} times 1,250 percent.

The precise formula is as follows:

Risk weight = greater of:

$$\left\{ \left[\frac{K_A - A}{D - A} \right] \times 1,250\% \right\} + \left\{ \left[\frac{D - K_A}{D - A} \right] \times 1,250\% \times K_{SSFA} \right\}; \text{ and}$$

20 percent (Supervisory Floor)

This formula begins by comparing the balance in the FLA to the required baseline capital percentage of K_A . The first part of the formula requires dollar for dollar capital treatment for the shortfall in the FLA account compared to K_A based on the losses a PFI could incur given its CE Recourse Obligation and the FLA percentage.

$$\left\{ \left[\frac{K_A - A}{D - A} \right] \times 1,250\% \right\}$$

The second part of the formula is a calculation of the losses a PFI could incur in excess of the required baseline capital requirement of K_A using the KSSFA formula.

Appendix F

The following MPF products are no longer offered for new loan originations.

MPF DIRECT

Under the MPF Direct product, the PFI would sell jumbo residential loans for properties such as 1- to 4-unit owner occupied residences, 1-unit second homes, 1- to 4-unit investment properties, condominiums, co-ops, PUDs and condotels. FHLBank would sell the loan concurrently to another investor. The PFI would not retain either the servicing or the credit risk for loans sold under this product. As a result, while the PFI continues to retain the normal loan origination representations and warranties of a secondary market sale, there is no risk-based capital or additional credit enhancement requirements. Wilary Winn notes that loans sold to the MPF Direct program were subject to loan level price adjustments.

As in all secondary market sales, the financial accounting and reporting for mortgage banking derivatives applies to this product while the accounting for servicing and credit enhancement does not.

MPF PLUS

Under the MPF Plus product, the CE for the pool of loans in a Master Commitment was set to achieve the equivalent of a “AA” credit rating. Under this product, the PFI procured an SMI policy that insured all or a portion (at the PFI’s option) of the PFI’s CE Recourse Obligation. The FLA was initially set to be equal to the deductible on the SMI policy. Losses on the pool of loans not covered by the FLA and the SMI coverage are paid by the PFI, up to the amount of the member’s uninsured CE Recourse Obligation, if any, under the Master Commitment. The FHLBank absorbs all losses in excess of the SMI coverage and the member’s uninsured CE Recourse Obligation.

Each month, the member is paid CE Income for providing a CE Recourse Obligation. The fee is split into fixed and performance income. The fixed CE Income is paid beginning with the month after delivery and is designed to cover the cost of the SMI policy. The performance-based CE Income, which is adjusted for loan losses, accrue and are paid monthly, commencing with the 13th month following each delivery of loans.

MPF 100

Under the MPF 100 product, the first layer of losses (following any PMI coverage) is paid by the FHLBank up to the amount of the FLA which is 100 basis points of the delivered amount. The member then provides a second loss CE Recourse Obligation for each Master Commitment. Loan losses beyond the first and second layers are absorbed by the FHLBank. The PFI’s minimum CE Recourse Obligation is 20 basis points based on delivered amount. The PFI is paid a performance-based CE Income for providing the CE Recourse Obligation, though the fee is guaranteed for at least two years.

The accounting for the MPF 100 product is similar to the MPF Original product. The differences are primarily related to the underlying economics of the product. The FLA is larger, the maximum potential CE Recourse Obligation is smaller, and the amount of CE Income to be received is generally less due to the fact that the CE Income is performance-based.

Prior to the issuance of Statement of FAS #156, there was diversity of practice as to whether or not a servicing asset should be recorded when originating loans under the MPF 100 product. We believe that a servicing asset should have been recorded for loans originated under this product. We believe the servicing asset arose in accordance with FAS ASC paragraph 860-50-25-1 b, which provides that a servicing asset should be recorded in connection with:

“An acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates.”

FASB WAS NOT EXPLICIT WITH REGARD TO RECORDING THE SERVICING ASSET UNDER THE MPF 100 PROGRAM. AS A RESULT, WE STRONGLY ENCOURAGE READERS TO CONSULT WITH THEIR INDEPENDENT ACCOUNTANTS AND PRIMARY REGULATORS BEFORE ADOPTING THIS ACCOUNTING.