



**Welcome to Wilary Winn University 2026
Day 2**



Hedging Mortgage Servicing Rights



THIS SESSIONS SPEAKERS



Eric Nokken
651-346-3973
enokken@wilwinn.com



Sam Gruer
971-671-1741
sgruer@bluroseadvisors.com



Tim Potter, CPA
952-746-6174
tpotter@hedgestar.com



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Resources

[Accounting & Regulatory Reporting for Mortgage Servicing Rights](#)

[Mortgage Servicing Rights Valuation - Input Assumption & Shocks](#)

[Call Report References for Loans Sold with Servicing Retained](#)

[Accounting & Regulatory Guidance for the MPF[®] Program](#)

[MPF SSFA Calculator](#)

[Resources | Wilary Winn](#)

Objectives

- Discuss MSR Accounting
- Review the risk profile of MSR assets.
- Discuss hedging the MSR asset using Swaptions.
- Potential costs of hedging the MSR asset.

MSR Accounting



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MSR Accounting

- Record the initial capitalization of the MSR asset at fair value to gain (loss) on sale of loans
 - For loans sold in years prior to when the asset is initially reported, the entry may require a prior period adjustment to equity whereas the fair value for current year loans would be reported to income
- As cash is received each month, record the offset to service fee income
- Two acceptable accounting methods under GAAP:
 - Fair Value
 - Amortization (LOCOM)

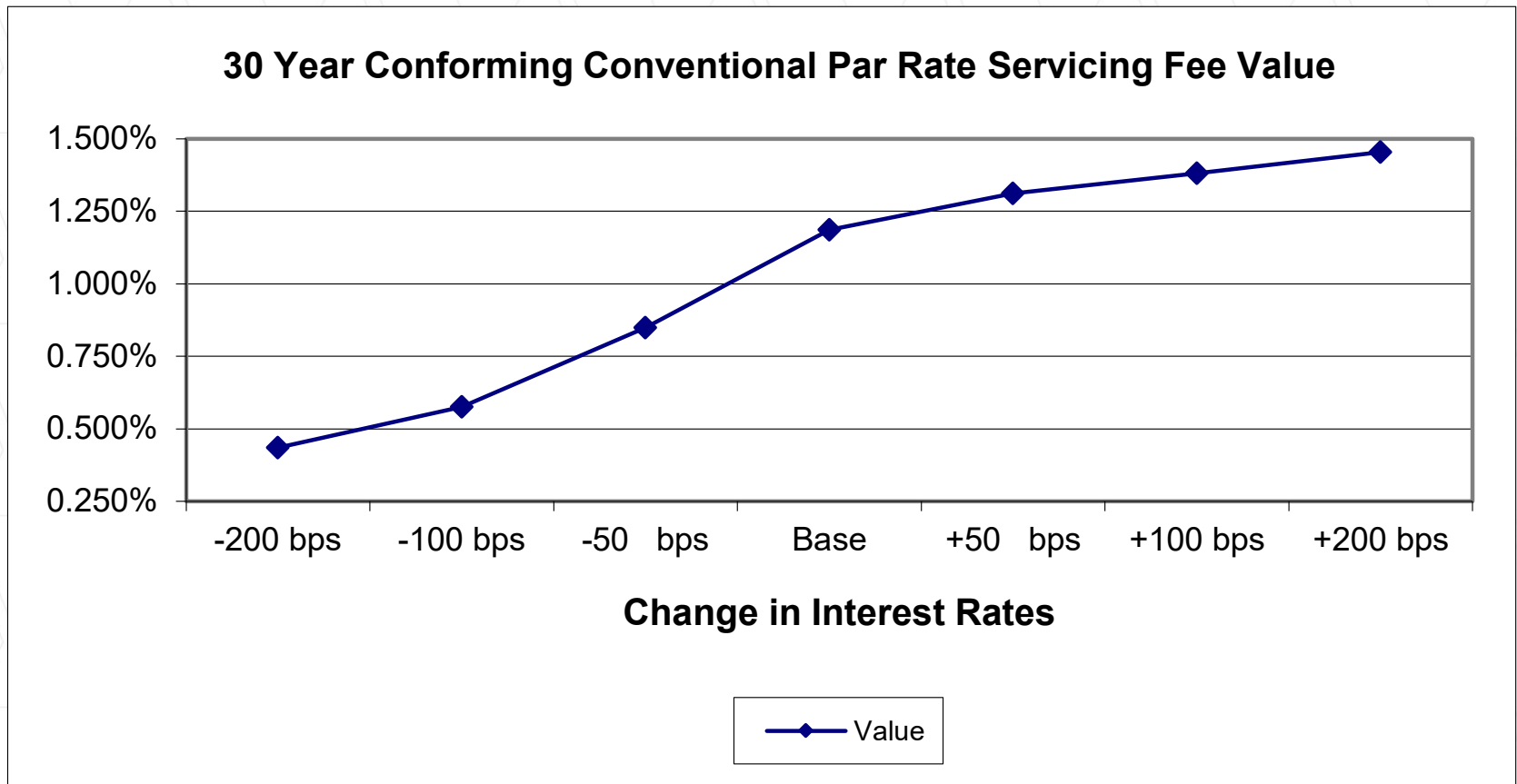
MSR Accounting – Fair Value Method

- The fair value is determined at each reporting period
- The asset is adjusted to equal its fair value
- The difference is taken into earnings (service fee income) for that reporting period
- Institutions that hedge their servicing rights portfolios can benefit from the fair value method because the accounting is less complex than under FAS ASC Topic 815 – Derivatives and Hedging. Institutions that do not hedge their portfolios and that elect the fair value method could experience earnings volatility.
- This is an irrevocable election

Managing Runoff Risk

- The operational / macro hedge
- Consider recapture strategies and initiatives
- Hedge with positive convexity instruments
- Utilize appropriate amortization methodology

MSR Yield Curve and Convexity

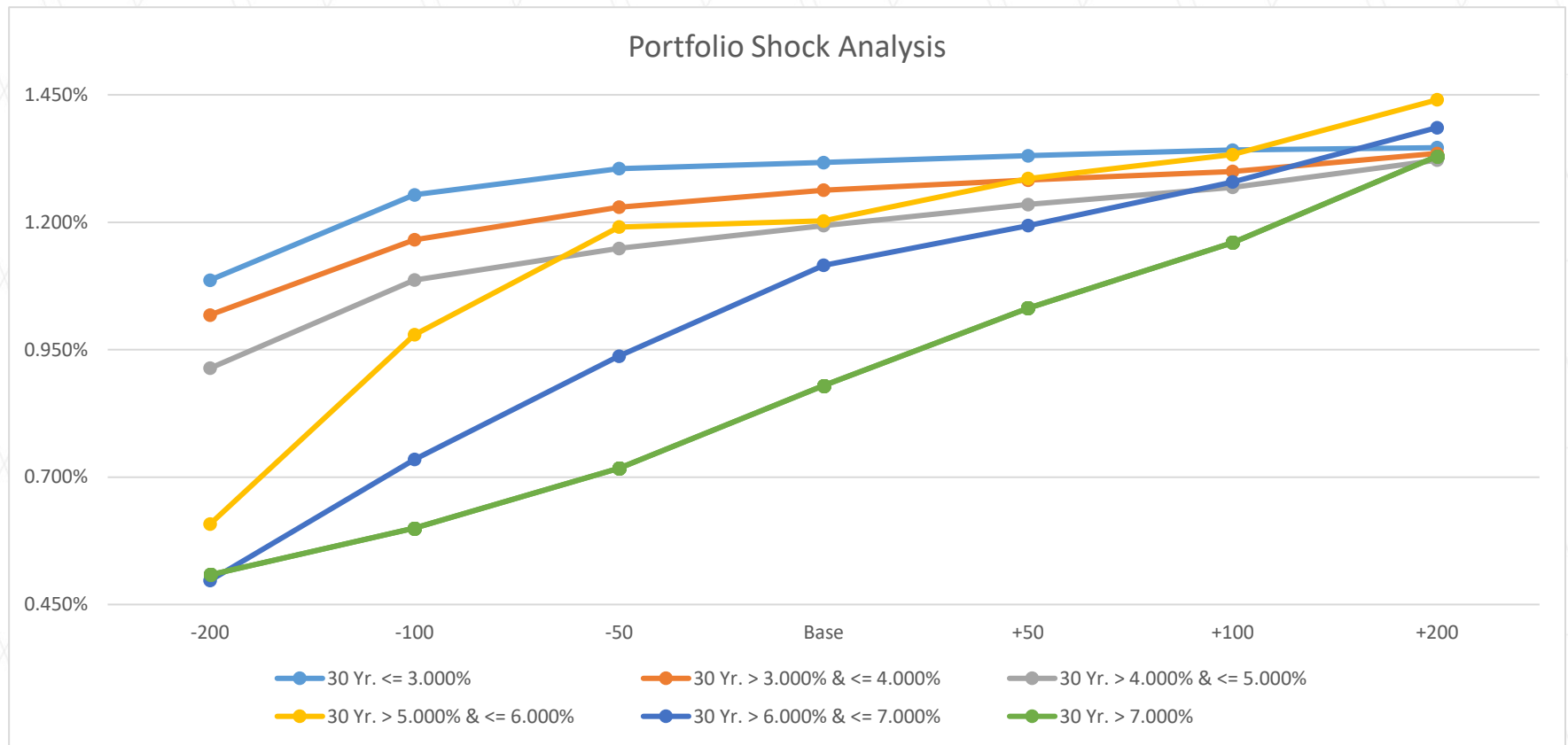


Input Sensitivity

	<u>Value</u>	<u>CPR %</u>	<u>Change</u>	<u>% Change</u>
Base (6.125% Int. Rate)	1.186%	11.079%		
Prepayments -50 bps Shock	0.848%	19.111%	-0.338%	-28.478%
Prepayments -100 bps Shock	0.576%	29.257%	-0.610%	-51.433%
Prepayments -200 bps Shock	0.435%	35.773%	-0.750%	-63.292%

MSR Hedging Considerations

- What is my portfolio's risk profile?



MSR Hedging Considerations

- What is our institution's risk tolerance?

	MSR Fair Value						
	-200	-100	-50	Base	+50	+100	+200
30 Yr. <= 3.000%	1,856,048	2,141,942	2,229,662	2,250,285	2,273,089	2,292,148	2,300,151
30 Yr. > 3.000% & <= 4.000%	2,186,480	2,503,745	2,641,254	2,712,591	2,755,398	2,791,474	2,867,645
30 Yr. > 4.000% & <= 5.000%	474,018	563,673	595,940	619,052	640,542	658,090	685,694
30 Yr. > 5.000% & <= 6.000%	1,140,899	1,838,315	2,235,255	2,257,407	2,413,496	2,501,914	2,703,728
30 Yr. > 6.000% & <= 7.000%	2,051,476	3,032,307	3,869,624	4,606,015	4,926,542	5,280,733	5,719,926
30 Yr. > 7.000%	297,397	350,896	419,850	514,713	603,687	678,835	778,123
Total MSR Fair Value	8,006,319	10,430,878	11,991,585	12,960,064	13,612,753	14,203,194	15,055,266

	Change in MSR Fair Value From Base						
	-200	-100	-50	Base	+50	+100	+200
30 Yr. <= 3.000%	(394,237)	(108,343)	(20,623)	-	22,804	41,862	49,866
30 Yr. > 3.000% & <= 4.000%	(526,111)	(208,846)	(71,337)	-	42,807	78,883	155,054
30 Yr. > 4.000% & <= 5.000%	(145,034)	(55,379)	(23,112)	-	21,490	39,038	66,642
30 Yr. > 5.000% & <= 6.000%	(1,116,508)	(419,092)	(22,152)	-	156,088	244,507	446,320
30 Yr. > 6.000% & <= 7.000%	(2,554,538)	(1,573,707)	(736,391)	-	320,527	674,719	1,113,911
30 Yr. > 7.000%	(217,316)	(163,817)	(94,864)	-	88,974	164,122	263,410
Total Risk	(4,953,745)	(2,529,186)	(968,479)	-	652,689	1,243,130	2,095,203
Exposure in Highest 3 Buckets	(3,888,363)	(2,156,617)	(853,407)		565,589	1,083,347	1,823,641
Percentage of Risk	78.5%	85.3%	88.1%		86.7%	87.1%	87.0%



Mortgage Servicing Rights

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Variability of Mortgage Servicing Rights

- Institution services an existing pool of mortgages and receives a fee (e.g., 25bps) for doing so
- As interest rates fall, a portion of mortgage pool prepays as borrowers look to refinance their mortgages to capture the benefit of falling rates
- As mortgages prepay, the servicing rights drop in value and Institution services fewer mortgages
- Swaptions can be used to hedge this risk

Fixed Receiver Swap (Swap-to-Floating)

Description

- **Institution enters into a swap**
 - Institution pays dealer a floating rate based upon an observable index (e.g., SOFR)
 - Dealer pays bank a fixed rate
 - The swap can be any term the two parties desire

Application

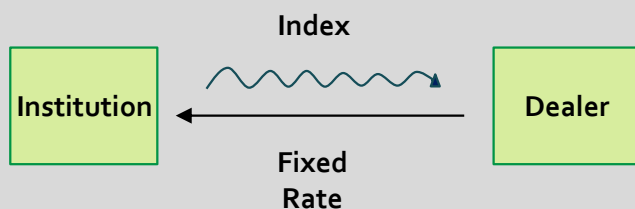
- Institution may achieve a lower floating rate cost of funds than a natural floater
- Committed term funding
- No ongoing support costs

**Swap Execution Services to be provided by Blue Rose Capital Advisors, LLC (an affiliate of HedgeStar and under common ownership)*

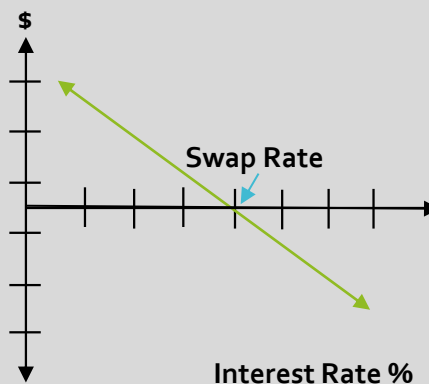
Fixed Receiver Swap (Swap-to-Floating) Cont'd

Mechanics

- Institution receives fixed and pays floating against a scheduled notional amount



Net Cash Flows vs Interest Rate



**Swap Execution Services to be provided by Blue Rose Capital Advisors, LLC (an affiliate of HedgeStar and under common ownership)*

Fixed Receiver Swaption

Description

- Institution purchases an option to enter into a fixed receiver swap
- Institution pays the option premium either upfront or over time
- Institution decides if/when to exercise the option to enter into the swap

Application

- Useful for entities who want to benefit if interest rates fall in the future
- Note: All other traditional swap-to-floating characteristics apply

Mechanics

- Institution purchases option to enter into a vanilla swap to floating
- Institution chooses whether or not to exercise the option and when
- If option is exercised, Institution can elect either to cash flow the swap through its final term or to cash settle the swap based upon its then current market volume

Hedging Mortgage Servicing Rights

Approach

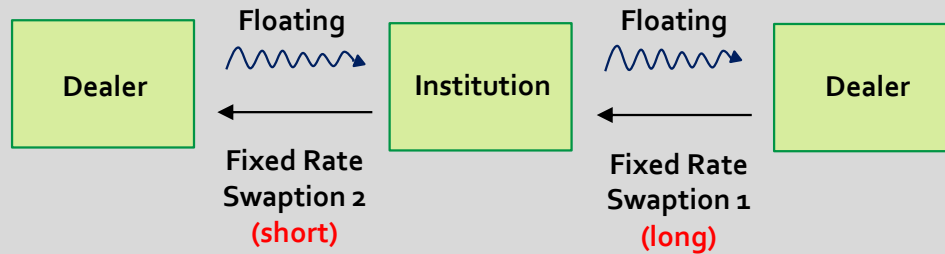
- Institution purchases an option to enter into a fixed receiver swap (call swaption) at a rate that corresponds to their feared prepayment trigger rate
- Institution partially offsets the cost of this option by selling a similar option to enter into a vanilla swap to floating to the same or different dealer. This swaption will be struck at a fixed rate lower than the option that the Institution purchases
- The option premium paid less than the option premium received will net to the net cost of the hedging strategy

Application

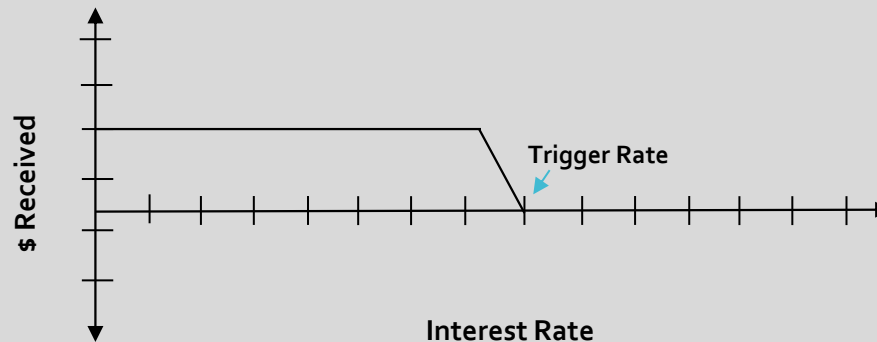
- Institution sets swaption strike levels to achieve its desired hedging threshold (e.g., 175 basis points lower than current levels)
- Institution purchases the call swaption struck at current swap rates less than 150 basis points
- Institution sells a call swaption struck at current swap rates less than 175 basis points
- Institution pays the net swaption premium
- If interest rates fall 175 basis points or more, both options will be exercised, leaving the Institution with a net 25 basis point annuity (the difference between the two fixed rates)

Hedging Mortgage Servicing Rights

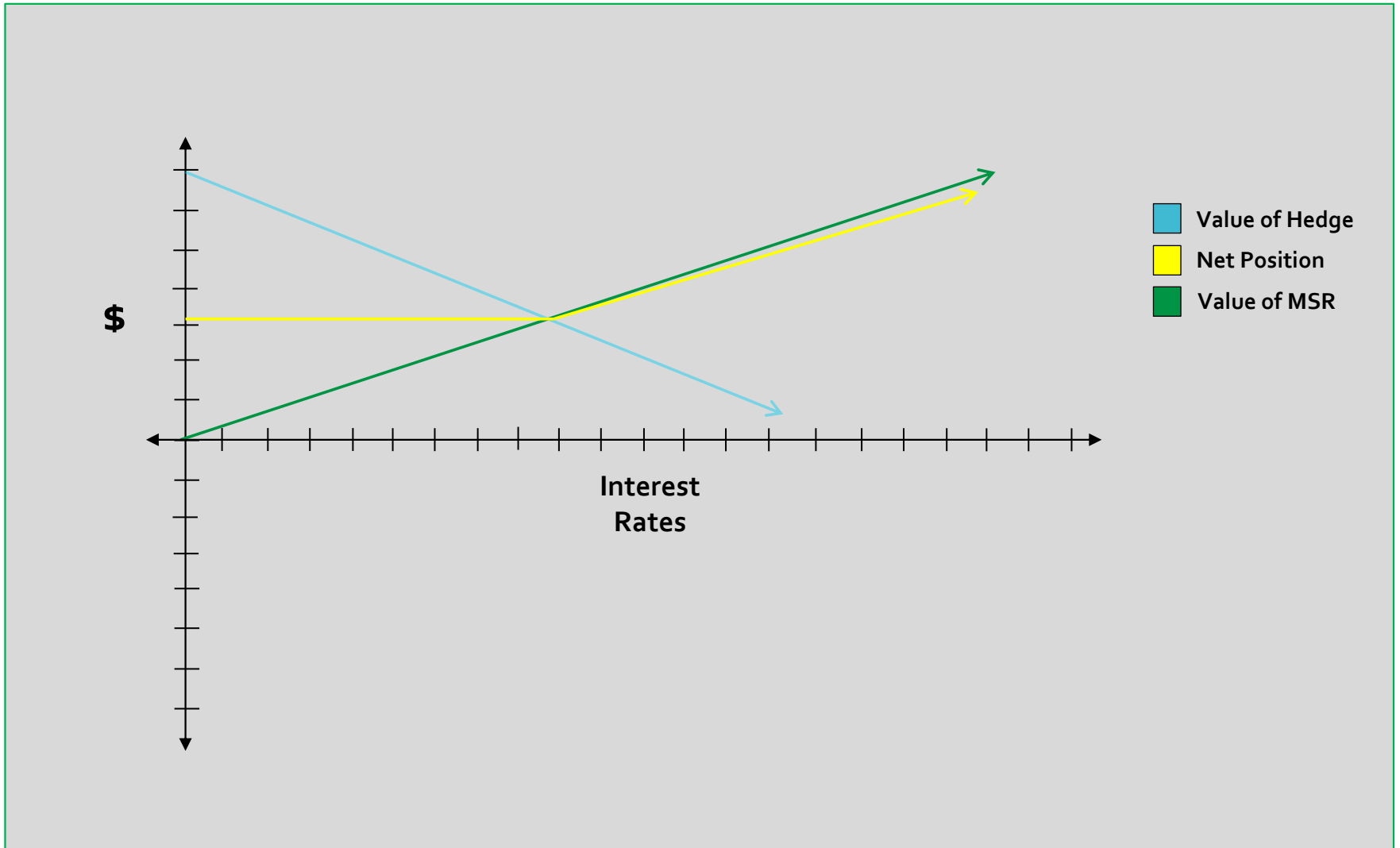
Mechanics



Results



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Indicative Pricing in bps per annum*

	10 –Year Term		5 –Year Term	
100 bps OTM	Long Option	21.84 bps	Long Option	16.44 bps
	Short Option	17.57 bps	Short Option	12.58 bps
	Net Option	4.26 bps	Net Option	3.86 bps
200 bps OTM	10 –Year Term		5 –Year Term	
	Long Option	9.23 bps	Long Option	5.59 bps
	Short Option	7.47 bps	Short Option	4.27 bps
	Net Option	1.76 bps	Net Option	1.31 bps

* Mid-market values as of 4/30/2026 market close. Does not include dealer execution spread.

Blue Rose Capital Advisors & HedgeStar at a Glance

Blue Rose Overview

- **Full-service independent** financial advisory firm registered with the SEC, MSRB, CFTC, and NFA
- National reach with advisors across the country
- 16 employees and 13 registered advisors
- 150+ years combined experience in finance
- \$136+ billion worth of financings to date
- Broad array of debt advisory and consulting services
- Sister company to HedgeStar

Services



Debt Advisory
Reinvestment Advisory
Derivatives Advisory
Financial & P3 Consulting

Sectors

Higher Education | Non-Profits | Charter Schools
Private K-12 | Healthcare | Government | Corporates

HedgeStar Overview

- **Independent** hedge accounting and valuations firm
- National reach with advisors across the country
- Dedicated team of CPAs and quantitative analysts
- \$100+ billion of valuations and hedge accounting
- 400+ entities served across all sectors
- SOC 1 compliant
- Sister company to Blue Rose

Services



Hedge Accounting
Risk Management
Valuation Services
Software Consulting

Sectors

Financial Institutions | Corporations
Audit Firms | Tax-Exempt Entities

Contact Us



John Trefethen

Director and Co-Founder of HedgeStar

Phone: 952-746-6040

Email: jtrefethen@hedgestar.com



Tim Potter, CPA

Managing Director of HedgeStar

Phone: 952-746-6174

Email: tpotter@hedgestar.com



Sam Gruer

**Managing Director of Blue Rose Capital
Advisors (A sister-company of HedgeStar)**

Phone: 973-671-1741

Email: sgruer@bluroseadvisors.com

Thank you!

Questions?