Mortgage Partnership Finance®

Federal Home Loan Bank of Boston
Federal Home Loan Bank of Chicago
Federal Home Loan Bank of Des Moines
Federal Home Loan Bank of New York
Federal Home Loan Bank of Pittsburgh
Federal Home Loan Bank of Topeka

December 21, 2009

VIA EMAIL: regs.comments@federalreserve.gov

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Regulation Z; Docket No. R-1366

Dear Ms. Johnson:

This letter addresses the Board of Governors of the Federal Reserve System's ("Federal Reserve") request for comments on the proposed rule regarding "Truth in Lending" published in the Federal Register on August 26, 2009 ("Proposed Rule"). The Federal Home Loan Banks of Boston, Chicago, Des Moines, New York, Pittsburgh and Topeka (collectively, the "Banks") welcome the opportunity to comment on this Proposed Rule.

The Proposed Rule creates several new regulatory protections for consumers in the residential mortgage market through amendments to Regulation Z, which implements the Truth in Lending Act. The Banks have reviewed the Proposed Rule in light of the Mortgage Partnership Finance® ("MPF®") Program offered by the Banks to their community bank, thrift, credit union and insurance company members (each participating financial institution called a "PFI"). The purpose of this letter is to inform the Federal Reserve of the potential impact that the loan originator compensation provisions of the Proposed Rule would have on the PFIs that originate mortgage loans which are acquired by the Banks under the MPF Program.

The Banks' comments are limited solely to the impact of the Proposed Rule on the MPF Program, a purely secondary market funding option for our PFI members. We express no opinion on the loan originator compensation provisions of the Proposed Rule as they pertain to individuals, including individuals that may be employees of PFIs or other members of the Banks. Though the word "person," as used in the loan originator compensation provisions of the Proposed Rule, could encompass companies or business organizations it would appear that the Federal Reserve's primary focus is on individuals that interact with consumers.

Mission of the Federal Home Loan Banks

The Banks are six of the twelve Federal Home Loan Banks ("FHLBs") which are government sponsored enterprises providing housing finance to more than 8,000 member commercial banks, savings institutions, credit unions and insurance companies throughout the Nation. The mission of the FHLBs is to safely and soundly support mortgage finance through a variety of programs and services, primarily credit programs to their financial institution membership, so that the members can provide economical residential mortgage financing in all phases of widely varying financial and economic cycles. With combined assets of more than $1 trillion, the FHLBs' credit products include floating and fixed-rate loans, the MPF Program, and related products to finance home mortgage portfolios. The FHLBs, which are chartered by Congress and privately owned by member financial institutions, also provide funding for affordable housing and community development activities.

The MPF Program is authorized under the Federal Housing Finance Agency's ("Finance Agency") Acquired Member Assets ("AMA") Regulation (12 CFR Part 955) as falling within the advances (lending) authority of the FHLBs. In the preamble to the AMA Regulation, AMA are described as follows:

> [W]hole loans ... that a Bank may acquire from or through its members ... in a transaction that is in purpose and economic substance functionally equivalent to the business of making advances in that: (1) It allows the member ... to use its eligible assets to access liquidity for further mission-related lending; and (2) all, or a material portion of, the credit risk attached to the assets is being borne by the member ... (Page 43974 of Federal Register Vol. 65, No. 137, July 17, 2000.) [1]

Background of the MPF Program

In 1997, the Federal Home Loan Bank of Chicago ("FHLBC") introduced the MPF Program to provide PFIs of the Banks a secondary mortgage market alternative for their one-to-four family residential mortgage loans ("MPF Loans"). The MPF Program supports the Banks' housing finance mission by aligning the various risks associated with mortgage finance in an optimal way. As a secondary mortgage market structure under which the Banks purchase and fund eligible MPF Loans from or through PFIs, the MPF Program allows PFIs to most economically manage their mortgage finance programs.

[1] The 5th Circuit Court of Appeals described the MPF Program as "a method of empowering member institutions to channel funds into residential housing finance in a manner that is technically more sophisticated than, yet functionally similar to, that which occurs when [an FHLB] makes an advance [to a member]." Texas Savings & Community Bankers Association, et al., v. Federal Housing Finance Board, 201 F.3d 551 (5th Circuit, 2000).

The MPF Program employs a unique risk sharing structure designed to allocate the risks of fixed-rate mortgages among the Banks and PFIs to better maximize each party's respective strengths in managing these risks. PFIs have direct knowledge of their borrowers and local mortgage markets and have developed expertise in underwriting and servicing residential mortgage loans. By allowing PFIs to originate MPF Loans, whether through retail or wholesale operations, and to retain or acquire servicing of MPF Loans, the MPF Program leaves PFIs in control of those functions that most impact credit quality. Alternatively, the Banks as GSEs with sophisticated treasury operations are better situated to manage the interest rate risk, prepayment risk, and liquidity risk associated with owning MPF Loans.

Unlike mortgage brokers or other originators that have no "skin in the game," the AMA Regulation not only requires PFIs to assume or retain credit risk in connection with MPF Loans, but also requires PFIs to pledge collateral to support their direct credit enhancement obligations in essentially the same manner that they pledge collateral to support any advances (loans) they obtain from the Banks.

Closed Loans and the MPF 100 Product Option

PFIs may currently choose from five AMA MPF Program products. Four of these products (Original MPF, MPF 125, MPF Plus, and MPF Government) are closed loan products under which the Banks purchase MPF Loans that have been acquired or have already been closed by PFIs with their own funds. However, under the MPF 100 product, the Banks "table fund" MPF Loans; that is, we provide the funds for the PFI as our agent to make the MPF Loan to the borrower. Also, the Bank is considered the originator of the MPF 100 Loans for accounting purposes while the PFI acts as the Bank's agent when originating the loans. Regardless of the product used, however, the PFI performs all the traditional retail loan origination functions and is compensated in the same manner.

On July 19, 1999, the Federal Reserve, jointly with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision issued a letter to the FHLBC approving certain risk-based capital treatment for PFIs using an MPF Program product (a copy is attached as Exhibit A) which is known as the MPF 100 product. Under this ruling, PFIs are required to hold risk-based capital in connection with the credit enhancement they assume while the Banks require the PFIs to pledge collateral to secure those credit enhancement obligations.

Of all the MPF Program products, the MPF 100 product is designed most specifically for smaller PFIs, such as commercial banks, thrifts and credit unions with assets of less than $1 billion that are most focused on serving their local communities. From the perspective of these PFIs, the MPF 100 product is a secondary market alternative to selling loans to Fannie Mae, Freddie Mac or the Banks under other closed loan products. Even though the Banks may provide funds, PFIs delivering MPF Loans under the MPF 100 product consider themselves as the lender of the loans to their customers and consider the Banks a secondary market outlet for those loans.

Perhaps as significant, consumers consider their local federally-insured bank, thrift or credit union as their lender rather than their mortgage broker notwithstanding any technical arrangement the PFI may have with a Bank to provide funds for their loan.

A PFI is permitted to deliver MPF Loans under more than one MPF Program product, so it is possible for a PFI to act as the Bank's agent for some MPF Loans which are funded by the Bank under the MPF 100 product, and to be the funding lender of other MPF Loans sold to the Bank under closed loan MPF Program products. However, many PFIs are unable to sell MPF Loans under closed loan MPF Program products or can only do so on a limited basis, so they don't have the economic option to use both types of MPF Program products or to use closed loan products to a large extent.

Those PFIs that use both the MPF 100 and closed loan products or have other secondary market alternatives don't have to determine which product to use until just prior to loan closing though they must make the decision to use the MPF 100 product sufficiently in advance of loan closing to provide appropriate disclosures to the borrower.

If the PFI decides to have the Bank fund the loan, the PFI submits loan data and requests funds from the Bank under the MPF 100 product on or up to three days in advance of the loan closing date. If the PFI doesn't choose to have the loan funded under the MPF 100 product, the PFI could close the MPF Loan with its own funds and (1) sell it to the Bank under a closed loan MPF Program product, (2) keep the loan in its own portfolio, or (3) if it has access to other secondary mortgage market participants, sell it to such other party.

The Banks publish, on a daily basis, the prices for which they will purchase closed MPF Loans from PFIs. The same price sheets that are used for the purchase of closed conventional MPF Loans are used to determine the "agent fee" paid to or by the PFIs under the MPF 100 product. In other words, the same premium or discount prices available for regular secondary market purchases of MPF Loans apply to the funding of MPF Loans under the MPF 100 product. Secondary market prices are based on the interest rate of the loan, the term of the loan, the remittance type and whether the loan is a conventional or a Government loan. Though most MPF Loans are acquired at premium prices, on occasion PFIs deliver loans at par or at a discount which means that for MPF Loans funded under the MPF 100 product, PFIs could have no or negative agent fees depending on the interest rate of those loans.

To assist PFIs in complying with RESPA, the MPF Program Origination Guide provides guidelines and disclosure forms specifically designed to provide notice to consumers of the Banks' role in providing funds for MPF Loans funded under the MPF 100 product. We have attached the most recent guidance, PFI Notice 2009-6, and the disclosure forms (OG5-1 and OG6) and instructions for completion of the HUD-1 (OG5-2) referenced therein as Exhibit B.

Contrast between Brokered Loans and the MPF 100 Product

In the wake of the ongoing financial crisis, mortgage brokers are typically viewed as having "perverse incentives" to act in a manner that may be harmful to consumers due to the manner of their compensation. For example, mortgage brokers have no credit risk, or no "skin in the game," with respect to the loans they broker. By contrast, the MPF Program was designed, and is mandated by the AMA Regulation, to require PFIs to assume material and significant risk in connection with MPF Loans. Specifically, PFIs are required to "bear the direct economic consequences of actual credit losses ... in an amount equal to or exceeding the amount of expected losses" on the MPF Loans they deliver to the Banks (12 CFR §955.3(b)(2)). This credit enhancement requirement aligns the interests of PFIs with both the interests of the Banks and the interests of their customers.

This credit sharing structure has resulted in MPF Loans performing consistently better than the national average throughout the MPF Program's existence.[2] In addition, because PFIs are full service financial institutions, they consider their mortgage business just one of many financial products they offer to their customers. PFIs are naturally motivated to maintain good relations with their customers for cross-selling purposes and have a strong incentive to ensure the mortgage products they sell are appropriate for each customer.

Moreover, as indicated above, consumers have entirely different expectations when dealing with a typical mortgage broker than when dealing with their local federally-insured financial institution. It makes no difference to consumers whether PFIs sell closed loans to the Banks, or close their loans under the MPF 100 product with funds provided by the Banks.

Credit Performance of MPF Conventional Loans

Given the incentives for PFIs, it should be no surprise that MPF mortgage loan pools have experienced demonstrably superior credit quality. The amount of loan delinquencies, foreclosures and credit losses for MPF Loans always have been *well* below the national average since the inception of the MPF Program. This is especially true today as the current mortgage crisis has deepened. As of October 31, 2009:

- Only 1.32% of MPF conventional loans were 90 days or more delinquent compared to the national average for conventional loans of 3.26%[3], or approximately 40% of the national average.

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[2] See discussion of Credit Performance of MPF Conventional Loans.

[3] Data on 1- to 4-Unit Prime Fixed-Rate Mortgages (not seasonally adjusted) from the MBA National Delinquency Survey, as of June 30, 2009.

- Total MPF conventional loan delinquencies (any delinquency of more than 30 days) were less than 1/2 of the national average, 3.03% vs. 6.21%.
- MPF conventional loans in foreclosure are about 1/3 of the national average, 0.55% vs. 1.66%.

An even more remarkable picture can be seen by looking at the actual number of MPF Loans that have experienced a credit loss. Through August 31, 2009, of the 945,923 conventional loans that have been funded since the MPF Program began, only 1,253 loans, or 0.13%, have experienced a credit loss. In dollar terms, these losses have amounted to only $14.5 million, or 0.0103%, of the total MPF Program conventional loan fundings of approximately $141 billion.

Of these credit losses, the vast majority have been absorbed by PFIs through the withholding of future fees that otherwise would have been paid or through a contractual credit reimbursement. Actual losses to the PFIs out of current income have amounted to only $133,380. In exchange for assuming the credit responsibility of these loans, PFIs have received approximately $547 million in monthly fees since 1997. These statistics speak eloquently to the value of having "skin in the game." Correctly aligning risks and rewards ensures a much safer and sounder structure for American homebuyers and a far better deal for community banks than other secondary market alternatives.

Impact of Proposed Rule

The Federal Reserve proposes to add Section 226.36(d) to Regulation Z which would prohibit the payment of yield spread premiums to loan originators including creditors that receive table funding. If §226.36(d) were to apply to PFIs under the MPF 100 product, because the fees paid to PFIs under the MPF 100 products are the same prices that are paid to PFIs for closed loans and because these payments are processed on the same system, the adoption of the rule effectively would end the MPF 100 product. The MPF Banks would be prohibited from appropriately compensating PFIs for the MPF Loans they originate under the MPF 100 product. Therefore, the product could no longer be offered.

Without the MPF 100 product, hundreds of community banks and thrifts would no longer be able to provide economical home financing for their retail customers because, with their limited size, loan volume and resources, they either can not make use of or can only make limited use of closed loan products. Those PFIs that have used the MPF 100 product to provide mortgage loans to customers in their communities would be forced to either stop making fixed rate home loans or charge higher interest rates and fees to sell those loans to other secondary market purchasers, assuming they can even find other secondary market purchasers who are willing to do business with sellers of extremely small volumes of loans.

The Banks expect that having previously authorized the use of the MPF 100 product by the PFIs it regulates, the Federal Reserve did not intend to include MPF Loans originated by FDIC- or NCUA- insured PFIs of the Banks and funded by the Banks under the MPF 100 product within the scope of the Proposed Rule.

Requested Action

To preserve the unique benefit of the MPF 100 product to the small banks, thrifts and credit unions that provide mortgage loans in their communities, the Banks request that the Federal Reserve revise the Proposed Rule to exclude from the definition of "loan originator" FDIC- and NCUA- insured institutions that substantially share in the credit risk of loss of mortgage loans, where the funds for such loans are provided by the Banks under the MPF 100 product or any similar product. This revision would recognize the secondary market nature of the MPF 100 product. MPF Loans do not present the concerns pertaining to mortgage brokers or other originators that have no "skin in the game," which the Federal Reserve seeks to address in promulgating the Proposed Rule. MPF Loans originated under the MPF 100 product are always retail mortgage loans processed by a PFI or its affiliate and never involve traditional mortgage brokers. Finally, this revision would be consistent with the Federal Reserve's previous review and authorization of the use of the MPF 100 product by the PFIs that it regulates.

Section 226.36(a)(1) (as proposed) would provide:

> (1) *Loan originator.* For purposes of this section, the term "loan originator" means with respect to a particular transaction, a person who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person. The term "loan originator" includes employees of the creditor. The term includes the creditor if the creditor does not provide the funds for the transaction at consummation out of the creditor's own resources, out of deposits held by the creditor, or by drawing on a bona fide warehouse line of credit. [74 Fed. Reg. 43331-32 (August 26, 2009)]

Specifically, the Banks request that proposed §226.36(a)(1) be amended by expanding the last sentence of the above quoted proposed provision as follows:

> The term includes the creditor if the creditor does not provide the funds for the transaction at consummation out of the creditor's own resources, out of deposits held by the creditor, or by drawing on a bona fide warehouse line of credit, unless the creditor bears the direct economic consequences of actual credit losses in an amount which equals or exceeds the amount of expected losses on the mortgage loan, such as funding provided to a creditor by a Federal Home Loan Bank under 12 CFR Part 955 or a successor regulation.

A simpler alternative could exclude from the term "loan originator" federally-insured depository institutions that receive table funds, as follows:

> The term includes the creditor if the creditor does not provide the funds for the transaction at consummation out of the creditor's own resources, out of deposits held by the creditor, or by drawing on a bona fide warehouse line of credit but does not include a creditor that is a financial institution insured pursuant to 12 USC §1815 or 12 USC §1781.

In addition, § 226.36 of the proposed Supplement I to Part 266--Official Staff Interpretations would provide in part:

> 36(a) Loan originator and mortgage broker defined.
>
> 1. *Meaning of loan originator.* Section 226.36(a) provides that a loan originator is any person who for compensation or other monetary gain arranges, negotiates, or otherwise obtains an extension of consumer credit for another person. The term "loan originator" includes employees of the creditor. In addition, this definition expressly includes any creditor that satisfies this definition but makes use of "table funding." Table funding occurs when a transaction is consummated with the debt obligation initially payable by its terms to one person, but another person provides the funds for the transaction at consummation and receives an immediate assignment of the note, loan contract, or other evidence of the debt obligation. Although § 226.2(a)(17)(i)(B) provides that a person to whom a debt obligation is initially payable on its face generally is a creditor, § 226.36(a) provides that, solely for the purposes of § 226.36, such a person is also considered a loan originator. The creditor is not considered a loan originator unless table funding occurs. [74 Fed. Reg. 43407 (August 26, 2009)]

The Banks request that this proposed section be amended by expanding the last sentence of the above quoted proposed provision as follows:

> The creditor is not considered a loan originator unless table funding occurs, excluding however, table funding under which the creditor bears the direct economic consequences of actual credit losses in an amount which equals or exceeds the amount of expected losses such as table funding provided by a Federal Home Loan Bank under 12 CFR Part 955 or a successor regulation.

Again, a simpler alternative could address insured depository institutions that receive table funds as not being included in the term "loan originator," as follows:

> The creditor is not considered a loan originator unless table funding occurs, excluding however, table funding provided to a financial institution insured pursuant to 12 USC §1815 or 12 USC §1781.

Conclusion

The Banks believe that PFIs undertaking shared credit risk and meeting the AMA Regulation requirements deserve to be excluded from the scope of the Proposed Rule that treats creditors that receive table funding as loan originators. PFIs under the MPF Program are truly creditors and should not be treated the same as mortgage brokers or other originators that have no "skin in the game" with respect to the mortgage loans they broker.

The focus of the Proposed Rule is to avoid consumers being ''steered'' to loans which are not in their interest in order to increase the loan originator's compensation. The Banks believe that federally-insured lenders will not "steer" their customers into more adverse loan products even when they use "table funds" rather than other sources of funding, such as advances from the FHLBs. Therefore, the Banks propose excluding federally-insured creditors from the definition of loan originators whether they use their own funds or "table funds" to provide mortgage loans to their customers.

Thank you for the opportunity to comment on the Proposed Rule. Should your staff have any questions regarding this comment letter, please contact Sybil C. Malinowski, Associate General Counsel of the FHLBC at 312-565-5738 or smalinowski@fhlbc.com.

Sincerely,

The Federal Home Loan Banks of
Boston, Chicago, Des Moines, New York,
Pittsburgh and Topeka

Attachments:

Exhibit A: July 19, 1999 Letter from four federal banking agencies
Exhibit B: MPF PFI Notice 2009-6, Forms OG5-1, OG5-2 and OG6

"Mortgage Partnership Finance," "MPF" and "MPF Xtra" are registered trademarks of the Federal Home Loan Bank of Chicago.

[Signatures on following pages]

Federal Home Loan Bank of Boston

Ellen McLaughlin
Senior Vice President & General Counsel

Federal Home Loan Bank of Chicago

Eric S. Schambow
Senior Vice President

Federal Home Loan Bank of Des Moines

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Dan Hess

Dan Hess
SVP, Director of Member Products

Office of the Comptroller of the Currency

Board of Governors of the Federal Reserve System

Federal Deposit Insurance Corporation

Office of Thrift Supervision

July 19, 1999

Mr. Peter E. Gutzmer
Senior Vice President,
General Counsel & Corporate Secretary
Federal Home Loan Bank of Chicago
111 East Wacker Drive
Chicago, Illinois 60601

Dear Mr. Gutzmer:

In letters dated February 18 and April 8, 1999, the Federal Home Loan Bank of Chicago ("FHLB-C") requested that the federal banking agencies ("Agencies") confirm the risk-based capital treatment of the credit enhancement provided by banks and thrifts ("participating financial institutions" or "PFIs") under the Mortgage Partnership Finance ("MPF") program. The FHLB-C expressed its view that the second loss credit enhancement should be treated as a direct credit substitute for purposes of the Agencies' risk-based capital standards. [1]

As we understand the proposed structure of the MPF program, a PFI acts as agent for the FHLB-C in the process of originating 1-to-4 family residential mortgage loans, which are funded and initially owned by the FHLB-C. [2] As agent, a PFI assists in the

[1] The risk-based capital treatment prescribed in this letter supersedes any previous guidance issued by any of the Agencies. If a PFI has entered into a MPF transaction that does not meet the conditions described in this letter, then the PFI should consult with its primary federal regulator.

[2] In addition, the FHLB-C requested confirmation that the use of a disclosure form would resolve the Agencies' concerns regarding the disclosure of the agency role of the PFI in a MPF transaction. We understand that all consumer disclosures will comply with applicable law, and that these disclosures will clearly describe the respective roles of the PFIs and the FHLB-C. The measures that the FHLB-C has proposed to take for disclosing the agency role

origination of mortgage loans and provides loan servicing and second loss credit enhancements, for which it receives fees. The FHLB-C retains both the first loss position and all losses beyond the second loss position provided by a PFI. The program is structured so that the FHLB-C also retains the interest rate risk associated with the funding of the mortgages and any prepayments, while the PFI is exposed to limited credit risk and the potential loss of its servicing and guarantee fees due to prepayments.

The size of the second loss credit enhancement provided by a PFI is a matter of contract between the FHLB-C and each PFI. Under the program, the size of the second loss credit enhancement is determined to be the amount that – together with the FHLB-C's first loss position – is sufficient to bring the FHLB-C's third loss position to the equivalent of a AA-level of credit quality. Typically, the enhancement is expected to be no higher than two percent of the unpaid balance of each pool of mortgages the institution has assisted in originating under the MPF program, depending upon the credit quality of the underlying loans. The FHLB-C has established minimum credit quality guidelines for program-acceptable mortgages, which is expected to result in the underwriting of high quality mortgages.

At the initiation of a transaction, the FHLB-C will agree to retain the first loss position and absorb all credit losses up to 100 basis points of the initial unpaid principal balance of each mortgage pool established under the MPF program.[3] More specifically, the FHLB-C agrees that it will not seek reimbursement from the PFI's second loss credit enhancement until the FHLB-C has absorbed losses equal to 100 basis points of the total mortgage pool's initial unpaid principal balance. As the mortgage pool amortizes, the first loss position is expected to increase as a percentage of the remaining unpaid balance of the mortgages in the MPF pool.

For a typical mortgage pool, the FHLB-C states that its first loss coverage level would provide sufficient credit protection so that the second loss credit enhancement provided by the PFI generally would be a creditworthy exposure, e.g., the equivalent of a BB level of credit quality as defined by one of the nationally-recognized statistical rating organizations. For many mortgage pools, the FHLB-C maintains that the PFI credit enhancement would qualify for an investment grade rating, e.g., BBB- or BBB. These credit quality assessments, however, do not explicitly consider concentration risk.

Based on our current understanding of the MPF program's structure, as described above, the Agencies believe that the second loss credit enhancement provided by PFIs may be treated for risk-based capital purposes as a direct credit substitute. A financial institution providing such a credit enhancement will be required to use the 100 percent conversion factor to convert the face amount of the enhancement to an on-balance sheet credit equivalent amount. This amount would then be assigned to the 100 percent risk category applicable to subordinated privately-issued mortgage-backed securities because the credit

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of a PFI in the MPF program would, if implemented, essentially resolve the concerns of the Agencies regarding disclosure.

[3] In some of the MPF program materials, the first loss position is sometimes referred to as a first loss spread account.

enhancement is, in substance, the economic equivalent of such an obligation. This treatment may be accorded when the FHLB-C agrees that a PFI's second loss enhancement will not be drawn on until it has absorbed the first 100 basis points of credit loss as defined under the MPF program. Moreover, the Agencies expect that the credit quality of future pools to be consistent with that represented in your letters dated February 18 and April 8, 1999.

The Agencies are concerned about the possibility of PFIs amassing a large degree of concentration risk and a significant volume of potentially lower credit quality risk positions through the MPF program. Financial institutions are expected, at all times, to maintain capital commensurate with the nature and extent of the risks to which they are exposed. The type, quantity, and quality of risk inherent in an institution's activities determine the extent to which it may be necessary to maintain capital at levels above the required regulatory minimums to adequately protect against potentially adverse consequences. In order to ensure that PFIs are maintaining an appropriate amount of capital against the second loss credit enhancements associated with the MPF program, examiners will consider a PFI's exposure to concentration risk and credit risk when assessing the overall capital adequacy of individual institutions.

Examiners will review a PFI's MPF program credit enhancements when rating the capital adequacy and management components of the CAMELS rating system.[4] PFIs must make available to examiners, upon request, relevant documentation indicating the credit quality of all the second loss credit enhancements they provide under the MPF program, as well as the performance of the individual mortgage pools. This documentation usually includes items such as current quarterly mortgage pool reports provided by the FHLB-C.

The Agencies may revisit the risk-based capital and supervisory treatment of second loss credit enhancements if sufficient experience with the program indicates that the credit quality or credit concentrations of the mortgage pools pose safety and soundness concerns. In addition, in the event that the credit risk to which a PFI is exposed changes, the Agencies retain all of their supervisory discretion to review and revise the regulatory capital treatment on either a case-by-case or programmatic basis.

We would like to point out that the Agencies currently are considering an outstanding proposal that sets forth comprehensive risk-based capital requirements for securitized transactions and structured financings. This proposal may have implications for the capital treatment of a second loss credit enhancement provided by a PFI in the MPF program. Under the proposal, risk-based capital requirements would reflect the relative risk of the various credit exposures within a structured financing and those requirements would be determined through the use of credit ratings. As currently set forth under the proposal, risk positions rated at least investment grade, i.e., at least BBB-, would be assessed capital against only the face value of the enhancement. However, risk positions rated below investment grade would be subject to higher risk-based capital requirements. If the Agencies were to adopt such a proposal, then the second loss credit enhancement provided by a PFI in the MPF program would be subject to the requirements set forth in a final rule.

[4] The Agencies may issue, either individually or jointly, additional supervisory guidance addressing the treatment of the second loss credit enhancements provided by PFIs.

The Agencies understand that MPF is an innovative program that does not fit neatly into the existing capital framework. Accordingly, the Agencies have sought to respond in a manner that ensures the safety and soundness of the institutions that participate in the MPF program and, at the same time, does not stifle innovation. The conclusions reached by the Agencies are based on information presented in your letters of February 18 and April 8, 1999, subsequent telephone conversations, and background material provided by the FHLB-C. These conclusions apply only to the modified MPF program described in this letter. If the facts and circumstances are, in fact, different or if they change, then the capital treatment prescribed above for the second loss credit enhancement may not apply.

If you have any questions, please contact Margot Schwadron (202/874-5070), Office of the Comptroller of the Currency; Tom Boemio (202/452-2982), Federal Reserve Board; Stephen Pfeifer (202/898-8904), Federal Deposit Insurance Corporation; or Michael Solomon (202/906-5654), Office of Thrift Supervision.

Sincerely,

Kevin J. Bailey

Kevin Bailey, Deputy Comptroller
Office of the Comptroller of the Currency

Norah Barger

Norah Barger, Assistant Director
Federal Reserve Board

Christie A. Sciacca

Christie A. Sciacca, Associate Director
Division of Supervision
Federal Deposit Insurance Corporation

John C. Price Jr.

John C. Price Jr., Director
Supervision Policy
Office of Thrift Supervision

MPF -- Mortgage Partnership Finance / Bulletins, Notices, and Advisories / Notices / 2009 PFI Notices / PFI Notice 2009-6 (11/10/09)

PFI Notice 2009-6 (11/10/09)

Effective Date: See the Description of Changes for the effective dates

Special Attention: PFI MPF® Program Management, Origination Management and Servicing Management

Note: The enhancements announced in this PFI Notice apply to the MPF 100, Original MPF, MPF 125 and MPF Plus mortgage products (not applicable to the MPF Xtra® product).

Subjects:

Announcing enhancements to the Origination, Underwriting and Servicing Guides:

- Minimum FICO (Credit) Score - Revised Eligibility Criteria
- Revised Disclosure Instructions under the MPF 100 Product
- Revised Temporary Loan Payment Modification Plan Forms
- Replacement of Mortgage Insurance Coverage
- Replacement of Property Hazard Insurance Coverage

Enhancements will affect the following Origination, Underwriting and Servicing Guide Chapters:

Origination Guide Chapter 12	**Conventional Mortgage Insurance, Late Charges and Prepayment Charges**
Origination Guide Forms & Exhibits	**Instructions for Completing the HUD-1 Settlement Statement & Good Faith Estimate (Form OG5-2)**
Underwriting Guide Chapter 2	**Mortgage Eligibility**
Underwriting Guide Chapter 4	**Borrower Eligibility**
Servicing Guide Chapter 105	**Custodial Accounts, Advances and Loan Accounting**
Servicing Guide Chapter 106	**Insurance**
Servicing Guide Chapter 107	**Mortgage Loan Delinquency**
Servicing Guide Forms & Exhibits	**Loan Workout Plan (Form SG400); and Temporary Loan Payment Modification Agreement (Form SG 401)**

Description of Changes:

Origination Guide Revisions:

Minimum FICO (Credit) Score - Revised Eligibility Criteria (Underwriting Guide Chapter 4.5.1)

Effective for all loans delivered on or after February 1, 2010, under the Conventional MPF portfolio products (MPF Original, MPF 100, MPF 125 and MPF Plus), the lowest primary FICO score for a loan must be greater than or equal to 620. PFIs are reminded that if the loan meets this minimum FICO score requirement, each borrower's credit history must also meet the requirements of Underwriting Guide Chapter

4.5.

The only exception to the minimum primary FICO score requirement is in the case of an unobtainable or unusable FICO score as defined in Underwriting Guide Chapter 4.5.1.

The minimum primary FICO score requirement of 620 is also applicable to loans that are underwritten utilizing an Automated Underwriting System (AUS) in accordance with Underwriting Guide Chapter 2.17.

Revised Disclosure Instructions under the MPF 100 Product (Origination Guide Form OG5-2)

HUD has issued new RESPA rules for all mortgages subject to RESPA, which include all mortgages delivered under the MPF Program. **Effective with loan applications dated on or after January 1, 2010**, PFIs must begin using the new Good Faith Estimate (GFE) and HUD-1 / HUD-1A forms issued by HUD in accordance with RESPA rules.

PFIs that deliver under the **MPF 100** product must also be aware of additional requirements with respect to the disclosure of compensation paid by the MPF Bank. To assist PFIs with these new requirements, we have revised the Instructions for Completing the HUD-1 Settlement Statement (Form OG5-2) and added additional instructions for completion of the GFE with respect to the treatment of Agent Fees. Although we are providing these instructions for the benefit of PFIs, a PFI that delivers a loan under the MPF 100 product must represent and warrant that the loan complies with the new RESPA rules and Applicable Laws. Therefore, PFIs may wish to seek their own legal advice to ensure full compliance with RESPA.

Servicing Guide Revisions:

Revised Temporary Loan Payment Modification Plan Forms (Servicing Guide Forms SG400 and SG401):

We have revised the two Temporary Loan Payment Modification Plan Forms (Servicing Guide Forms SG400 and SG401) to include certain borrower and lender covenants. These added covenants are meant to provide additional details and information to help borrowers understand and comply with the Temporary Loan Payment Modification Plan. No new program requirements are being added.

- SG400 changes include the following:
  - Section 1 now includes a statement that the borrower's first payment during the trial period must be received by the PFI on time and, if not, the Modification Plan will be terminated;
  - Section 1A now emphasizes that the borrower must make all payments on or before the due dates;
  - Section 1E clarifies that when the PFI accepts a payment during the trial period of the plan, the payment is held in suspense and not applied until the trial period is successfully completed;
  - Section 1G includes a statement that if a PFI is required to obtain a title endorsement or a subordination agreement necessary to maintain its first lien position and the enforceability of the modification documents and the PFI has not received such title endorsement or subordination agreement, it is not obligated to execute the modification agreement;
  - Section 4C includes a statement that in cases where the original loan documents did not establish an escrow account, one shall be established in accordance with Applicable Law; and
  - Section 4E, 4F and 4G are new sections that require the borrower to agree to execute documents to further consummate the terms and conditions of the modification plan, disclose to the borrower the collection and use of the borrower's personal information and an explanation regarding transfer or assumption under the plan.
- SG401 changes include the following:

- Section 3 now emphasizes that the borrower's payments during the trial period must be received by the PFI on time or the Modification Plan will be terminated;
- Section 3B further clarifies that any unpaid amounts (capitalized interest) added to the modified principal balance shall accrue interest based on the interest in effect under the modification agreement;
- Section 3E has been revised to clarify that if a default interest rate is permitted under the original loan documents and the borrower defaults under the loan modification plan, the interest rate shall be adjusted to the default interest rate;
- Section 4A clarifies who may sign the modification agreements where the original borrower(s) have transferred ownership;
- Section 4I is a new section that nullifies any pre-payment penalty provision if one existed in the original Note;
- Section 4J is a new section for the borrower's agreement to cooperate with the PFI in obtaining any title endorsement(s), title insurance or subordination agreement as applicable;
- Section 4K is a new section for the borrower's agreement to execute documents to further consummate the terms and conditions of the modification plan or correct the terms and conditions of the plan if an error is detected;
- Section 4L is a new section providing an explanation in the event Mortgage Electronic Registration Systems, Inc. (MERS) is the mortgagee of record for a mortgage;
- Section 4M is a new section disclosing to the borrower the collection and use of the borrower's personal information; and
- Section 4N is a new section for the borrower's agreement to comply with a PFI's request to re-execute any documents related to the loan documents which may have been lost, misplaced, misstated or inaccurately reflects the terms and conditions of the loan as modified.

We have also upgraded the format of the two forms to make their completion by PFIs more efficient. The forms are now in a "writable fields" format that allows PFIs to complete the forms on-line. This is done by opening the form in the AllRegs® website, typing in the applicable fields and printing it for borrower and PFI signatures. Although you may save an electronic version of the forms on your computer for later completion, we recommend that you use the form in AllRegs to ensure that you are using the most up-to-date version of the forms at all times.

Replacement of Mortgage Insurance (MI) Coverage (Origination Guide Chapter 12.1 and Servicing Guide Chapter 106.2.3)

We are revising the requirements for the replacement of primary mortgage insurance (MI) providers due downgrades of their rating related to their claims paying ability. PFIs will no longer need to monitor these ratings in order to know when they must begin the process of replacing primary MI. These efforts will only need to be undertaken when a mortgage insurer is removed from the MPF approved mortgage insurers list in Origination Guide Chapter 12.1.1. All other requirements for the replacement of MI remain the same.

Replacement of Property Insurance Coverage (Servicing Guide Chapter 106.1.4)

We are adding clarification to the Guides regarding any subsequent downgrading for the rating of a property insurer that provides coverage for hazard, flood, homeowner association or any other applicable property insurance. If any such property insurer's rating decreases below the minimum ratings required under Origination Guide Chapter 15.1.3 after a policy is issued or is subsequently renewed, the PFI is responsible for replacement of the insurance policy in accordance with Applicable Standards. The replacement policy must be from another eligible insurer that meets the MPF Program requirements, unless the PFI maintains mortgage impairment or mortgagee interest insurance in accordance with Servicing Guide Chapter 106.1.6.

Additional Revisions

PFI Notice 2009-6 incorporates the following revisions:

- **Servicing Guide Chapter 105.7.5.3 - Reamortization and Note Modification:** Where a borrower requests a reamortization and note modification after a curtailment, we have removed the condition that there can have been no other note modifications within the prior 12 months.
- **Servicing Guide Chapter 107.6.4 - Establishment of Escrow under the Temporary Loan Modification Plan:** We are clarifying that the Servicer must collect escrow funds if the borrower does not already have an escrow account, in accordance with Servicing Guide Chapter 105.4.1, 105.4.3 and 105.4.5. Until Applicable Law prohibits collection of escrow funds, the Servicer shall continue to collect escrow funds for the remaining life of the loan.

Origination, Underwriting and Servicing Guide Revisions:

The following Servicing Guide changes can be found on the AllRegs® and eMPF® websites. Links to these sites are on fhlbmpf.com and fhlb-mpf.com or may be accessed directly at http://www.allregs.com/fhlbmpf/.

- Origination Guide
  - Chapter 12
  - Form OG5-2
- Underwriting Guide
  - Chapter 2 - Changed text is highlighted in AllRegs
  - Chapter 4 - Changed text is highlighted in AllRegs
- Servicing Guide
  - Chapter 105
  - Chapter 106 - Changed text is highlighted in AllRegs
  - Chapter 107 - Changed text is highlighted in AllRegs
  - Form SG400 and SG401

If you have any questions about these changes, please contact your MPF Bank Representative or call the MPF Customer Support Desk at 877-INFO-MPF (877-463-6673).