Credit Enhanced Products

OVERVIEW

Credit enhanced products require PFIs to share in the credit risk of the loans sold under the MPF Program. In return for holding a portion of the credit risk, the PFIs are paid credit enhancement fees, which provide an economic incentive to PFIs to retain credit risk on high quality loans. MPF credit enhanced products vary by the amount of credit enhancement fee income paid to the PFI and whether or not that credit enhancement fee is impacted by loan performance, as well as the amount and structure of the shared credit-risk arrangement between the PFI and the FHLB. Generally, higher levels of credit risk assumed by the PFI equates to higher credit enhancement fees paid to the PFI. Depending on a PFI's risk tolerance and collateral needs, one product may provide greater benefit over another. While the MPF Program offers three distinct credit enhanced products, each financial institution should carefully review the impact of the income stream associated with the product as well as the credit enhancement obligations and assess the risks and benefits.

The risk-sharing structures on all three MPF credit enhanced products are multi-layered. After accounting for any principal the borrower has paid down on the loan, loan losses are paid first from any existing primary mortgage insurance policy on the property. Mortgage insurance is required on all MPF transactions with loan-to-values greater than 80 percent. Any remaining losses are divided between the FHLB and the PFI. The amount of risk assumed by the FHLB and the PFI varies by product. The first layer of losses is absorbed by the FHLBs' "first loss account." The second layer of losses, called the "credit enhancement obligation," is paid by the PFI. Any losses incurred beyond the credit enhancement obligation are absorbed by the FHLB.

The credit enhancement obligation is calculated so that the total credit enhancement amount plus the first loss account is sufficient to bring the total loss reserves for the master commitment to achieve an Acquired Member Assets (AMA) investment grade.[19] Over time, this credit enhancement obligation is recalculated. If the newly calculated credit enhancement obligation is lower than the remaining obligation, the PFI's credit enhancement obligation is reset to the new, lower level.

The credit enhancement fees paid to the PFI vary by loan product and by the total size of the MPF delivery contract.

FHLBs provide three MPF credit-enhanced secondary market products, MPF Original, MPF 125, and MPF 35.

MPF Original: Secondary market fixed-rate conventional mortgage product purchased by the FHLB and held on its balance sheet. Credit risk is shared between the FHLB and the PFI. For sharing the risk, PFIs are usually paid a fixed monthly credit enhancement fee, typically 10 basis points. Credit enhancement fee income is not impacted by loan performance. The first loss account starts at zero and builds at 4 basis points of outstanding balance each year. Servicing released or retained options are available.

[19] The FHFA has issued, "Acquired Member Assets (AMA) Final Rule For Federal Home Loan Bank Investments" that makes certain changes to the AMA programs. To comply with Dodd-Frank Act mandates that generally bar regulatory agencies from incorporating NRSRO credit-rating requirements into regulations, the FHLBs are now required to determine and document that AMA assets are enhanced at least to an "AMA investment grade," which is a determination made by each FHLB based on documented analysis that includes consideration of applicable insurance, credit enhancements, and other sources for repayment on the assets. The FHLB must now determine the total credit enhancement obligation no later than 30 calendar days after the FHLB completes the purchase of an AMA asset. The final rule can be found at Federal Register 81 FR 91674 or https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Acquired-Member-Assets-Final-Rule.aspx

MPF 125: Secondary market fixed-rate conventional mortgage product purchased by an FHLB and held on its balance sheet. Credit risk is shared between the FHLB and the PFI. For sharing the risk, PFIs are paid between 6 basis points to 9 basis points credit enhancement fee monthly. Credit enhancement fee income is impacted by loan performance. The first loss account is set at the time of delivery at 100 basis points of all loans delivered. Servicing released or retained options are available.

MPF 35: Secondary market fixed-rate conventional mortgage product purchased by an FHLB and held on its balance sheet. Credit risk is shared between the FHLB and the PFI. For sharing the risk, PFIs are paid between 9 basis points to 12 basis points credit enhancement fee monthly. Credit enhancement fee income is impacted by loan performance. The first loss account is set at the time of delivery at 35 basis points of all loans delivered. Servicing released or retained options are available.

MPF CREDIT ENHANCED PRODUCT COMPARISON

	Credit Enhancement Fee Amount	Credit Enhancement Fee impacted by loan performance	FHLB First Loss Account	PFI Credit Enhancement Obligation	Servicing Options	Servicing Income
MPF Original	10 basis points	No	Starts at zero, builds at 4 basis points each year calculated on the outstanding principal balance	AMA investment grade	Retained or released	25 basis points, if retained
MPF 125	6-9 basis points	Yes	Fixed at 100 basis points of all loans sold under the master commitment	AMA investment grade less 100 basis points first loss account, minimum 25 basis points	Retained or released	25 basis points, if retained
MPF 35	9-12 basis points	Yes	Fixed at 35 basis points of all loans sold under the master commitment	AMA investment grade less 35 basis points first loss account	Retained or released	25 basis points, if retained