Mortgage Partnership Finance™

FHLBANKS
A NATION OF LOCAL LENDERS

December 3, 2019

Frequently Asked Questions - Pool Level Credit Enhancement and Minimum Credit Enhancement Amounts

What products are subject to the adjustment?

The Credit Enhancement (CE) update applies to all of the risk-sharing products (MPF® Original, MPF 35, and MPF 125).

What creates the need for an adjustment?

We have an operational model that is used for calculating credit enhancement as needed for both the CE Estimator and for loan presentments and delivery. We are also required to have a supplemental model which is used to periodically verify that the credit enhancement amount calculated by the operational model is sufficient based on regulatory stress testing requirements. All Master Commitments must sufficiently demonstrate adequate coverage compared to results calculated by both the operational model and the supplemental model processes. An adjustment may occur when a Master Commitment closes if the supplemental model provides a credit enhancement amount higher than the operational model.

Up until now, the MPF Program has not adjusted the credit enhancement amount based on supplemental results because the impact was viewed to be immaterial. However, based on regulatory guidance, we can no longer waive adjusting the credit enhancement.

Why does the MPF Program have both an operational model and a supplemental model?

The supplemental model is used to verify that the PFI Credit Enhancement Obligation is sufficient to meet regulatory requirements. The supplemental model methodology requires significant time to calculate the required credit support. Therefore, it is impractical to replace the operational model with the supplemental model in the MPF Program systems.

What is the effective date of the change?

The updated credit enhancement process is effective as of January 1, 2020 to meet regulatory timeframes.

Will model updates impact the likelihood of an adjustment?

The operational model and supplemental model are updated periodically to reflect current and projected economic conditions that may impact mortgage loan loss projections. The MPF Program will monitor model updates and their potential impact to the MPF Traditional Products. If model updates increase the likelihood of an adjustment, the MPF Program may revise operational model assumptions or take other steps to mitigate the impact to PFI Credit Enhancement Obligations.

If the supplemental model is updated, will loans funded previously be re-reviewed?

If the supplemental model is updated, loans previously analyzed will not be re-reviewed. Each month, the MPF Program will run loans delivered during the prior month through the supplemental model process and retain the results of that analysis. Therefore, an update to the supplemental model will only impact loans that have not been previously analyzed on a go-forward basis.

Will my Master Commitments be impacted?

The operational model is set with a goal to ensure that results are sufficient to establish an appropriate level of credit enhancement. Because no model can predict with 100% certainty, it is possible, although highly unlikely, that a Master Commitment may be impacted, and, if a Master Commitment were to be impacted, we expect the impact would be minimal. Based on our analysis, one out of 750 Master Commitments (0.1% of Master Commitments) could be impacted and the average PFI Credit Enhancement Obligation difference would likely be $1,000.[1]

[1] The analysis was based on outstanding Master Commitments as of 6/30/2019 using the model versions in use at that time. The results may change based on economic scenario and modeling updates.

What is the process if the PFI Credit Enhancement Obligation requires adjustment?

The MPF Program will review supplemental model results monthly to identify and communicate if we think there is a risk of a PFI Credit Enhancement Obligation adjustment for a Master Commitment. If a supplemental model adjustment is needed, the adjustment will occur no later than 30 days after all open Delivery Commitments have been satisfied and the Master Commitment is closed.

When is a Master Commitment closed?

As part of the supplemental model adjustment process, a Master Commitment is closed if:

- The Master Commitment has surpassed/met the MC Amount or the Estimated Completion Date has passed; AND
- All open Delivery Commitments have been satisfied.
- The MPF Bank determines if the Master Commitment is closed.

What kinds of loans are more likely to lead to a credit enhancement adjustment?

There is no single loan characteristic that would increase the likelihood of a credit enhancement adjustment. In general, regardless of loan characteristics, the more loans sold into a Master Commitment, the less likelihood of an adjustment.

If I anticipate selling fewer than 10 loans into a Master Commitment, should I sell under the MPF Traditional products?

There is an increased likelihood of an adjustment to the credit enhancement if only a few loans are sold into a Master Commitment. You may consider selling under the MPF Xtra® product, if offered by your MPF Bank. MPF Xtra does not have a PFI Credit Enhancement Obligation.

Will my PFI Credit Enhancement Obligation be lowered if the supplemental model provides a lower result?

No. The operational model provides a base level of credit enhancement that in rare occasions may be increased to meet regulatory requirements.

Why is the MPF Program Guide Chapter 2 - MPF Mortgage Products being updated regarding minimum credit enhancement amounts?

The MPF Program anticipates implementing new minimum CE amounts for MPF Original, MPF 35, and MPF 125 in 2020. Your MPF Traditional product Master Commitment specifies the minimum CE amount, if applicable. The MPF Program Guide has been updated to clarify that minimum CE amounts are detailed in the Master Commitment.

What will the new minimum CE amounts be?

The MPF Program is waiting for final regulatory guidance in December. We will communicate the new minimum CE amounts shortly thereafter.

Will the updated CE process impact resets of the PFI CE obligation?

The MPF Program will continue to recalculate the CE as described in the MPF Program Guide and, if such recalculated CE would result in a PFI CE obligation lower than the remaining obligation, the PFI's CE obligation will be reset to the new, lower level. The recalculation will incorporate the new regulatory requirements regarding supplemental model validation and minimum CE amounts.

And if I have additional questions?

Please contact your MPF Bank representative if you have any additional questions regarding the MPF Traditional Selling Guide and MPF Program Guide updates.

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