PFI Advisory

April 1, 2002

Special Attention:

PFI's MPF® Program Management

Subject:

Revised Risk-Based Capital Requirements – Impact for **MPF 100** Participants

Regulatory Update:

The four Banking Agencies (Federal Reserve, FDIC, OCC and OTS) adopted a risk-based capital rule in late 2001 which, when in effect for the MPF Program, will have a positive impact on the Program. This Advisory provides an overview of the rule's impact on MPF 100 participants.

Brief Overview

Upon qualification of the MPF Program by the Banking Agencies under the new capital rule, Participating Financial Institutions (PFIs) will be able to deliver Closed Loans into MPF 100 Master Commitments. Under the prior risk-based capital rule, direct credit substitutes (e.g. flow loans) received preferential capital treatment. The new capital rule eliminates the structural distinction between "recourse" (for sale of Closed Loans) and "direct credit substitutes" (for flow loans), and establishes a credit risk-based approach.

The basic principle of the credit risk-based approach is that if the PFI's risk position for a Master Commitment – the PFI's Credit Enhancement (CE) obligation after the credit enhancement provided by the First Loss Account (FLA) – is "BBB" or higher, the PFI would be required to hold risk-based capital of only 8% of the PFI's CE obligation. For a risk position of "BB" the PFI would be required to hold capital of only 16% of the PFI's CE obligation. For risk positions lower than "BB" the PFI would be required to hold capital equal to 100% of the PFI's CE obligation or 4% of the unpaid principal balance of loans delivered, whichever is less.

Timing

The MPF Provider is taking the necessary steps to secure Banking Agency qualification of the MPF Program. We hope to complete this process shortly. The effective date of the new capital rule was January 1, 2002 so that, for qualified products, changes in capital would begin to be reported in first quarter call reports.

When Banking Agency qualification is received, the MPF Provider will notify PFIs, and will provide details concerning capital requirements for each Master Commitment.

The new capital rule permits institutions to delay until December 31, 2002 application of the rule to Master Commitments entered into prior to January 1, 2002, which have increased capital requirements under the rule. Existing MPF 100 Master Commitments for which the PFI's risk position is less than "BBB" are likely to have increased capital requirements under the new rule, but capital reporting will not need to change until early 2003. The new regulation modifies the risk based capital treatment referred to in the MPF Guides or other MPF materials.

Other Issues

Press coverage of the new risk-based capital rule has emphasized the stringent capital requirements in the rule for residual interests. However, the MPF Program does not create "residual interests" as defined in the rule. Hence, the capital requirements in the rule regarding residual interests will not apply to any MPF products.

Additional information concerning revised capital requirements for each MPF product will be provided in a subsequent PFI Advisory. That Advisory will be issued after Banking Agency qualification of the MPF Program is obtained, and assistance will be provided to PFIs as needed prior to that time.

Please contact your MPF Marketing representative should you have any questions regarding this advisory.