PFI Advisory

April 1, 2002

Special Attention:

PFI's MPF® Program Management

Subject:

Revised Risk-Based Capital Requirements – Impact for **MPF 125** 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 125 participants.

Brief Overview

Upon qualification of the MPF Program by the Banking Agencies under the new capital rule, the Participating Financial Institution's (PFI's) risk-based capital may fall by as much as 92% for MPF 125 Master Commitments, depending on the overall size of the PFI's Credit Enhancement (CE) obligation in relation to the size of the First Loss Account (FLA). The new capital rule establishes a credit risk-based approach to determine risk-based capital requirements.

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 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 the previous capital requirement.

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.

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.