PRESS RELEASE

Federal Deposit Insurance Corporation

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FDIC PROPOSES TO INCREASE THE REGULATORY CAPITAL LIMIT ON MORTGAGE SERVICING ASSETS

FOR IMMEDIATE RELEASE

The FDIC Board of Directors proposed to ease limits on the volume of mortgage servicing assets that state nonmember banks can recognize in calculating asset levels and Tier 1 capital. However, under the proposed rule, servicing assets derived from financial instruments other than mortgages would continue to be deducted from both assets and Tier 1 capital in a bank's regulatory capital calculations.

Servicing rights arise from contracts to service loans owned by others, usually for a fee. Over the past two years, the accounting rules for servicing rights under generally accepted accounting principles (GAAP) have changed significantly.

Servicing rights, or assets, are divided into two types -- purchased rights, which are bought from others; and originated rights, which an institution generally obtains when it makes a loan and sells or securitizes the loan while retaining the servicing rights. Prior to 1996, only purchased servicing rights could be recorded as assets. In 1996, the Financial Accounting Standards Board's Statement No. 122, "Accounting for Mortgage Servicing Rights," permitted institutions also to count originated rights as an asset.

Beginning this year, institutions must follow the Financial Accounting Standards Board's Statement No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." Under this standard, institutions now record servicing assets (or liabilities) on the balance sheet for all financial assets that are serviced for others, including financial assets other than mortgages, regardless of the manner in

Congress created the Federal Deposit Insurance Corporation in 1933 to restore public confidence in the nation's banking system. It promotes the safety and soundness of these institutions by identifying, monitoring and addressing risks to which they are exposed. The FDIC receives no federal tax dollars — insured financial institutions fund its operations.

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which the servicing is acquired. In addition, Statement No. 125 changed the interest cash flows that institutions must include in their measurement of servicing assets compared to previous accounting rules.

Under the proposed rule, when determining an institution's risk-based and leverage capital ratios, the total amount of its mortgage servicing assets (MSAs) -- either purchased or originated -- and "purchased credit card relationships (PCCRs)" that may be included in regulatory capital would be increased from 50 percent to 100 percent of Tier 1 capital. Treatment of PCCRs -- the value of the customer relationships that is obtained with the purchase of credit card accounts -- would not be changed under the proposed rule. They would continue to be subject to a sublimit of 25 percent of Tier 1 capital. Consistent with current capital standards, the amount of MSAs and PCCRs that may be recognized for Tier 1 capital purposes also would remain limited to the lesser of 90 percent of fair value or 100 percent of book value (net of any valuation allowance).

The FDIC previously limited the amount of mortgage servicing rights that an institution can include in regulatory capital because of the significant adverse impact on capital that could result from a high concentration of these assets, which are potentially volatile due to interest-rate and prepayment risk. However, the FDIC believes that a higher limit is more reasonable in light of the specific valuation and impairment guidance for servicing assets in the current accounting standards. In addition, some institutions may exceed the current Tier 1 capital limitation only because of changes in the measurement of MSAs under Statement No. 125.

The FDIC is not proposing to change the existing regulatory capital treatment of non-mortgage servicing assets, which must be fully deducted from Tier 1 capital. Although the markets for some types of non-mortgage servicing assets are growing, these markets are not as fully developed as the mortgage servicing market. Because of the uncertainty surrounding the valuation of these servicing assets, the FDIC would continue to exclude them from capital.

The proposal also seeks comment on whether assets representing rights to future interest cash flows from serviced assets in excess of contractually specified servicing fees, so-called "interest-only strips receivable," should be subject to the same regulatory capital limits as servicing assets.

The proposed capital rule has been developed in consultation with the three other federal regulators of banks and savings associations. Written comments on the proposal are due within 60 days of its publication in the Federal Register.

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