Capital Standards

FIL-56-95
August 15, 1995

TO: CHIEF EXECUTIVE OFFICER
SUBJECT: *Interim Rule Addressing the Regulatory Capital Treatment of Originated Mortgage Servicing Rights*

The FDIC Board of Directors has approved an interim rule placing regulatory capital limits on the amount of "originated mortgage servicing rights" (OMSRs) held by FDIC-supervised banks. The interim rule, which was adopted jointly with the other federal banking agencies, amends Part 325 of the FDIC's regulations and went into effect August 1, 1995.

In general, mortgage servicing rights are the contractual obligations undertaken by an institution to provide servicing for mortgage loans owned by others, typically for a fee. OMSRs generally represent the servicing rights acquired when an institution originates mortgage loans and subsequently sells the loans but retains the servicing rights. This differs from "purchased mortgage servicing rights" (PMSRs), which are mortgage servicing rights that have been purchased from other parties.

The need for the interim rule arises because of the May 1995 release of the Financial Accounting Standards Board's Statement No. 122, "Accounting for Mortgage Servicing Rights" (FASB 122). As previously announced by the Federal Financial Institutions Examination Council (see FIL-41-95 dated June 21, 1995), banks must adopt FASB 122 for purposes of the Reports of Condition and Income (Call Report) for fiscal years beginning after December 15, 1995. Early adoption also is permitted to the extent allowable under FASB 122. For institutions on a calendar year fiscal year that do not elect early adoption, the Call Report for March 31, 1996, will be the first report to be completed using FASB 122.

Once an institution adopts FASB 122, it generally is required to capitalize OMSRs as balance sheet assets on a prospective basis. The interim rule provides early guidance on the regulatory capital treatment of OMSRs for those institutions considering whether to implement FASB 122 before its 1996 effective date.

Under the interim rule, the regulatory capital limitations the FDIC applies to OMSRs are the same as those for PMSRs. Specifically, when determining an institution's risk-based and leverage capital ratios, the total amount of mortgage servicing rights (including PMSRs and OMSRs) and "purchased credit card relationships" that may be included in regulatory capital is limited to 50 percent of Tier 1 capital. In addition, when calculating Tier 1 capital, all mortgage servicing rights are valued -- as PMSRs previously were -- at the lesser of 90 percent of fair value or 100 percent of book value. This valuation of mortgage servicing rights must be performed at least quarterly.

The agencies previously limited the amount of PMSRs that an institution could include in regulatory capital because of the subjectivity and uncertainty surrounding the valuation of these assets and the risks resulting from a high concentration of PMSRs. Since the risk characteristics of PMSRs and OMSRs are similar, the interim rule reflects the agencies' decision to place regulatory capital limits on OMSRs that are the same as those applied to PMSRs. As an interim rule, however, written comments will be accepted until October 2, 1995. Based on the comments received, the agencies will consider whether to alter the interim capital rule as part of a final rule.

The attached Federal Register notice includes a detailed explanation of the FDIC's interim capital rule, as well as a listing of specific questions for comment. For more information, contact Stephen G. Pfeifer, an Examination Specialist in the Division of Supervision's Accounting Section (202-898-8904).

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