ARKANSAS STATE BANK DEPARTMENT
EXAMINATION POLICY

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Supersedes	None
Approval	

SUBJECT: Treatment of Mortgage Loan pools and Mortgage Servicing Rights Acquired from the RTC

The Resolution Trust Corporation (RTC) packages 1 to 4-family residential mortgage loans into pools for sale to various financial institutions and other entities. Questions have arisen concerning the accounting for the loan pools depends upon whether they are to be held for resale or for long-term investment.

POLICY

Before the mortgage loan pool can be classified as a long-term investment, the intent and ability of the bank to hold the loans to maturity or for an extended period must be established. A corporate resolution may be used to document management's intent to hold the pool of loans for an extended period of time or until maturity.

Mortgage loan pools acquired from the RTC for long-term investment are to be booked at cost and carried on the bank's balance sheet in the loan category. The subsidiary loan trial may carry the loans on an individual basis or carry a control amount for the block of loans purchased. A premium or discount may be associated with the purchase of this type of asset and must be amortized or accreted over the life of the loans.

A premium exists when a bank purchases the pool of loans at a price in excess of the principle of the loans within the pool. The difference between the purchase price and balance represents the premium which the bank is required to amortize. Amortization may be calculated on an individual loan basis or may be calculated on the entire pool utilizing a weighted average life method. (The remaining life of each loan is determined and totaled. The total life is then divided by the number of loans within the pool.)

A discount exists when a bank purchases a pool of loans at a price below the principle balance of the loans within the pool The difference between the proposed balance and purchase price presents the discount which the bank is required to accrete. Accretion may be calculated on the individual loans or may be calculated on the entire pool utilizing the weighted average life method previously described.

Mortgage loan pools acquired for sale are booked at the lower of cost or principle balance of the loans within the pool. Discounts resulting from the purchase of a loan pool that are held for sale shall not be realized as income until the loans are actually sold. A gain or loss on he sale is the difference between the sale price and the net carrying amount of the pool. This gain or loss will be reported as noninterest income and will not affect the yield on the pool of loans for the carrying period.

Certain costs incurred in block purchases of mortgage loans can be associated with future servicing income and capitalized and amortized over the estimated average term of the mortgage loans. Appropriately capitalized costs can be added to the book value of the loans, and the lower of cost or principle balance has been determined.

Loans are sometimes warehoused for s short period of time and sold under a repurchase agreement (repo). If the loans are not repurchased in accordance with the repo agreement, the lending institution may exercise ownership of the pool of loans. The seller may pay an agreed-upon rate of interest for the use of funds provided by the lending institution. Repos are accounted for as a borrowing and no sale is recorded.

When the interest paid on the short-term warehouse loans is less than interest received on the asset, a positive spread is created for the repo seller. However sometimes interest rates reverse, and short-term rates exceed long-term rates. This results in a negative spread in interest rates for the repo seller which must be charged to current operations as they are incurred.

Mortgage loans pools held for resale should be segregated on the balance sheet. Disclosure must be made of the method used to determine the lower of cost or market value of the loan pools. Capitalization of servicing rights must be disclosed as follows: (a) amount capitalized; (b) method of amortization used; and (c) amount of amortization.

The bank's loan policy is to address the following information for the purchase of mortgage loan pools from the RTC: inclusion of mortgage loan pools on the list of loans suitable for investment; the maturity desired for these type of loans; documentation requirements; assignment of responsibility for oversight of the pool; and guidelines for accounting, assignment of risk rating, and sale of individual loans from the pool or the entire pool. The reserve for loan losses is to be increased according to the risk assigned to this pool of loans.

ACCOUNTING FOR SERVICING RIGHTS

Part of the mortgage loan pool's purchase price may be the right to receive future servicing income. The amount directly attributable to servicing rights shall be deferred with certain limitations. The first limitation is that the amount deferred shall not be more than the difference between the market value (excluding servicing rights) of the loans at the date of purchase and the total purchase must be in accordance with FASB-65 (lower of cost or market). The following conditions must be met:

a. Prior to date of purchase, commitments from investors to purchase the mortgage loans must be obtained, or the commitments must be obtained no later than 30 days after the date of purchase. The commitment must provide for the seller to continue servicing the mortgage loans.

b. If the sales price to the permanent investor exceeds the market value of the loans at date of purchase, the difference must be applied to reduce any amount deferred for mortgage servicing rights.

c. No other costs relating to the purchase of the loans can be deferred.

NOTE: If the above conditions are not met, the cost of the right to receive future servicing income is usually included as part of the cost of the mortgage loans for the purpose of determining lower of cost or market.

The second limitation is that the amount allocated to the right to receive future servicing income cannot exceed the present value of the estimated future net servicing income. Future net servicing income is the difference between the estimated future servicing revenue and the estimated future servicing costs. probable late charges can be included in future revenues. Servicing costs may be determined on an incremental cost basis.