

DATE: March 3, 2003

SUBJECT: Risk Management and Valuation of Mortgage Servicing Assets Arising from Mortgage Banking Activities (SR Letter 03-4)

HIGHLIGHTS: The Federal Reserve, along with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (the agencies), has issued an Interagency Advisory on Mortgage Banking. The advisory highlights various supervisory concerns regarding the valuation and hedging of mortgage servicing assets (MSAs) and similar mortgage banking assets. It also provides supervisory guidance on sound risk management practices regarding valuation and modeling processes, management information systems, and internal audit as applied to mortgage banking activities.

As set forth in the guidance, the agencies expect institutions to conduct all aspects of their mortgage-banking operations in a safe and sound manner and consistent with sound risk management practices. Institutions are expected to take into account the potential exposure of both earnings and capital to changes in mortgage banking assets and operations under expected and stressed market conditions. The practices advanced in the interagency advisory supplement and expand upon existing Federal Reserve supervisory guidance on interest rate risk management,

mortgage-banking, and financial modeling.

Additional information is included in the SR letter.

DOCUMENT LOCATION: The February 25, 2003 SR letter, along with the Interagency Guidance, is available at:

<http://fedweb.frb.gov/fedweb/bsr/srltrs/SR0304.htm>

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