



Why Hedge MSR

MSR Risk Management Decision

Important to Demonstrate Understanding and Control of MSR Risk

- MSR represents material risk to current period earnings and capital position
- Current regulatory environment stresses control of financial risk
- Understanding and control of MSR risk creates greater business flexibility and smarter strategic decision making

Dimensioning MSR Risk is Key First Step

- Define *All* key drivers of fair value and measure level of *All* risks
- Understand timing of gains or losses associated with fair value
- Track predictability of risk models and continually refine/revise processes

Determine How MSR Fair Value Risk Fits in Business Model

- MSR risk vs other market-driven risks in the institution
- Magnitude, key drivers, and timing
- Capital markets offset to portion of MSR risk that does not have effective business offset – *Hedge*

Hedging MSR risk is simpler, more effective, and cheaper than most realize

Reasons to Hedge MSR at Current Rates

- **Risk Reduction** MSR hedging is an essential part of the enterprise risk management function in any institution with significant mortgage securitization operations
 - Goal of MSR hedging is to offset interest rate risk (*thereby earnings volatility*) associated with MSR
 - To the extent that most enterprise risks are managed, unmanaged risks become a disproportionately larger part of business uncertainty
 - Capital markets hedges are extremely efficient at offsetting fair value risk (page 3)
- **Regulatory Oversight and Market Valuation**
 - Financial regulators have issued an interagency advisory recommending that institutions have processes in place “*for measuring and, where necessary, mitigating*” portfolio risk relative to market factors (January 6, 2010 FFIEC *Interagency Advisory*)
 - Equity markets assign a lower multiple to firms with significant earnings volatility or with lower quality earnings
- **Uncertainty of Future Market Environment**
 - Many participants are convinced we are at the lows in interest rates, however with a faltering economic recovery, this may not be true
 - The Administration has attempted to stimulate economic activity through fiscal and financial means, with minimal results. Further attempts are possible, with rate-driven refinances as a key lever that the federal government might utilize.
 - Rate bias is not a reliable way to achieve consistent earnings

Reasons to Hedge MSR at Current Rates

• **Favorable MSR Hedging Environment** The current market environment is the most conducive to MSR hedging in memory. Almost all MSR hedgers are producing positive results (hedge results net of MSR fair value changes, table below)

Q3, 2011 MSR Hedge Result Summary				
	Net Hedge Results (\$MM)	Average MSR Value (\$MM)	Percent Value Decline Due to Changes in Inputs/ Assumptions	Annualized (Cost)/Benefit From Hedging (% Annualized)
Wells Fargo	577	13,575	-18.1%	17%
Chase	16	10,038	-37.5%	1%
Bank of America	361	10,126	-31.2%	0%
Suntrust	6	1,228	-27.5%	2%
BB&T	30	726	-34.0%	17%
Trustmark	3	47	-15.2%	24%
Average MVRA Performance			-27.2%	10%
Based on public disclosures				

• **Inexpensive and Effective Hedge Services** MVRA offers the most complete suite of MSR risk-management services in the industry at lower cost than competitors and at a fraction of the cost of organic development

Hedging Produces Stable MSR Results

