FFIEC 051

CALL REPORT

INSTRUCTION BOOK UPDATE

DECEMBER 2022

FILING INSTRUCTIONS

NOTE: This update for the instruction book for the FFIEC 051 Call Report is designed for two-sided (duplex) printing. The pages listed in the column below headed “Remove Pages” are no longer needed in the *Instructions for Preparation of Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only and Total Assets Less than $5 Billion* (FFIEC 051) and should be removed and discarded. The pages listed in the column headed “Insert Pages” are included in this instruction book update and should be filed promptly in your instruction book for the FFIEC 051 Call Report.

Remove Pages	**Insert Pages**
Cover Page (6-22)	Cover Page (12-22)
1 – 2 (9-20)	1 – 2 (12-22)*
7 – 8 (6-22)	7 – 8 (12-22)
RI-1 – RI-2 (12-20)	RI-1 – RI-2a (12-22)
RI-A-5 – RI-A-6 (9-21)	RI-A-5 – RI-A-6 (12-22)
RC-19 – RC-20 (12-20)	RC-19 – RC-20 (12-22)
RC-B-11 – RC-B-12 (6-22)	RC-B-11 – RC-B-12 (12-22)*
RC-C-23 – RC-C-24 (6-22)	RC-C-23 – RC-C-24 (12-22)*
RC-R-21 – RC-R-22 (6-22)	RC-R-21 – RC-R-22 (12-22)*
A-33 – A-40 (3-17, 12-18, 3-21)	A-33 – A-40 (12-22)
A-47 – A-48 (6-22)	A-47 – A-48 (12-21)**
A-59 – A-60 (9-18)	A-59 – A-60 (12-22)*
A-63 – A-64 (9-18)	A-63 – A-64 (12-22)

*Updates to these pages are limited solely to technical and non-substantive edits such as correction, formatting, spacing, indentation, capitalization, and removal of outdated accounting terminology.

**Updates to pages A-47 and A-48 are solely limited to reverting back to the original date on the footer and vertical line as there no changes to these pages in the June 2022 instruction book update from December 2021.

Instructions for Preparation of

Consolidated Reports of Condition and Income

FFIEC 051

Updated December 2022

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GENERAL INSTRUCTIONS

Schedules RC and RC-B through RC-T constitute the FFIEC 051 version of the Consolidated Report of Condition and its supporting schedules. Schedules RI and RI-A through RI-E constitute the Consolidated Report of Income and its supporting schedules. Schedule SU – Supplemental Information collects additional information in the FFIEC 051 on certain complex or specialized activities in which an institution may engage. The Consolidated Reports of Condition and Income are commonly referred to as the Call Report. For purposes of these General Instructions, the Financial Accounting Standards Board (FASB) Accounting Standards Codification is referred to as the "ASC." In addition, a FASB Accounting Standards Update is referred to as "ASU."

Unless the context indicates otherwise, the term "bank" in the Call Report instructions refers to both banks and savings associations.

WHO MUST REPORT ON WHAT FORMS

Every national bank, state member bank, insured state nonmember bank, and savings association is required to file a consolidated Call Report normally as of the close of business on the last calendar day of each calendar quarter, i.e., the report date. The specific reporting requirements for a bank depend upon the size of the bank, whether it has any "foreign" offices, and the capital standards applicable to the bank. Banks must file the appropriate report form as described below:

(1) BANKS WITH FOREIGN OFFICES: Banks of <u>any</u> size that have any "foreign" offices (as defined below) must file quarterly the *Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices* (FFIEC 031). For purposes of these reports, all of the following constitute "foreign" offices:

(a) An International Banking Facility (IBF);
(b) A branch or consolidated subsidiary in a foreign country; and
(c) A majority-owned Edge or Agreement subsidiary.

In addition, for banks chartered and headquartered in the 50 states of the United States and the District of Columbia, a branch or consolidated subsidiary in Puerto Rico or a U.S. territory or possession is a "foreign" office. However, for purposes of these reports, a branch at a U.S. military facility located in a foreign country is a "domestic" office.

(2) BANKS WITHOUT FOREIGN OFFICES: Banks that have domestic offices only must file quarterly:

(a) The *Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices* (FFIEC 031) if the bank:
(i) Is an advanced approaches institutions for regulatory capital purposes,[1] regardless of asset size; or

[1] An advanced approaches institution as defined in the federal supervisor's regulatory capital rules is (i) a subsidiary of a global systemically important bank holding company, as identified pursuant to 12 CFR 217.402; (ii) a Category II institution; (iii) a subsidiary of a depository institution that uses the advanced approaches pursuant to subpart E of 12 CFR part 3 (OCC), 12 CFR part 217 (Board), or 12 CFR part 324 (FDIC) to calculate its risk-based capital requirements; (iv) a subsidiary of a bank holding company or savings and loan holding company that uses the advanced approaches pursuant to subpart E of 12 CFR part 217 to calculate its risk-based capital requirements; or (v) an institution that elects to use the advanced approaches to calculate its risk-based capital requirements.

Category II institutions include institutions that have (1) at least $700 billion in total consolidated assets or (2) at least $75 billion in cross-jurisdictional activity and at least $100 billion in total consolidated assets. In addition, depository institution subsidiaries of Category II institutions are considered Category II institutions.

(ii) Has total consolidated assets of $100 billion or more,[1] including a bank of this size that is subject to Category III capital standards[2];

(b) The *Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only* (FFIEC 041) if the bank has total consolidated assets less than $100 billion, including a bank of this size that is subject to Category III capital standards, but excluding a bank of this size that is an advanced approaches institution; or

(c) The *Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only and Total Assets Less than $5 Billion* (FFIEC 051) subject to the eligibility criteria discussed below, as appropriate to the reporting institution. An institution eligible to file the FFIEC 051 report may choose instead to file the FFIEC 041 report.

For banks chartered and headquartered in Puerto Rico or a U.S. territory or possession, a branch or consolidated subsidiary in one of the 50 states of the United States, the District of Columbia, Puerto Rico, or a U.S. territory or possession is a "domestic" office.

For those institutions filing the FFIEC 031 or FFIEC 041, a separate instruction book covers both of these report forms. Please refer to this separate instruction book for the General Instructions for the FFIEC 031 and the FFIEC 041 report forms.

Eligibility to File the FFIEC 051

Institutions with domestic offices only and total assets less than $5 billion, excluding (1) those that are advanced approaches institutions or are subject to Category III capital standards for regulatory capital purposes and (2) those that are large or highly complex institutions for deposit insurance assessment purposes,[3] are eligible to file the FFIEC 051 Call Report. An institution's total assets are measured as of June 30 each year to determine the institution's eligibility to file the FFIEC 051 beginning in March of the following year. Institutions are expected to file the same report form, either the FFIEC 051 or the FFIEC 041, for each quarterly report date in a given year.

For an institution otherwise eligible to file the FFIEC 051, the institution's primary federal regulatory agency, jointly with the state chartering authority, if applicable, may require the institution to file the FFIEC 041 instead based on supervisory needs. In making this determination, the appropriate agency may consider criteria including, but not limited to, whether the eligible institution is significantly engaged in one or more complex, specialized, or other higher risk activities, such as those for which limited information is reported in the FFIEC 051 compared to the FFIEC 041 (trading; derivatives; mortgage banking; fair value option usage; servicing, securitization, and asset sales; and variable interest entities). The agencies anticipate making such determinations only in a limited number of cases.

Close of Business

The term "close of business" refers to the time established by the reporting bank as the cut-off time for receipt of work for posting transactions to its general ledger accounts for that day. The time designated as the close of business should be reasonable and applied consistently. The posting of a transaction to the general ledger means that both debit and credit entries are recorded as of the same date. In addition, entries made to general ledger accounts in the period subsequent to the close of business on the report date that are applicable to the period covered by the Call Report (e.g., adjustments of accruals, posting of

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[1] The $100 billion asset-size test is based on the total assets reported as of June 30 each year to determine whether the institution must file the FFIEC 031 report form beginning in March of the following year.

[2] Category III institutions include institutions, which are not advanced approaches institutions, that have (1) at least $250 billion in average total consolidated assets or (2) at least $100 billion in average total consolidated assets and at least $75 billion in average total nonbank assets, average weighted short-term wholesale funding, or average off-balance sheet exposure. In addition, depository institution subsidiaries of Category III institutions are considered Category III institutions.

[3] See 12 CFR § 327.8 and 12 CFR § 327.16(f).

For example, if June 30, 2019, is the first June 30 as of which an institution reports $300 million or more in total assets, the institution must begin reporting the data items to which the $300 million total assets threshold applies as of the March 31, 2020, report date. If the institution reports less than $300 million in total assets each quarter-end from September 30, 2019, through June 30, 2020, it may cease reporting the data items applicable to institutions with $300 million or more in total assets beginning September 30, 2020. In contrast, if instead the institution reports $300 million or more in total assets as of September 30 and December 31, 2019, but then reports less than $300 million in total assets each quarter-end from March 31, 2020, through December 31, 2020, it may cease reporting the data items applicable to institutions with $300 million or more in total assets beginning March 31, 2021.

For a bank that files the FFIEC 051 report, other shifts in reporting status occur when:

(1) The bank establishes or acquires any "foreign" office. The bank must begin filing the FFIEC 031 report form (Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices) for the first quarterly report date following the commencement of operations by the "foreign" office. However, a bank with "foreign" offices that divests itself of *all* its "foreign" offices must continue filing the FFIEC 031 report form through the end of the calendar year in which the cessation of all operations of its "foreign" offices was completed.

(2) The institution is involved in a business combination, a transaction between entities under common control, or a branch acquisition that is not a business combination. Beginning with the first quarterly report date following the effective date of such a transaction involving an institution and one or more other depository institutions, the resulting institution, regardless of its size prior to the transaction, must (a) file the FFIEC 031 report form if it acquires any "foreign" office, or has total consolidated assets of $100 billion or more, and (b) report the additional required information on the FFIEC 031 report form (described in the General Instructions section of the instruction book for the FFIEC 031 and FFIEC 041 report forms) or FFIEC 051 report form (described above), as appropriate, if after the consummation of the transaction, its consolidated total assets surpass the total asset thresholds, it exceeds the credit card lines threshold, or on the FFIEC 051 report form, it exceeds the agricultural loan percentage.

(3) The institution becomes an advanced approaches institution for regulatory capital purposes. The institution must begin filing the FFIEC 031 report form for the first quarterly report date after the date it becomes such an institution.

(4) The institution becomes a Category III institution for regulatory capital purposes or a large or highly complex institution for deposit insurance assessment purposes. The institution must begin filing the FFIEC 041 report form for the first quarterly report date after the date it becomes such an institution (unless it establishes or acquires a “foreign office” in the same quarter that it becomes such an institution, in which case the institution must begin filing the FFIEC 031 report form for that first quarterly report date).

In addition, beginning with the first quarterly report date after an operating depository institution that was not previously a member of the Federal Deposit Insurance Corporation (FDIC) becomes an FDIC-insured institution and is eligible to, and chooses to, file the FFIEC 051, it must report the additional required information described above, based on its total assets and agricultural loans at the time it becomes FDIC-insured.

ORGANIZATION OF THE INSTRUCTION BOOK

This instruction book covers the FFIEC 051 report form.[1] It is divided into the following sections:

(1) The General Instructions describe overall reporting requirements.

[1] A separate instruction book covers both the FFIEC 031 and the FFIEC 041 report forms.

(2) The Line Item Instructions for each schedule of the Consolidated Report of Income.

(3) The Line Item Instructions for each schedule of the Consolidated Report of Condition.

(4) The Line Item Instructions for Schedule SU – Supplemental Information.

The instructions and definitions in sections (2), (3), and (4) are not necessarily self-contained; reference to more detailed treatments in the Glossary may be needed.

(5) The Glossary presents, in alphabetical order, definitions and discussions of accounting and reporting issues and other topics that require more extensive treatment than is practical to include in the line item instructions or that are relevant to several line items or to the overall preparation of these reports. The Glossary is not, and is not intended to be, a comprehensive discussion of the principles of bank accounting or reporting.

In determining the required treatment of particular transactions or portfolio items or in determining the definitions and scope of the various items, the General Instructions, the line item instructions, and the Glossary (all of which are extensively cross-referenced) must be used jointly. A single section does not necessarily give the complete instructions for completing all the items of the reports.

The instruction book for the FFIEC 051 report form is available on the Internet on the FFIEC's website (https://www.ffiec.gov/forms051.htm) and on the FDIC's website (https://www.fdic.gov/regulations/resources/call/call.html).

PREPARATION OF THE REPORT

Banks are required to prepare and file the Call Report in accordance with these instructions. All reports shall be prepared in a consistent manner.

The bank's financial records shall be maintained in such a manner and scope so as to ensure that the Call Report can be prepared and filed in accordance with these instructions and reflect a fair presentation of the bank's financial condition and results of operations.

Questions and requests for interpretations of matters appearing in any part of these instructions should be addressed to the bank's primary federal bank supervisory agency (i.e., the Federal Reserve Banks, the OCC, or the FDIC). Such inquiries will be referred for resolution to the Task Force on Reports of the Federal Financial Institutions Examination Council (FFIEC). Regardless of whether a bank requests an interpretation of a matter appearing in these instructions, when a bank's primary federal bank supervisory agency's interpretation of the instructions differs from the bank's interpretation, the supervisory agency may require the bank to prepare its Call Report in accordance with the agency's interpretation and to amend previously submitted reports.

SIGNATURES

Either the cover (signature) page of any agency-supplied sample set of report forms, a photocopy of this cover page, or a copy of the cover page printed from the bank's report preparation software or from the FFIEC's or the FDIC's website should be used to fulfill the signature and attestation requirement.

Chief Financial Officer Declaration

The chief financial officer of the bank (or the individual performing an equivalent function) shall sign a declaration on the cover (signature) page attesting to the correctness of the Consolidated Reports of Condition and Income that the bank has filed with the appropriate supervisory agency.

LINE ITEM INSTRUCTIONS FOR THE CONSOLIDATED REPORT OF INCOME

The line item instructions should be read in conjunction with the Glossary and other sections of these instructions. See the discussion of the Organization of the Instruction Books in the General Instructions. For purposes of these Consolidated Report of Income instructions, the Financial Accounting Standards Board (FASB) Accounting Standards Codification is referred to as the "ASC."

SCHEDULE RI – INCOME STATEMENT

General Instructions

Report in accordance with these instructions all income and expense of the institution for the calendar year-to-date. Include adjustments of accruals and other accounting estimates made shortly after the end of a reporting period which relate to the income and expense of the reporting period.

For qualifying fair value and cash flow hedges, institutions should report both of the following in earnings in Schedule RI in the same income statement item that is used to present the earnings effect of the hedged item:

(1) The change in the fair value of the hedging instrument that is included in the assessment of hedge effectiveness; and
(2) Amounts excluded from the assessment of hedge effectiveness in accordance with ASC Topic 815, Derivatives and Hedging.

In addition, for qualifying net investment hedges, institutions should report amounts reclassified from accumulated other comprehensive income to earnings in Schedule RI in the same income statement item that is used to present the earnings effect of the hedged net investment.

For further information on fair value, cash flow, and net investment hedges, see the Glossary entry for "Derivative Contracts."

An institution that began operating during the year-to-date reporting period should report in the appropriate items of Schedule RI all income earned and expenses incurred since commencing operations. The institution should report pre-opening income earned and expenses incurred from inception until the date operations commenced using one of the two methods described in the Glossary entry for "Start-up Activities."

Business Combinations, Pushdown Accounting Transactions, and Transactions between Entities under Common Control – If the reporting institution entered into a business combination that became effective during the year-to-date reporting period and has been accounted for under the acquisition method, report the income and expense of the acquired institution or business only after its acquisition. If the reporting institution was acquired in a transaction that became effective during the reporting period, retained its separate corporate existence, and elected to apply pushdown accounting in its separate financial statements (including its Consolidated Reports of Condition and Income), Schedule RI should only include amounts from the date of the institution's acquisition through the end of the year-to-date reporting period. If the reporting institution was involved in a transaction between entities under common control that became effective during the year-to-date reporting period and has been accounted for in a manner similar to a pooling of interests, report the income and expense of the combined entities for the entire calendar year-to-date as though they had combined at the beginning of the year. For further information on business combinations, pushdown accounting, and transactions between entities under common control, see the Glossary entry for "Business Combinations."

General Instructions (cont.)

Assets and Liabilities Accounted for under the Fair Value Option – Under U.S. generally accepted accounting principles (GAAP) (i.e., ASC Subtopic 825-10, Financial Instruments – Overall, ASC Subtopic 815-15, Derivatives and Hedging – Embedded Derivatives, and ASC Subtopic 860-50, Transfers and Servicing – Servicing Assets and Liabilities), the institution may elect to report certain assets and liabilities at fair value with changes in fair value recognized in earnings. This election is generally referred to as the fair value option. If the institution has elected to apply the fair value option to interest-bearing financial assets and liabilities, it should report the interest income on these financial assets (except any that are in nonaccrual status) and the interest expense on these financial liabilities for the year-to-date in the appropriate interest income and interest expense items on Schedule RI, not as part of the reported change in fair value of these assets and liabilities for the year-to-date. The institution should measure the interest income or interest expense on a financial asset or liability to which the fair value option has been applied using either the contractual interest rate on the asset or liability or the effective yield method based on the amount at which the asset or liability was first recognized on the balance sheet. Although the use of the contractual interest rate is an acceptable method under GAAP, when a financial asset or liability has a significant premium or discount upon initial recognition, the measurement of interest income or interest expense under the effective yield method more accurately portrays the economic substance of the transaction. In addition, in some cases, GAAP requires a particular method of interest income recognition when the fair value option is elected. For example, when the fair value option has been applied to a beneficial interest in securitized financial assets within the scope of ASC Subtopic 325-40, Investments-Other – Beneficial Interests in Securitized Financial Assets, interest income should be measured in accordance with this Subtopic. Similarly, when the fair value option has been applied to a purchased impaired loan or debt security accounted for under ASC Subtopic 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality, interest income on the loan or debt security should be measured in accordance with this Subtopic when accrual of income is appropriate. For further information, see the Glossary entry for “Purchased Impaired Loans and Debt Securities.”

Revaluation adjustments, excluding amounts reported as interest income and interest expense, to the carrying value of all assets and liabilities reported in Schedule RC at fair value under a fair value option (excluding servicing assets and liabilities reported in Schedule RC, item 10, “Intangible assets,” and Schedule RC, item 20, “Other liabilities,” respectively) resulting from the periodic marking of such assets and liabilities to fair value should be reported as “Other noninterest income” in Schedule RI, item 5.l. However, an institution should report in Schedule RI-A, item 10, “Other comprehensive income,” the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk (“own credit risk”) when the institution has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.

Item Instructions

Item No. **Caption and Instructions**

1 **Interest income:**

1.a **Interest and fee income on loans.** Report in the appropriate subitem all interest, fees, and similar charges levied against or associated with all assets reportable as loans in Schedule RC-C, Part I, items 1 through 9.

Deduct interest rebated to customers on loans paid before maturity from gross interest earned on loans; do *not* report as an expense.

Include as interest and fee income on loans:

(1) Interest on all assets reportable as loans extended directly, purchased from others, sold

Item No.	Caption and Instructions
1.a (cont.)	under agreements to repurchase, or pledged as collateral for any purpose.
	(2) Loan origination fees, direct loan origination costs, and purchase premiums and discounts on loans held for investment, all of which should be deferred and recognized over the life of the related loan as an adjustment of yield in accordance with ASC Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs (formerly FASB Statement No. 91, “Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases”) as described in the Glossary entry for "Loan Fees." See exclusion (3) on page 3.

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Item No. **Caption and Instructions**

10 (cont.) other-than-temporary impairment losses) or increases in the fair value of available-for-sale debt securities previously written down as other-than-temporarily impaired, and subsequent accretion (based on the amount and timing of future estimated cash flows) of the portion of other-than-temporary impairment losses on held-to-maturity debt securities not recognized in earnings.

(5) The change in the institution's accumulated net gains (losses) on derivative instruments that are designated as, and qualify as, cash flow hedges.

(6) For derivative instruments that are designated in qualifying hedging relationships, the year-to-date difference between the changes in fair value of components excluded from assessments of effectiveness and the initial value of the excluded components recognized in earnings under a systematic and rational method when the amortization approach for excluded components has been elected in accordance with ASC Topic 815, Derivatives and Hedging.

(7) Gains (losses) and transition assets or obligations associated with single-employer defined benefit pension and other postretirement plans not recognized immediately as a component of net periodic benefit cost and prior service costs or credits associated with such plans, which are accounted for in accordance with ASC Topic 715, Compensation-Retirement Benefits.

(8) The portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk ("own credit risk") when the institution has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.

Exclude the year-to-date change in net unrealized holding gains (losses) on equity securities with readily determinable fair values not held for trading (report in Schedule RI, item 8.b).

For further guidance on reporting other comprehensive income, see ASC Topic 220, Comprehensive Income.

11 **Other transactions with stockholders (including a parent holding company).** Report the net aggregate amount of transactions with the institution's stockholders, including its parent holding company, if any, that affect equity capital directly (other than those transactions reported in Schedule RI-A, items 5, 6, 8, and 9, above), such as:

(1) Capital contributions other than those for which stock has been issued to stockholders. Include amounts contributed to the subsidiary institution from stockholders, including grants received by a parent holding company that are in turn transferred to the subsidiary institution. Report issuances of perpetual preferred and common stock and sales of treasury stock in Schedule RI-A, items 5 and 6, respectively; issuances of limited-life preferred stock are not reported in Schedule RI-A.

(2) Dividends distributed to stockholders in the form of property rather than cash (report cash dividends in Schedule RI-A, items 8 or 9, as appropriate). Record such property dividends at the fair value of the transferred asset. Include any gain or loss recognized on the disposition of the asset in the determination of net income for the calendar year-to-date in Schedule RI, Income Statement. Refer to the Glossary entry for "Dividends" for additional information on property dividends.

(3) Return-of-capital transactions in which contributed capital (i.e., surplus) is reduced without retiring stock and cash is distributed to the institution's stockholders.

Item No.	Caption and Instructions
11 (cont.)	State the dollar amount of and describe each transaction included in this item in Schedule RI-E, item 5. State the dollar amount of and describe each transaction included
12	**Total bank equity capital end of current period.** Report the sum of Schedule RI-A, items 3 through 11. This item must equal Schedule RC, item 27.a, "Total bank equity capital."

Item No.	Caption and Instructions
26.b (cont.)	(2) The unamortized balance of the unrealized holding gain (loss) that existed at the date of transfer of a debt security transferred into the held-to-maturity category from the available-for-sale category. Consistent with ASC Topic 320, when a debt security is transferred from the available-for-sale category into the held-to-maturity category, the unrealized holding gain (loss) at the date of transfer continues to be reported in the accumulated other comprehensive income account, but must be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount.

(3) (a) For institutions that have not adopted ASU 2016-13, the unaccreted portion of other-than-temporary impairment losses on available-for-sale and held-to-maturity debt securities that was not recognized in earnings in accordance with ASC Topic 320, plus the accumulated amount of subsequent decreases (if not other-than-temporary impairment losses) or increases in the fair value of available-for-sale debt securities previously written down as other-than-temporarily impaired.

(b) For institutions that have adopted ASU 2016-13, the unaccreted portion of unrealized losses on available-for-sale and held-to-maturity debt securities that was not recognized in earnings in accordance with ASC Topic 320, plus the accumulated amount of subsequent increases or decreases (not attributable to credit impairment) in the fair value of available-for-sale debt securities, and increases in the fair value of available-for-sale debt securities after a write-down that resulted from the intent to sell or a more-likely-than-not requirement to sell.

(4) (a) Amounts in accumulated other comprehensive income related to derivative instruments that are designated as, and qualify as, cash flow hedges,[1] in accordance with ASC Topic 815, Derivatives and Hedging. See also the Glossary entry for "Derivative Contracts."

The balance in accumulated other comprehensive income associated with each transaction hedged in a cash flow hedge should be the cumulative gain (loss) on the derivative instrument from inception of the hedge less all of the following:

(i) The derivative's gains (losses) previously reclassified from accumulated other comprehensive income into earnings to offset the hedged transaction;
(ii) The cumulative amount amortized to earnings related to components excluded from assessments of effectiveness that are accounted for through an amortization approach when this treatment of excluded components has been elected in accordance with ASC Topic 815; and
(iii) The cumulative change in fair value of an excluded component for which changes in fair value are recorded currently in earnings when this treatment of excluded components has been elected in accordance with ASC Topic 815.

Accordingly, the amount reported in this item 26.b by an institution should reflect the sum of the cumulative gain (loss) less the specified amounts described above for each derivative designated as, and qualifying as, a cash flow hedge. Amounts in

[1] Generally, the objective of a cash flow hedge is to link a derivative to an existing recognized asset or liability or a forecasted transaction with exposure to variability in expected future cash flows, e.g., the future interest payments (receipts) on a variable-rate liability (asset) or a forecasted purchase (sale). The changes in cash flows of the derivative are expected to offset changes in cash flows of the hedged item or transaction. To achieve the matching of cash flows, ASC Topic 815 requires that the changes in the fair value of derivatives designated and qualifying as cash flow hedges initially be reported in the accumulated other comprehensive income component of equity capital and subsequently be reclassified into earnings in the same future period or periods that the hedged transaction affects earnings.

Item No.	Caption and Instructions

26.b (cont.)

accumulated other comprehensive income related to the derivative designated as a hedging instrument included in the assessment of hedge effectiveness should be reclassified to earnings in the same period or periods during which the hedged transaction affects earnings (for example, when a hedged variable-rate interest receipt on a loan is accrued or when a forecasted sale occurs) and presented in the same income statement item in Schedule RI as the earnings effect of the hedged item. In addition, amounts in accumulated other comprehensive income related to components excluded from assessments of effectiveness that are recognized in earnings through an amortization approach should be presented in the same income statement item in Schedule RI as the earnings effect of the hedged item.

(b) For all types of hedges, if certain portions of a hedging instrument's change in fair value are excluded from assessments of hedge effectiveness, the cumulative change in fair value of the excluded components from inception of the hedges less the cumulative amounts amortized to earnings related to the excluded components that are accounted for through an amortization approach when this treatment of excluded components has been elected in accordance with ASC Topic 815.

(5) The accumulated amounts of gains (losses), transition assets or obligations, and prior service costs or credits associated with single-employer defined benefit pension and other postretirement plans that have not yet been recognized as components of net periodic benefit cost in accordance with ASC Topic 715, Compensation-Retirement Benefits.

(6) The accumulated amount of net gains (losses) resulting from changes in fair value attributable to instrument-specific credit risk ("own credit risk") of liabilities for which the fair value option for financial instruments has been elected.

26.c **Other equity capital components.** Report in this item as a negative amount the carrying value of any treasury stock and any unearned Employee Stock Ownership Plan (ESOP) shares, which under generally accepted accounting principles are reported in a contra-equity account on the balance sheet. For further information, see the Glossary entry for "Treasury Stock" and ASC Subtopic 718-40, Compensation-Stock Compensation – Employee Stock Ownership Plans.

Report in this item as a negative amount notes receivable that represent a capital contribution and are reported as a deduction from equity capital in accordance with ASC Subtopic 505-10, Equity – Overall, and SEC Staff Accounting Bulletin No. 107 (Topic 4.E., Receivables from Sale of Stock, in the Codification of Staff Accounting Bulletins). Also report in this item as a negative amount accrued interest receivable on such notes receivable that are reported as a deduction from equity capital in accordance with ASC Subtopic 505-10. Interest income accrued on such notes receivable should not be reported as interest income in Schedule RI, but as additional paid-in-capital in Schedule RC, item 23 or 25, as appropriate. For further information, see the Glossary entry for "Capital Contributions of Cash and Notes Receivable" and ASC Subtopic 505-10.

27.a **Total bank equity capital.** Report the sum of Schedule RC, items 23 through 26.c. This item must equal Report of Income Schedule RI-A, item 12, "Total bank equity capital end of current period."

Item No.	Caption and Instructions

6.a **Other domestic debt securities.** Report in the appropriate columns the amortized cost and fair value of all other domestic debt securities not held for trading.

Other domestic debt securities include:

(1) Bonds, notes, debentures, equipment trust certificates, and commercial paper (except asset-backed commercial paper) issued by U.S.-chartered corporations and other U.S. issuers and not reportable elsewhere in Schedule RC-B.

(2) Preferred stock of U.S.-chartered corporations and business trusts that by its terms either must be redeemed by the issuing corporation or trust or is redeemable at the option of the investor (i.e., redeemable or limited-life preferred stock), including trust preferred securities issued by a single U.S. business trust that are subject to mandatory redemption.

(3) Detached U.S. Government security coupons and ex-coupon U.S. Government securities held as the result of either their purchase or the bank's stripping of such securities and Treasury receipts such as CATS, TIGRs, COUGARs, LIONs, and ETRs. Refer to the Glossary entry for "coupon stripping, Treasury receipts, and STRIPS" for additional information.

Exclude from other domestic debt securities investments in collateralized debt obligations for which the underlying collateral is a pool of trust preferred securities issued by U.S. business trusts (report as structured financial products in Schedule RC-B, item 5.b).

6.b **Other foreign debt securities.** Report in the appropriate columns the amortized cost and fair value of all other foreign debt securities not held for trading.

Other foreign debt securities include:

(1) Bonds, notes, debentures, equipment trust certificates, and commercial paper (except asset-backed commercial paper) issued by non-U.S.-chartered corporations.

(2) Debt securities issued by foreign governmental units.

(3) Debt securities issued by international organizations such as the International Bank for Reconstruction and Development (World Bank), Inter-American Development Bank, and Asian Development Bank.

(4) Preferred stock of non-U.S.-chartered corporations that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor (i.e., redeemable or limited-life preferred stock).

Item No. **Caption and Instructions**

NOTE: Investments in equity securities, including investment in mutual funds, with readily determinable fair values not held for trading that were previously reportable in Schedule RC-B, item 7, columns C and D, should be reported in Schedule RC, item 2.c, “Equity securities with readily determinable fair values not held for trading.” Insured state banks that have received FDIC approval in accordance with Section 362.3(a) of the FDIC’s regulations to hold certain equity investments (“grandfathered equity securities”) should report in Schedule RC-M, item 4, the aggregate cost basis of all equity securities with readily determinable fair values not held for trading that are reported in Schedule RC, item 2.c, not just the cost basis of those equity securities that are treated as “grandfathered.”

7 **Unallocated portfolio layer fair value hedge basis adjustments.** Report the total amount of portfolio layer fair value hedge basis adjustments (FVHBAs) not allocated to individual AFS debt securities in column C only. As defined in Accounting Standards Update No. 2022-01 Derivatives and Hedging (Topic 815), “Fair Value Hedging - Portfolio Layer Method” (ASU 2022-01), the portfolio layer method was added to allow entities to apply hedge accounting to a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments that is not expected to be affected by prepayments, defaults, or other factors affecting the timing and amount of cash flows for the designated hedge period. Under ASU 2022-01, different types of qualifying assets can be grouped together in a portfolio layer hedge.

Per the standard, an institution should not adjust the recorded investment or the discount rate of the individual assets or individual beneficial interest included in the closed portfolio for a basis adjustment that is maintained on a closed portfolio basis. As such, an institution that applies the portfolio layer method to a closed portfolio of AFS debt securities should not allocate the portfolio layer FVHBAs to a more granular level. Institutions should report these unallocated amounts in this item 7, column C.

If the amount to be reported in this item represents a reduction in the amounts reported in Schedule RC-B, items 1 through 6.b, column C, report the amount with a minus (-) sign.

8 **Total.** Report the sum of items 1 through 7. For institutions that have not adopted FASB Accounting Standards Update No. 2016-13 (ASU 2016-13), which governs the accounting for credit losses, the total of column A for this item must equal Schedule RC, item 2.a, "Held-to-maturity securities." For institutions that have adopted ASU 2016-13, the total of column A for this item must equal Schedule RC, item 2.a, "Held-to-maturity securities," plus Schedule RI-B, Part II, item 7, column B, “Balance end of current period,” for the allowance for credit losses on held-to-maturity debt securities. For all institutions, the total of column D for this item must equal Schedule RC, item 2.b, "Available-for-sale debt securities."

Part I. (cont.)

Item No. Caption and Instructions

11 **LESS: Any unearned income on loans reflected in items 1-9 above.** To the extent possible, the preferred treatment is to report the specific loan categories net of both unearned income and net unamortized loan fees. A reporting bank should enter unearned income and net unamortized loan fees only to the extent that these amounts are included in (i.e., not deducted from) the various loan items of this schedule (Schedule RC-C, Part I, items 1 through 9).

As defined in Accounting Standards Update No. 2022-01, Derivatives and Hedging (Topic 815), "Fair Value Hedging - Portfolio Layer Method" (ASU 2022-01), the portfolio layer method was added to allow entities to apply hedge accounting to a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments that is not expected to be affected by prepayments, defaults, or other factors affecting the timing and amount of cash flows for the designated hedge period. Under ASU 2022-01, different types of qualifying assets can be grouped together in a portfolio layer hedge.

Per the standard, an institution should not adjust the recorded investment or the discount rate of the individual assets or individual beneficial interest included in the closed portfolio for a basis adjustment that is maintained on a closed portfolio basis. As such, an institution that applies the portfolio layer method to a closed portfolio of loans should not allocate the portfolio layer fair value hedge basis adjustments (FVHBAs) to a more granular level and should include these unallocated amounts in this item 11.

If an institution reports each loan item in this schedule net of both unearned income and net unamortized loan fees and has no unallocated portfolio layer FVHBAs applicable to loans, enter a zero in this item. If the amount to be reported in this item represents an addition to the amounts reported in Schedule RC-C, Part I, items 1 through 10, because of unallocated portfolio layer FVHBAs, report the amount with a minus (-) sign.

Do not include net unamortized direct loan origination costs in this item; such costs must be added to the related loan balances reported in Schedule RC-C, Part I, items 1 through 9. In addition, do not include unearned income on lease financing receivables in this item. Leases should be reported net of unearned income in Schedule RC-C, Part I, item 10.

12 **Total loans and leases held for investment and held for sale.** Report the sum of items 1.a.(1) through 10, less item 11.

The amount reported for this item must equal Schedule RC, item 4.a plus item 4.b.

Part I. (cont.)

Memoranda

Item No. **Caption and Instructions**

NOTE: Schedule RC-C, Part I, Memorandum items 1.a.(1) through 1.f.(5), are to be completed semiannually in the June and December reports only. Memorandum item 1.g is to be completed quarterly.

1 **Loans restructured in troubled debt restructurings that are in compliance with their modified terms.** Report in the appropriate subitem loans that have been restructured in troubled debt restructurings and are in compliance with their modified terms. As set forth in ASC Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors (formerly FASB Statement No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings," as amended by FASB Statement No. 114, "Accounting by Creditors for Impairment of a Loan"), a troubled debt restructuring is a restructuring of a loan in which a bank, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. For purposes of this Memorandum item, the concession consists of a modification of terms, such as a reduction of the loan's stated interest rate, principal, or accrued interest or an extension of the loan's maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, regardless of whether the loan is secured or unsecured and regardless of whether the loan is guaranteed by the government or by others.

Once an obligation has been restructured in a troubled debt restructuring, it continues to be considered a troubled debt restructuring until paid in full or otherwise settled, sold, or charged off. However, if a restructured obligation is in compliance with its modified terms and the restructuring agreement specifies an interest rate that at the time of the restructuring is greater than or equal to the rate that the bank was willing to accept for a new extension of credit with comparable risk, the loan need not continue to be reported as a troubled debt restructuring in this Memorandum item in calendar years after the year in which the restructuring took place. A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not considered a troubled debt restructuring. Also, a loan to a third party purchaser of "other real estate owned" by the reporting bank for the purpose of facilitating the disposal of such real estate is not considered a troubled debt restructuring. For further information, see the Glossary entry for "troubled debt restructurings."

Include in the appropriate subitem all loans restructured in troubled debt restructurings as defined above that are in compliance with their modified terms, that is, restructured loans (1) on which all contractual payments of principal or interest scheduled that are due under the modified repayment terms have been paid or (2) on which contractual payments of both principal and interest scheduled under the modified repayment terms are less than 30 days past due.

Exclude from this item (1) those loans restructured in troubled debt restructurings on which under their modified repayment terms either principal or interest is 30 days or more past due and (2) those loans restructured in troubled debt restructurings that are in nonaccrual status under their modified repayment terms. Report such loans restructured in troubled debt restructurings in the category and column appropriate to the loan in Schedule RC-N, items 1 through 7, column A, B, or C, and in Schedule RC-N, Memorandum items 1.a through 1.f, column A, B, or C.

Loan amounts should be reported net of unearned income to the extent that they are reported net of unearned income in Schedule RC-C, Part I.

Item No. **Caption and Instructions**

29 (cont.) AOCI into earnings. The intent of the adjustment reported in this item (together with the amount reported in Schedule RC-R, Part I, item 9.d) is to reverse the effects on AOCI of applying ASC Topic 715 for regulatory capital purposes. Specifically, assets recognized or derecognized as an adjustment to AOCI as part of the incremental effect of applying ASC Topic 715 should be reported as an adjustment to total assets for leverage ratio purposes. For example, the derecognition of an asset recorded as an offset to AOCI as part of the initial incremental effect of applying ASC Topic 715 should be added back to total assets for leverage ratio purposes by reporting the amount as a negative number in this item. As another example, the portion of a benefit plan surplus asset that is included in Schedule RC, item 26.b, as an increase to AOCI and in total assets should be deducted from total assets for leverage ratio purposes by reporting the amount as a positive number in this item.

Institutions that do not make the AOCI opt-out election – Available-for-sale debt securities:

Available-for-sale debt securities are reflected at amortized cost when calculating average total consolidated assets for Schedule RC-K, item 9. Therefore, include in this item as a deduction from (addition to) assets for leverage ratio purposes the amount needed to adjust the quarterly average for available-for-sale debt securities included in Schedule RC-K, item 9, from an average based on amortized cost to an average based on fair value. If the deferred tax effects of any net unrealized gains (losses) on available-for-sale debt securities were excluded from the determination of average total consolidated assets for Schedule RC-K, item 9, also include in this item as a deduction from (addition to) assets for leverage ratio purposes the quarterly average amount necessary to reverse the effect of this exclusion on the quarterly average amount of net deferred tax assets included in Schedule RC-K, item 9.

Financial Subsidiaries:

If a financial subsidiary is not consolidated into the bank for purposes of the bank's balance sheet, include in this item 29 as a deduction from the bank's average total assets (as reported in Schedule RC-R, Part I, item 27) the quarterly average for the bank's ownership interest in the financial subsidiary accounted for under the equity method of accounting that is included in the bank's average total assets reported in Schedule RC-K, item 9.

If a financial subsidiary is consolidated into the bank for purposes of the bank's balance sheet, include in this item 29 as a deduction from the bank's average total assets (as reported in Schedule RC-R, Part I, item 27) the quarterly average of the assets of the subsidiary that have been included in the bank's consolidated average total assets reported in Schedule RC-K, item 9; minus any deductions from common equity tier 1 capital and additional tier 1 capital attributable to the financial subsidiary that have been included in Schedule RC-R, Part I, item 28; and plus the quarterly average of bank assets representing claims on the financial subsidiary, other than the bank's ownership interest in the subsidiary, that were eliminated in consolidation. Because the bank's claims on the subsidiary were eliminated in consolidation, these bank assets were not included in the bank's consolidated average total assets reported in Schedule RC-K, item 9.

Non-Includable Subsidiaries:

A savings association with a non-includable subsidiary should include in this item 29 a deduction from average total assets (as reported in Schedule RC-R, Part I, item 27) determined in the same manner as described above for financial subsidiaries, except that for a non-includable subsidiary accounted for under the equity method of accounting, the deduction should be the quarterly average for the savings association's outstanding investments (both equity and debt) in, and extensions of credit to, the subsidiary.

Part I. (cont.)

Item No. Caption and Instructions

30 **Total assets for the leverage ratio.** Report Schedule RC-R, Part I, item 27, less items 28 and 29.

Leverage Ratio

31 **Leverage ratio.** Report the institution's leverage ratio as a percentage, rounded to four decimal places. Divide Schedule RC-R, Part I, item 26 by item 30.

31.a **Does your institution have a community bank leverage ratio (CBLR) framework election in effect as of the quarter-end report date?**
Enter "1" for Yes or enter "0" for No. Refer to the qualifying criteria for using the CBLR framework, which are explained in the instructions for Schedule RC-R, Part I, items 32 through 34, below.

NOTE: Item 31.b is to be completed by non-advanced approaches institutions that elect to use the Standardized Approach for Counterparty Credit Risk (SA-CCR) for purposes of the standardized approach. Other non-advanced approaches institutions that did not elect to use SA-CCR should leave this item blank.

31.b **Standardized Approach for Counterparty Credit Risk opt-in election.** A non-advanced approaches institution may continue to use the Current Exposure Method or elect to use SA-CCR for purposes of the standardized approach and supplementary leverage ratio (as applicable). Where a banking institution has the option to choose among the approaches applicable to such institution under the capital rule, it must use the same approach for all purposes. The SA-CCR rule provides non-advanced approaches institutions the option to adopt SA-CCR for purposes of standardized total risk-weighted assets.[1]

Non-advanced approaches institutions that elect to use SA-CCR must notify their appropriate federal supervisor. These institutions would complete this item as prescribed below:

A non-advanced approaches institution that adopts SA-CCR would enter "1" for "Yes" in item 31.b. A non-advanced approaches institution that does not make a SA-CCR opt-in election should leave item 31.b blank. A non-advanced approaches institution must use the same methodology to calculate the exposure amount for all its derivative contracts and, if an institution has elected to use SA-CCR, an institution may change its election only with prior approval of its appropriate federal supervisor.

[1] See 12 CFR 3 (OCC); 12 CFR 217 (Board); 12 CFR 324 (FDIC).

Deposits (cont.):

Examples Illustrating Distinctions Between
MONEY MARKET DEPOSIT ACCOUNTS (MMDAs) and OTHER SAVINGS DEPOSITS

Example 1

A savings deposit account permits no transfers of any type to other accounts or to third parties. Report this account as an other savings deposit.

Example 2

A savings deposit permits unlimited, "preauthorized, automatic, or telephonic" transfers to other accounts or to third parties. None of the third-party payments may be made by check, draft, or similar order (including debit card).
Report this account as an other savings deposit.

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Example 3

A savings deposit permits unlimited "preauthorized, automatic, or telephonic" transfers to other accounts or to third parties, any or all which may be by check, draft, debit card or similar order made by the depositor and payable to third parties.
Report this account as an MMDA.

Derivative Contracts: Banks commonly use derivative instruments for managing (positioning or hedging) their exposure to market risk (including interest rate risk and foreign exchange risk), cash flow risk, and other risks in their operations and for trading. The accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities are set forth in ASC Topic 815, Derivatives and Hedging , which banks must follow for purposes of these reports. ASC Topic 815 requires all derivatives to be recognized on the balance sheet as either assets or liabilities at their fair value. For further information, institutions should refer to the subtopics within ASC Topic 815, as appropriate, for a comprehensive understanding of the accounting for derivatives and hedging activities.

When applicable, institutions may also refer to Accounting Standards Update No. ASU 2020-04, “Reference Rate Reform (Topic 848),” (ASU 2020-04), which provides optional expedients for fair value, cash flow, and net investment hedging relationships affected by reference rate reform for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting as the London Interbank Offered Rate (LIBOR) and other reference rates are being discontinued. ASU 2020-04 provides exceptions to the guidance in ASC Topic 815 related to changes to the critical terms of a hedging relationship due to reference rate reform.

Definition of Derivative

ASC Topic 815 defines a "derivative instrument" as a financial instrument or other contract with all three of the following characteristics:

(1) It has one or more underlyings (i.e., specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable) and one or more notional amounts (i.e., number of currency units, shares, bushels, pounds, or other units specified in the contract) or payment provisions or both. These terms determine the amount of the settlement or settlements, and in some cases, whether or not a settlement is required.

(2) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have similar response to changes in market factors.

Derivative Contracts (cont.):

(3) Its terms require or permit net settlement, it can be readily settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Certain contracts that may meet the definition of a derivative are specifically excluded from the scope of ASC Topic 815, including:

- "Regular-way" securities trades, which are trades that are completed within the time period generally established by regulations and conventions in the marketplace or by the exchange on which the trade is executed;
- Normal purchases and sales of an item other than a financial instrument or derivative instrument (e.g., a commodity) that will be delivered in quantities expected to be used or sold by the reporting entity over a reasonable period in the normal course of business;
- Traditional life insurance and property and casualty contracts; and
- Certain financial guarantee contracts.

ASC Topic 815 has special criteria for determining whether commitments to originate loans meet the definition of a derivative. Commitments to originate mortgage loans that will be held for sale are accounted for as derivatives. Commitments to originate mortgage loans that will be held for investment are not accounted for as derivatives. Also, all commitments to originate loans other than mortgage loans are not accounted for as derivatives. Commitments to purchase loans must be evaluated to determine whether the commitment meets the definition of a derivative under ASC Topic 815.

<u>Types of Derivatives</u>

The most common types of freestanding derivatives are forwards, futures, swaps, options, caps, floors, and collars.

<u>Forward contracts</u> are agreements that obligate two parties to purchase (long) and sell (short) a specific financial instrument, foreign currency, or commodity at a specified price with delivery and settlement at a specified future date.

<u>Futures contracts</u> are standardized forward contracts that are traded on organized exchanges. Exchanges in the U.S. are registered with and regulated by the Commodity Futures Trading Commission. The deliverable financial instruments underlying interest-rate future contracts are specified investment-grade financial instruments, such as U.S. Treasury securities or mortgage-backed securities. <u>Foreign currency futures contracts</u> involve specified deliverable amounts of a particular foreign currency. The deliverable products under <u>commodity futures contracts</u> are specified amounts and grades of commodities such as gold bullion. <u>Equity futures contracts</u> are derivatives that have a portion of their return linked to the price of a particular equity or to an index of equity prices, such as the Standard and Poor's 500.

Other forward contracts are traded over the counter and their terms are not standardized. Such contracts can only be terminated, other than by receipt of the underlying asset, by agreement of both buyer and seller. A <u>forward rate agreement</u> is a forward contract that specifies a reference interest rate and an agreed on interest rate (one to be paid and one to be received), an assumed principal amount (the notional amount), and a specific maturity and settlement date.

<u>Swap contracts</u> are forward-based contracts in which two parties agree to swap streams of payments over a specified period. The payments are based on an agreed upon notional principal amount. An <u>interest rate swap</u> generally involves no exchange of principal at inception or maturity. Rather, the notional amount is used to calculate the payment streams to be exchanged. However, <u>foreign exchange swaps</u> often involve the exchange of principal.

<u>Option contracts</u> (standby contracts) are traded on exchanges and over the counter. Option contracts grant the right, but do not obligate, the purchaser (holder) to buy (call) or sell (put) a specific or standard commodity, financial, or equity instrument at a specified price during a specified period or at a

Derivative Contracts (cont.):

specified date. A purchased option is a contract in which the buyer has paid compensation (such as a fee or premium) to acquire the right to sell or purchase an instrument at a stated price on a specified future date. A written option obligates the option seller to purchase or sell the instrument at the option of the buyer of the contract. Option contracts may relate to purchases or sales of securities, money market instruments, futures contracts, other financial instruments, or commodities.

Interest rate caps are option contracts in which the cap seller, in return for a premium, agrees to limit the cap holder's risk associated with an increase in interest rates. If rates go above a specified interest-rate level (the strike price or cap rate), the cap holder is entitled to receive cash payments equal to the excess of the market rate over the strike price multiplied by the notional principal amount. For example, an issuer of floating-rate debt may purchase a cap to protect against rising interest rates, while retaining the ability to benefit from a decline in rates.

Interest rate floors are option contracts in which the floor seller, in return for a premium, agrees to limit the risk associated with a decline in interest rates based on a notional amount. If rates fall below an agreed rate, the floor holder will receive cash payments from the floor writer equal to the difference between the market rate and an agreed rate, multiplied by the notional principal amount.

Interest rate collars are option contracts that combine a cap and a floor (one held and one written). Interest rate collars enable a user with a floating rate contract to lock into a predetermined interest-rate range often at a lower cost than a cap or a floor.

Embedded Derivatives

Contracts that do not in their entirety meet the definition of a derivative instrument, such as bonds, insurance policies, and leases, may contain "embedded" derivative instruments. Embedded derivatives are implicit or explicit terms within a contract that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument. The effect of embedding a derivative instrument in another type of contract ("the host contract") is that some or all of the cash flows or other exchanges that otherwise would be required by the host contract, whether unconditional or contingent upon the occurrence of a specified event, will be modified based on one or more of the underlyings.

An embedded derivative instrument shall be separated from the host contract and accounted for as a derivative instrument, i.e., bifurcated, if and only if all three of the following conditions are met:

(1) The economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract,

(2) The contract ("the hybrid instrument") that embodies the embedded derivative and the host contract is not remeasured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur, and

(3) A separate instrument with the same terms as the embedded derivative instrument would be a considered a derivative.

An embedded derivative instrument in which the underlying is an interest rate or interest rate index that alters net interest payments that otherwise would be paid or received on an interest-bearing host contract is considered to be clearly and closely related to the host contract unless either of the following conditions exist:

(1) The hybrid instrument can contractually be settled in such a way that the investor (holder) would not recover substantially all of its initial recorded investment,
or

(2) The embedded derivative could at least double the investor's initial rate of return on the host contract and could also result in a rate of return that is at least twice what otherwise would be the

<u>Derivative Contracts (cont.):</u>

market return for a contract that has the same terms as the host contract and that involves a debtor with a similar credit quality.

Examples of hybrid instruments (not held for trading purposes) with embedded derivatives which meet the three conditions listed above and must be accounted for separately include debt instruments (including deposit liabilities) whose return or yield is indexed to: changes in an equity securities index (e.g., the Standard & Poor's 500); changes in the price of a specific equity security; or changes in the price of gold, crude oil, or some other commodity. For purposes of these reports, when an embedded derivative must be accounted for separately from the host contract under ASC Topic 815, the carrying value of the host contract and the fair value of the embedded derivative may be combined and presented together on the balance sheet in the asset or liability category appropriate to the host contract.

Under ASC Subtopic 815-15, Derivatives and Hedging – Embedded Derivatives, a bank with a hybrid instrument for which bifurcation would otherwise be required is permitted to irrevocably elect to initially and subsequently measure the hybrid instrument in its entirety at fair value with changes in fair value recognized in earnings. In addition, ASC Subtopic 815-15 subjects all but the simplest forms of interest-only and principal-only strips and all forms of beneficial interests in securitized financial assets to the requirements of ASC Topic 815. Thus, a bank must evaluate such instruments to identify those that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. However, a beneficial interest that contains a concentration of credit risk in the form of subordination to another financial instrument and certain securitized interests in prepayable financial assets are not considered to contain embedded derivatives that must be accounted for separately from the host contract. For further information, see ASC Subtopic 815-15.

Except in limited circumstances, interest-only and principal-only strips and beneficial interests in securitized assets that were recognized prior to the effective date (or early adoption date) of ASC Subtopic 815-15 are not subject to evaluation for embedded derivatives under ASC Topic 815.

<u>Recognition of Derivatives and Measurement of Derivatives and Hedged Items</u>

A bank should recognize all of its derivative instruments on its balance sheet as either assets or liabilities at fair value. As defined in ASC Topic 820, Fair Value Measurement, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. For further information, see the Glossary entry for "Fair Value."

The accounting for changes in the fair value (that is, gains and losses) of a derivative depends on whether the derivative has been designated as, and qualifies as part of a hedging relationship under ASC Topic 815 and, if so, on the reason for holding it. Either all or a proportion of a derivative may be designated as a hedging instrument. The proportion must be expressed as a percentage of the entire derivative. Gains and losses on derivative instruments are accounted for as follows:

(1) <u>No hedging designation under ASC Topic 815</u> – The gain or loss on a derivative instrument not designated in a hedge under ASC Topic 815, including all derivatives held for trading purposes and derivatives used in transactions that economically hedge exposures to various risks, is recognized currently in earnings through the income statement.

(2) <u>Fair value hedge under ASC Topic 815</u> – For a derivative designated as, and qualifying as, a hedge of the exposure to changes in the fair value of a recognized asset or liability, or of an unrecognized firm commitment that is attributable to a particular risk (i.e., a fair value hedge), the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the risk being hedged should be recognized currently in earnings through the income statement. For example, an exposure to changes in fair value typically results from holding or issuing a debt

Derivative Contracts (cont.):

instrument that has a fixed interest rate or is denominated in a currency other than the institution's functional currency or from a change in the credit and/or foreign exchange risk of a held-to-maturity debt security.

(3) Cash flow hedge under ASC Topic 815 – For a derivative designated as, and qualifying as, a hedge of the exposure to variability in the cash flows of an existing recognized asset or liability or of a forecasted purchase or sale transaction that is attributable to a particular risk (i.e., a cash flow hedge), the entire gain or loss on the derivative should initially be reported outside of earnings as a component of other comprehensive income and subsequently reclassified into earnings in the same period or periods during which the hedged transaction affects earnings.

The individual cash flows related to a recognized asset or liability and the cash flows related to a forecasted purchase or sale transaction are both referred to as a forecasted transaction. A forecasted transaction is eligible for designation as a hedged transaction if the forecasted transaction is specifically identified as a single transaction or a group of individual transactions, the occurrence of the forecasted transaction is probable, and certain other criteria specified in ASC Topic 815 are met. If the hedged transaction is a group of individual transactions, those individual transactions must share the same risk exposure for which they are designated as being hedged. For example, an exposure to variability in cash flows can result from a debt instrument with a variable interest rate or from a transaction amount that will be settled in a nonfunctional currency.

(4) Foreign currency hedge under ASC Topic 815 – For a derivative designated as, and qualifying as, hedging the foreign currency exposure (i.e., an exposure to a currency other than the hedging unit's functional currency) of a net investment in a foreign operation (i.e., a net investment hedge), the gain or loss is reported outside of earnings in other comprehensive income as part of the cumulative translation adjustment. For a derivative designated as, and qualifying as, (1) a hedge of the foreign currency exposure of an unrecognized firm commitment or an available-for-sale security, the accounting for a fair value hedge should be applied, or (2) a hedge of the foreign currency exposure of a foreign-currency denominated forecasted transaction, the accounting for a cash flow hedge should be applied.

For fair value and cash flow hedges, an institution may elect with appropriate documentation of its risk management decision to recognize the initial value of certain excluded components from the assessment of effectiveness in earnings using a systematic and rational method over the life of the hedging instrument. Any difference between the change in fair value of the excluded component and amounts recognized in earnings under that systematic and rational method should be recognized in other comprehensive income. Alternatively, an institution may elect to record changes in the fair value of the excluded component currently in earnings. This election should be applied consistently to similar hedges.

To qualify for hedge accounting, the risk being hedged must represent an exposure to an institution's earnings. In general, if the hedged item is a financial asset or liability, the designated risk being hedged can be overall risks (i.e., the risk of changes in the overall fair value of the hedged item or the risk of overall changes in the hedged cash flows), or portions, or components, of the total risk within the hedged item. The components of the total risk within the hedged item can include: (1) the risk of changes in the fair value or cash flows of the hedged item attributable to changes in the benchmark interest rate;[1] (2) the risk of changes in the cash flows of the hedged item attributable to changes in the contractually specified interest rate; (3) the risk of changes in the fair value or cash flows of the hedged item attributable to changes in foreign exchange rates; or (4) the risk of changes in the fair value or cash flows of the hedged item attributable to changes in the obligor's creditworthiness.

[1] The benchmark interest rate is a widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market. In theory, this should be a risk-free rate. In the U.S., interest rates on U.S. Treasury securities, the London Interbank Offered Rate (LIBOR) swap rate, the Overnight Index Swap (OIS) Rate based on the Fed Funds Effective Rate, the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate, and the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate are considered benchmark interest rates.

Derivative Contracts (cont.):

For held-to-maturity securities, only credit risk, foreign exchange risk, or both may be hedged. An institution can also hedge the risk of changes in the cash flows attributable to changes in an identified contractually specified component of a nonfinancial asset in a forecasted purchase or sale of the nonfinancial asset.

Designated hedging instruments and hedged items qualify for fair value, cash flow, or net investment hedge accounting if all of the criteria specified in ASC Topic 815 are met. These criteria include:

(1) At inception of the hedge, there is formal designation and documentation of the hedging relationship and the institution's risk management objective and strategy for undertaking the hedge, including identification of the eligible hedging instrument (e.g., the derivative), the hedged item or transaction eligible to be hedged, the nature of the risk being hedged, and how the hedging instrument's effectiveness will be assessed. At inception of the hedge (using information applicable as of the date of hedge inception), there must be a reasonable basis for how the institution plans to assess the hedging instrument's effectiveness. When hedging foreign currency risk on an after-tax basis, documentation that hedge effectiveness will be assessed on an after-tax basis (rather than on a pre-tax basis) is also required at hedge inception.

(2) Both at inception of the hedge and on an ongoing basis, the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value or offsetting cash flows attributable to the hedged risk during the period that the hedge is designated (i.e., term of the hedge). An assessment of effectiveness is required whenever financial statements or earnings are reported, and at least every three months. All assessments of effectiveness shall be consistent with the risk management strategy documented for that particular hedging relationship.

    Some hedging relationships (e.g., those meeting the requirements of the "shortcut" or "critical terms match" methods) require only a qualitative assessment. The initial prospective quantitative assessment of hedge effectiveness may be performed at any time after hedge designation, but no later than the first quarterly effectiveness testing date and, for forecasted transactions, before the first transaction occurs, using data applicable as of the date of hedge inception. The ongoing effectiveness assessments may be qualitative and/or quantitative, assuming the expectation of high effectiveness is reasonably supported.

In a fair value hedge, an asset or a liability is eligible for designation as a hedged item if the hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment, the hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof), and certain other criteria specified in ASC Topic 815 are met. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk.

<u>Portfolio Layer Method</u>

Accounting Standards Update No. 2022-01, "Derivatives and Hedging (Topic 815): Fair Value Hedging - Portfolio Layer Method" (ASU 2022-01) expands the current single-layer method and allows for multiple hedged layers of a closed portfolio.

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[1] ASC Master Glossary defines prepayable as "able to be settled by either party before its scheduled maturity".

Derivative Contracts (cont.):

In addition, ASU 2022-01 expands the scope of the portfolio layer method from prepayable[1] assets to also include nonprepayable assets; specifies eligible hedging instruments in a single-layer hedge; provides additional guidance on the accounting for and disclosure of fair value hedge basis adjustments (FVHBAs) under the portfolio layer method; and specifies how hedge basis adjustments should be considered when determining credit losses for the assets included in the closed portfolio. ASU 2022-01 applies to all entities that elect to apply the portfolio layer method of hedge accounting. For public business entities, the ASU is effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. For all other entities, ASU 2022-01 is effective for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years. Early adoption is permitted.

For further guidance refer to Schedule RC-B, item 7, "Unallocated portfolio layer fair value hedge basis adjustments" and Schedule RC-C, item 11, "LESS: Any unearned income on loans reflected in items 1-9 above."

Recognition of Derivatives and Measurement When Criteria for Hedge Accounting is No Longer Met

An institution should discontinue prospectively its use of fair value or cash flow hedge accounting for an existing hedge if any of the qualifying criteria for hedge accounting is no longer met; the derivative expires or is sold, terminated, or exercised; or the institution removes the designation of the hedge.

For a fair value hedge, in general, if a periodic assessment of hedge effectiveness indicates noncompliance with the highly effective criterion that must be met to qualify for hedge accounting, an institution should not recognize an adjustment of the carrying amount of the hedged item for the change in the item's fair value attributable to the hedged risk after the last date on which compliance with the effectiveness criterion was established.

When this occurs for a cash flow hedge, the net gain or loss on the derivative should remain in "Accumulated other comprehensive income" and be reclassified into earnings in the periods during which the hedged forecasted transaction affects earnings. However, if it is probable that the forecasted transaction will not occur by the end of the originally specified time period (as documented at the inception of the hedging relationship) or within an additional two-month period of time thereafter (except as noted in ASC Topic 815), the derivative gain or loss reported in "Accumulated other comprehensive income" should be reclassified into earnings immediately.

Other Considerations

With certain limited exceptions, a nonderivative instrument, such as a U.S. Treasury security, may not be designated as a hedging instrument in a qualifying ASC Topic 815 hedging relationship.

Reporting Derivative Contracts in the Call Report

When an institution enters into a derivative contract, it should classify the derivative as either held for trading or held for purposes other than trading (end-user derivatives) based on the reasons for entering into the contract. All derivatives must be reported at fair value on the balance sheet (Schedule RC). Each institution must report whether it has any derivative contracts in Schedule SU, item 1. If the institution has derivative contracts, it must complete items 1.a through 1.d of Schedule SU, as appropriate, to report separately the notional amounts of interest rate derivatives and all other derivatives, distinguishing between derivatives held for trading and derivatives not held for trading.

Derivative Contracts (cont.):

Trading derivatives with positive fair values should be reported as trading assets in Schedule RC, item 5. Trading derivatives with negative fair values should be reported as trading liabilities in Schedule RC, item 15. Changes in the fair value of (that is, gains and losses on) trading derivatives should be recognized currently in earnings and included as trading revenue in Schedule RI, item 5.l, “Other noninterest income.”

Freestanding derivatives held for purposes other than trading (and embedded derivatives that are accounted for separately under ASC Topic 815, which the bank has chosen to present separately from the host contract on the balance sheet) that have positive fair values should be included in Schedule RC-F, item 6, "All other assets." In the Call Reports for June and December, if the total fair value of these derivatives is greater than $100,000 and exceeds 25 percent of "All other assets" this amount should be disclosed in Schedule RC-F, item 6.c. Freestanding derivatives held for purposes other than trading (and embedded derivatives that are accounted for separately under ASC Topic 815, which the bank has chosen to present separately from the host contract on the balance sheet) that have negative fair values should be included in Schedule RC-G, item 4, "All other liabilities." In the Call Reports for June and December, if the total fair value of these derivatives is greater than $100,000 and exceeds 25 percent of "All other liabilities," this amount should be disclosed in Schedule RC-G, item 4.d. Net gains (losses) on derivatives held for purposes other than trading that are not designated as hedging instruments in hedging relationships that qualify for hedge accounting in accordance with ASC Topic 815 should be recognized currently in earnings and reported consistently as either “Other noninterest income” or “Other noninterest expense” in Schedule RI, item 5.l or item 7.d, respectively.

Derivative Contracts (cont.):

For qualifying fair value and cash flow hedges, institutions should report the following in earnings in Schedule RI in the same income statement item that is used to present the earnings effect of the hedged item:

(1) The change in the fair value of the hedging derivative instrument that is included in the assessment of hedge effectiveness;
(2) Amounts excluded from the assessment of hedge effectiveness in accordance with the discussion above in this Glossary entry of the treatment of excluded components; and
(3) For one or more existing hedged layer or layers that are designated under the portfolio layer method in accordance with ASC paragraph 815-20- 25-12A, the gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall not adjust the carrying value of the individual beneficial interest or individual assets in or removed from the closed portfolio. Instead, that amount shall be maintained on a closed portfolio basis and recognized currently in earnings.

Netting of derivative assets and liabilities is prohibited on the balance sheet except as permitted under ASC Subtopic 210-20, Balance Sheet – Offsetting. See the Glossary entry for "Offsetting."

Discounts: See "premiums and discounts."

Dividends: Cash dividends are payments of cash to stockholders in proportion to the number of shares they own. Cash dividends on preferred and common stock are to be reported on the date they are declared by the bank's board of directors (the declaration date) by debiting "retained earnings" and crediting "dividends declared not yet payable," which is to be reported in other liabilities. Upon payment of the dividend, "dividends declared not yet payable" is debited for the amount of the cash dividend with an offsetting credit, normally in an equal amount, to "dividend checks outstanding" which is reportable in the "demand deposits" category of the bank's deposit liabilities.

A liability for dividends payable may not be accrued in advance of the formal declaration of a dividend by the board of directors. However, the bank may segregate a portion of retained earnings in the form of a net worth reserve in anticipation of the declaration of a dividend.

Stock dividends are distributions of additional shares to stockholders in proportion to the number of shares they own. Stock dividends are to be reported by transferring an amount equal to the fair value of the additional shares issued from retained earnings to a category of permanent capitalization (common stock and surplus). However, the amount transferred from retained earnings must be reduced by the amount of any mandatory and discretionary transfers previously made (such as those from retained earnings to surplus for increasing the bank's legal lending limit) provided such transfers have not already been used to record a stock dividend. In any event, the amount transferred from retained earnings may not be less than the par or stated value of the additional shares being issued.

Property dividends, also known as dividends in kind, are distributions to stockholders of assets other than cash. The transfer of securities of other companies, real property, or any other asset owned by the reporting bank to a stockholder or related party is to be recorded at the fair value of the asset on the declaration date of the dividend. A gain or loss on the transferred asset must be recognized in the same manner as if the property had been disposed of in an outright sale at or near the declaration date. In those instances where a bank transfers bank premises to a parent holding company in the form of a property dividend and the parent immediately enters into a sale-leaseback transaction with a third party, the gain must be deferred by the bank and amortized over the life of the lease.

Domestic Office: For purposes of these reports, a domestic office of the reporting bank is a branch or consolidated subsidiary (other than an Edge or Agreement subsidiary) located in the 50 states of the United States or the District of Columbia or a branch on a U.S. military facility wherever located. However, if the reporting bank is chartered and headquartered in Puerto Rico or a U.S. territory or possession, a branch or consolidated subsidiary located in the 50 states of the United States, the District of Columbia, Puerto Rico, or a U.S. territory or possession is a domestic office. The domestic offices of the reporting bank exclude all International Banking Facilities (IBFs); all offices of Edge and Agreement subsidiaries, including their U.S. offices; and all branches and other consolidated subsidiaries of the bank located in foreign countries.

Due Bills: A due bill is an obligation that results when a bank sells an asset and receives payment, but does not deliver the security or other asset. A due bill can also result from a promise to deliver an asset in exchange for value received. In both cases, the receipt of the payment creates an obligation regardless of whether the due bill is issued in written form. Outstanding due bill obligations shall be reported as borrowings in Schedule RC, item 16, "Other borrowed money," by the issuing bank. Conversely, when the reporting bank is the holder of a due bill, the outstanding due bill obligation of the seller shall be reported as a loan to that party.

Edge and Agreement Corporation: An Edge corporation is a federally-chartered corporation organized under Section 25A of the Federal Reserve Act and subject to Federal Reserve Regulation K. Edge corporations are allowed to engage only in international banking or other financial transactions related to international business.

An Agreement corporation is a state-chartered corporation that has agreed to operate as if it were organized under Section 25 of the Federal Reserve Act and has agreed to be subject to Federal Reserve Regulation K. Agreement corporations are restricted, in general, to international banking operations. Banks must apply to the Federal Reserve for permission to acquire stock in an Agreement corporation.

A reporting bank's Edge or Agreement subsidiary, i.e., the bank's majority-owned Edge or Agreement corporation, is treated for purposes of these reports as a "foreign" office of the reporting bank.

Equity-Indexed Certificates of Deposit: Under ASC Topic 815, Derivatives and Hedging (formerly FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended), a certificate of deposit that pays "interest" based on changes in an equity securities index is a hybrid instrument with an embedded derivative that must be accounted for separately from the host contract, i.e., the certificate of deposit. For further information, see the Glossary entry for "Derivative Contracts." Examples of equity-indexed certificates of deposit include the "Index Powered® CD" and the “Dow Jones Industrials Indexed Certificate of Deposit.”

At the maturity date of a typical equity-indexed certificate of deposit, the holder of the certificate of deposit receives the original amount invested in the deposit plus some or all of the appreciation, if any, in an index of stock prices over the term of the certificate of deposit. Thus, the equity-indexed certificate of deposit contains an embedded equity call option. To manage the market risk of its equity-indexed certificates of deposit, a bank that issues these deposits normally enters into one or more separate freestanding equity derivative contracts with an overall term that matches the term of the certificates of deposit. At maturity, these separate derivatives are expected to provide the bank with a cash payment in an amount equal to the amount of appreciation, if any, in the same stock price index that is embedded in the certificates of deposit, thereby providing the bank with the funds to pay the "interest" on the equity-indexed certificates of deposit. During the term of the separate freestanding equity derivative contracts, the bank will periodically make either fixed or variable payments to the counterparty on these contracts.

When a bank issues an equity-indexed certificate of deposit, it must either account for the written equity call option embedded in the deposit separately from the certificate of deposit host contract or irrevocably elect to account for the hybrid instrument (the equity-indexed certificate of deposit) in its entirety at fair value.

Foreclosed Assets (cont.):

An asset received in partial satisfaction of a loan should be initially measured as described above and the recorded investment in, or amortized cost basis of, the loan, as applicable, should be reduced by the fair value (less cost to sell, if applicable) of the asset at the time of restructuring, foreclosure, or repossession.

The measurement and accounting subsequent to acquisition for real estate received in full or partial satisfaction of a loan, including through foreclosure or repossession, is discussed below in this Glossary entry. For other types of assets that an institution receives in full or partial satisfaction of a loan, the institution generally should subsequently measure and account for such assets in accordance with other applicable generally accepted accounting principles and regulatory reporting instructions for such assets.

For purposes of these reports, foreclosed assets include loans (other than residential real estate property collateralizing a consumer mortgage loan) where an institution, as creditor, has received physical possession of a borrower's assets, regardless of whether formal foreclosure proceedings take place. An institution, as creditor, is considered to have received physical possession (resulting from an in-substance repossession or foreclosure) of residential real estate property collateralizing a consumer mortgage loan only upon the occurrence of either of the following:

(1) The institution obtains legal title to the residential real estate property upon completion of a foreclosure even if the borrower has redemption rights that provide the borrower with a legal right for a period of time after a foreclosure to reclaim the real estate property by paying certain amounts specified by law, or
(2) The borrower conveys all interest in the residential real estate property to the bank to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The deed in lieu of foreclosure or similar legal agreement is completed when agreed-upon terms and conditions have been satisfied by both the borrower and the creditor.

In situations where physical possession is received, the secured loan should be recategorized on the balance sheet in the asset category appropriate to the underlying collateral (e.g., as other real estate owned for real estate collateral) and accounted for as described above, except for foreclosures on certain fully and partially government-guaranteed mortgage loans, which are to be reported in Schedule RC-F, item 6, “All other assets,” as discussed below in this Glossary entry.

The amount of any senior debt (principal and accrued interest) to which foreclosed real estate is subject at the time of foreclosure must be reported as a liability in Schedule RC-M, item 5.b, "Other borrowings."

After foreclosure, each foreclosed real estate asset (including any real estate for which the institution receives physical possession) must be carried at the lower of (1) the fair value of the asset minus the estimated costs to sell the asset or (2) the cost of the asset (as defined in the preceding paragraphs). This determination must be made on an asset-by-asset basis. If the fair value of a foreclosed real estate asset minus the estimated costs to sell the asset is less than the asset's cost, the deficiency must be recognized as a valuation allowance against the asset which is created through a charge to expense. The valuation allowance should thereafter be increased or decreased (but not below zero) through charges or credits to expense for changes in the asset's fair value or estimated selling costs.

If a foreclosed real estate asset is held for more than a short period of time, any declines in value after foreclosure and any gain or loss from the sale or disposition of the asset shall not be reported as a loan or lease loss or recovery and shall not be debited or credited to the allowance for loan and lease losses (or allowance for credit losses, if the institution has adopted ASC Topic 326). Such additional declines in value and the gain or loss from the sale or disposition shall be reported net on the income statement in Schedule RI, item 5.j, “Net gains (losses) on sales of other real estate owned.”

Foreclosed Assets (cont.):

Reporting Certain Government-Guaranteed Mortgage Loans upon Foreclosure – ASC Subtopic 310-40 clarifies the conditions under which a creditor must derecognize a government-guaranteed mortgage loan and recognize a separate "other receivable" upon foreclosure (that is, when a creditor receives physical possession of real estate property collateralizing a mortgage loan). When these conditions are met, other real estate owned should not be recognized by an institution.

An institution should derecognize a mortgage loan and record a separate other receivable upon foreclosure of the real estate collateral if all of the following conditions are met:

- The loan has a government guarantee that is not separable from the loan before foreclosure.
- At the time of foreclosure, the institution has the intent to convey the property to the guarantor and make a claim on the guarantee and it has the ability to recover under that claim.
- At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed (that is, the real estate property has been appraised for purposes of the claim and thus the institution is not exposed to changes in the fair value of the property).

This guidance is applicable to fully and partially government-guaranteed mortgage loans provided the three conditions identified above have been met. In such situations, upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. This other receivable should be reported in Schedule RC-F, item 6, "All other assets." Any interest income earned on the other receivable should be reported in Schedule RI, item 1.g, "Other interest income."

Accounting under ASC Subtopic 610-20 (and ASC Topic 606) – Under ASC Subtopic 610-20, if the buyer of the OREO is a legal entity, an institution should first assess whether it has a controlling financial interest in the legal entity buying the OREO by applying the guidance in ASC Topic 810, Consolidation. If an institution determines that it has a controlling financial interest in the buying legal entity, it should not derecognize the OREO and should apply the guidance in ASC Subtopic 810-10. When an institution does not have a controlling financial interest in the buying legal entity or the OREO buyer is not a legal entity, which is expected to be the case for most sales of OREO, the institution will recognize the entire gain or loss, if any, and derecognize the OREO at the time of sale if the transaction meets certain requirements of ASC Topic 606. Otherwise, the institution generally will continue reporting the OREO as an asset, with any cash payments or other consideration received from the individual or entity acquiring the OREO (i.e., any down payment and any subsequent payments of principal or interest) reported as a liability in Schedule RC-G, item 4, "All other liabilities," until it becomes appropriate to recognize the revenue and the sale of the OREO in accordance with ASC Subtopic 610-20 and ASC Topic 606.[1]

When applying ASC Subtopic 610-20 and Topic 606, an institution will need to exercise judgment in determining whether a contract (within the meaning of Topic 606) exists for the sale or transfer of OREO, whether the institution has performed its obligations identified in the contract, and what the transaction price is for calculation of the amount of gain or loss. These standards apply to all sales or transfers of real estate by institutions, but greater judgment will generally be required for seller-financed sales of OREO.

[1] Although ASC Topic 606 describes the consideration received (including any cash payments) using such terms a "liability," "deposit," and "deposit liability," for regulatory reporting purposes these amounts should be reported in Schedule RC-G, item 4, and not as a deposit in Schedule RC, item 13.

Income Taxes (cont.):

positions. No tax benefit can be recorded for a tax position that fails to meet the more-likely-than-not recognition threshold.

Each tax position that meets the more-likely-than-not recognition threshold should be measured to determine the amount of benefit to recognize in the Consolidated Reports of Condition and Income. The tax position is measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. When measuring the tax benefit, a bank must consider the amounts and probabilities of the outcomes that could be realized upon ultimate settlement using the facts, circumstances, and information available at the reporting date. A bank may not use the valuation allowance associated with any deferred tax asset as a substitute for measuring this tax benefit or as an offset to this amount.

If a bank's assessment of the merits of a tax position subsequently changes, the bank should adjust the amount of tax benefit it has recognized and accrue interest and penalties for any underpayment of taxes in accordance with the tax laws of each applicable jurisdiction. In this regard, a tax position that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent quarterly reporting period in which the threshold is met. A previously recognized tax position that no longer meets the more-likely-than-not recognition threshold should be derecognized in the first subsequent quarterly reporting period in which the threshold is no longer met.

Temporary differences result when events are recognized in one period on the bank's books but are recognized in another period on the bank's tax return. These differences result in amounts of income or expense being reported in the Consolidated Report of Income in one period but in another period in the tax returns. There are two types of temporary differences. Deductible temporary differences reduce taxable income in future periods. Taxable temporary differences result in additional taxable income in future periods.

For example, a bank's provision for loan and lease losses is expensed for financial reporting purposes in one period. However, for some banks, this amount may not be deducted for tax purposes until the loans are actually charged off in a subsequent period. This deductible temporary difference "originates" when the provision for loan and lease losses is recorded in the financial statements and "turns around" or "reverses" when the loans are subsequently charged off, creating tax deductions. Other deductible temporary differences include write-downs of other real estate owned, the recognition of loan origination fees, and other postemployment benefits expense.

Depreciation can result in a taxable temporary difference if a bank uses the straight-line method to determine the amount of depreciation expense to be reported in the Consolidated Report of Income but uses an accelerated method for tax purposes. In the early years, tax depreciation under the accelerated method will typically be larger than book depreciation under the straight-line method. During this period, a taxable temporary difference originates. Tax depreciation will be less than book depreciation in the later years when the temporary difference reverses. Therefore, in any given year, the depreciation reported in the Consolidated Report of Income will differ from that reported in the bank's tax returns. However, total depreciation taken over the useful life of the asset will be the same under either method. Other taxable temporary differences include the undistributed earnings of unconsolidated subsidiaries and associated companies and amounts funded to pension plans that exceed the recorded expense.

Some events do not have tax consequences and therefore do not give rise to temporary differences. Certain revenues are exempt from taxation and certain expenses are not deductible. These events were previously known as "permanent differences." Examples of such events (for federal income tax purposes) are interest received on certain obligations of states and political subdivisions in the U.S., premiums paid on officers' life insurance policies where the bank is the beneficiary, and 50 percent[1] of cash dividends received on the corporate stock of domestic U.S. corporations owned less than 20 percent.

[1] The percentage is 70 percent for tax years beginning before January 1, 2018.

Income Taxes (cont.):

Deferred tax assets shall be calculated at the report date by applying the "applicable tax rate" (defined below) to the bank's total deductible temporary differences and operating loss carryforwards. A deferred tax asset shall also be recorded for the amount of tax credit carryforwards available to the bank. Based on the estimated realizability of the deferred tax asset, a valuation allowance should be established to reduce the recorded deferred tax asset to the amount that is considered "more likely than not" (i.e., greater than 50 percent chance) to be realized.

Deferred tax liabilities should be calculated by applying the "applicable tax rate" to total taxable temporary differences at the report date.

Net operating loss carrybacks and carryforwards and tax credit carryforwards – When a bank's deductions exceed its income for income tax purposes, it has sustained a net operating loss. To the extent permitted under a taxing authority's laws and regulations, a net operating loss that occurs in a year following periods when the bank had taxable income may be carried back to recover income taxes previously paid. The tax effects of any loss carrybacks that are realizable through a refund of taxes previously paid is recognized in the year the loss occurs. In this situation, the applicable income taxes on the Consolidated Report of Income will reflect a credit rather than an expense. For tax years beginning before January 1, 2018, a bank may carry back net operating losses for two years for federal income tax purposes. However, in general, for tax years beginning on or after January 1, 2018, a bank may no longer carry back operating losses to recover taxes paid in prior tax years.

Generally, a net operating loss that occurs when loss carrybacks are not available becomes a net operating loss carryforward. For tax years beginning before January 1, 2018, a bank may carry operating losses forward 20 years for federal income tax purposes. For tax years beginning on or after January 1, 2018, net operating losses can be carried forward indefinitely for federal income tax purposes; however, for net operating losses arising in such tax years, the amount of loss that can be carried forward and deducted in a particular year is limited to 80 percent of a bank's taxable income in that year.

Tax credit carryforwards are tax credits which cannot be used for tax purposes in the current year, but which can be carried forward to reduce taxes payable in a future period.

Deferred tax assets are recognized for net operating loss and tax credit carryforwards just as they are for deductible temporary differences. As a result, a bank can recognize the benefit of a net operating loss for tax purposes or a tax credit carryforward to the extent the bank determines that a valuation allowance is not considered necessary (i.e., if the realization of the benefit is more likely than not).

Applicable tax rate – The income tax rate to be used in determining deferred tax assets and liabilities is the rate under current tax law that is expected to apply to taxable income in the periods in which the deferred tax assets or liabilities are expected to be realized or paid. For tax years beginning on or after January 1, 2018, the federal corporate tax rate is a flat 21 percent rate. This flat rate replaced the graduated federal corporate tax rate structure that applied in prior tax years. If a bank is subject to graduated tax rates and the bank's income level is such that graduated tax rates are a significant factor, then the bank shall use the average graduated tax rate applicable to the amount of estimated taxable income in the period in which the deferred tax asset or liability is expected to be realized or settled.

When the tax law changes, banks shall determine the effect of the change, adjust the deferred tax asset or liability and include the effect of the change in Schedule RI, item 9, "Applicable income taxes (on item 8.c)."

Valuation allowance – A valuation allowance must be recorded, if needed, to reduce the amount of deferred tax assets to an amount that is more likely than not to be realized. Changes in the valuation allowance generally shall be reported in Schedule RI, item 9, "Applicable income taxes (on item 8.c)." The following discussion of the valuation allowance relates to the allowance, if any, included in the

Income Taxes (cont.):

jurisdiction. For example, since state and local taxes are deductible for federal purposes, the aggregate combined rate would generally be (1) the federal tax rate plus (2) the state and local tax rates minus (3) the federal tax effect of the deductibility of the state and local taxes at the federal tax rate.

Income taxes of a bank subsidiary of a holding company – A bank should generally report income tax amounts in its Consolidated Reports of Condition and Income as if it were a separate entity. A bank's separate entity taxes include taxes of subsidiaries of the bank that are included with the bank in a consolidated tax return. In other words, when a bank has subsidiaries of its own, the bank and its consolidated subsidiaries are treated as one separate taxpayer for purposes of computing the bank's applicable income taxes. This treatment is also applied in determining net deferred tax asset limitations for regulatory capital purposes.

During profitable periods, a bank subsidiary of a holding company that files a consolidated tax return should record current tax expense for the amount that would be due on a separate entity basis. Certain adjustments resulting from the consolidated status may, however, be made to the separate entity calculation as long as these adjustments are made on a consistent and equitable basis. Such adjustments should be reflected in the bank's applicable income taxes, rather than as "Other transactions with stockholders (including a parent holding company)" in Schedule RI-A, Changes in Bank Equity Capital.

In addition, bank subsidiaries should first compute their taxes on a separate entity basis without considering the alternative minimum tax (AMT).[1] The AMT should be determined on a consolidated basis, and if it exceeds the regular tax on a consolidated basis, the holding company should allocate that excess to its affiliates on an equitable and consistent basis. The allocation method must be based upon the portion of tax preferences, adjustments, and other items causing the AMT to be applicable at the consolidated level that are generated by the parent holding company and each bank and nonbank subsidiary. In no case should amounts be allocated to bank subsidiaries that have not generated any tax preference or positive tax adjustment items. Furthermore, the AMT allocated to banks within the consolidated group should not exceed the consolidated AMT in any year.

In future years when a consolidated AMT credit carryforward is utilized, the credit must be reallocated to the subsidiary banks. The allocation should be done on an equitable and consistent basis based upon the amount of AMT giving rise to the credit that had been previously allocated. In addition, the amount of AMT credit reallocated to affiliates within the consolidated group should not exceed the consolidated AMT credit in any year. All AMT allocations should be reflected in the bank's applicable income taxes, rather than as "Other transactions with stockholders (including a parent holding company)" in Schedule RI-A, Changes in Bank Equity Capital.

Similarly, bank subsidiaries incurring a loss should record an income tax benefit and receive an equitable refund from their parent, if appropriate. The refund should be based on the amount they would have received on a separate entity basis, adjusted for statutory tax considerations, and shall be made on a timely basis.

An exception to this rule is made when the bank, on a separate entity basis, would not be entitled to a current refund because it has exhausted benefits available through carryback on a separate entity basis, yet the holding company can utilize the bank's tax loss to reduce the consolidated liability for the current year. In this situation, realization of the tax benefit is assured. Accordingly, the bank may

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[1] Effective for tax years beginning after December 31, 2022, the Inflation Reduction Act of 2022 imposes a 15 percent corporate AMT. A corporate AMT may also be applicable in some states, and tax rates may vary by jurisdiction.

Income Taxes (cont.):

recognize a current tax benefit in the year in which the operating loss occurs, provided the holding company reimburses the bank on a timely basis for the amount of benefit recognized. Any such tax benefits recognized in the loss year should be reflected in the bank's applicable income taxes. If timely reimbursement is not made, the bank cannot recognize the tax benefit in the current year. Rather, the tax loss becomes a net operating loss carryforward for the bank.

A parent holding company shall not adopt an arbitrary tax allocation policy within its consolidated group if it results in a significantly different amount of subsidiary bank applicable income taxes than would have been provided on a separate entity basis. If a holding company forgives payment by the subsidiary of all or a significant portion of the current portion of the applicable income taxes computed in the manner discussed above, such forgiveness should be treated as a capital contribution and reported in Schedule RI-A, item 11, "Other transactions with stockholders (including a parent holding company)," and in Schedule RI-E, item 5.

Further, if the subsidiary bank pays an amount greater than its separate entity current tax liability (calculated as previously discussed), the excess should be reported as a cash dividend to the holding company in Schedule RI-A, item 9. Payment by the bank of its deferred tax liability, in addition to its current tax liability, is considered an excessive payment of taxes. As a result, the deferred portion should likewise be reported as a cash dividend. Failure to pay the subsidiary bank an equitable refund attributable to the bank's net operating loss should also be considered a cash dividend paid by the bank to the parent holding company.

Purchase business combinations -- In purchase business combinations (as described in the Glossary entry for "business combinations"), banks shall recognize as a temporary difference the difference between the tax basis of acquired assets or liabilities and the amount of the purchase price allocated to the acquired assets and liabilities (with certain exceptions specified in ASC Topic 740). As a result, the acquired asset or liability shall be recorded gross and a deferred tax asset or liability shall be recorded for any resulting temporary difference.

In a purchase business combination, a deferred tax asset shall generally be recognized at the date of acquisition for deductible temporary differences and net operating loss and tax credit carryforwards of either company in the transaction, net of an appropriate valuation allowance. The determination of the valuation allowance should consider any provisions in the tax law that may restrict the use of an acquired company's carryforwards.

Subsequent recognition (i.e., by elimination of the valuation allowance) of the benefit of deductible temporary differences and net operating loss or tax credit carryforwards not recognized at the acquisition date will depend on the source of the benefit. If the valuation allowance relates to deductible temporary differences and carryforwards of the acquiring company established before the acquisition, then subsequent recognition is reported as a reduction of income tax expense. If the benefit is related to the acquired company's deductible temporary differences and carryforwards, then the benefit is subsequently recognized by first reducing any goodwill related to the acquisition, then by reducing all other noncurrent intangible assets related to the acquisition, and finally, by reducing income tax expense.

Alternative Minimum Tax[1] – Any taxes a bank must pay in accordance with the alternative minimum tax (AMT) shall be included in the bank's current tax expense. Amounts of AMT paid can be carried forward in certain instances to reduce the bank's regular tax liability in future years. The bank may record a deferred tax asset for the amount of the AMT credit carryforward, which shall then be evaluated in the same manner as other deferred tax assets to determine whether a valuation allowance is needed.

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[1] See the footnote on the alternative minimum tax on page A-63.