FIL-109-96
December 31, 1996

BANK REPORTS

TO: CHIEF EXECUTIVE OFFICER

SUBJECT: Revisions to the Reports of Condition and Income (Call Reports) for 1997

The Federal Financial Institutions Examination Council (FFIEC) has approved revisions to the reporting requirements for the Reports of Condition and Income (Call Report) for 1997. The Examination Council is providing this early notification to assist you in planning for these upcoming Call Report changes, which also must be approved by the U.S. Office of Management and Budget (OMB) before they can become final. More detailed information about changes in Call Report requirements for 1997, including the related instructions, will be distributed to all banks within the coming weeks.

Proposed Call Report revisions for 1997 were issued for public comment on September 16, 1996. The revisions approved by the Examination Council, which are described in the attached document, incorporate modifications made to the proposal in response to the comments received. The revisions for 1997 include:

- Deletions of several existing Call Report items and other reductions in the detail required in certain schedules, including the combining of separate balance sheet items for federal funds transactions and repurchase/resale agreements, the elimination of the breakdown of taxes by taxing authority reported annually in December, and the combining or modification of a number of items on the regulatory capital schedule;

- The adoption of generally accepted accounting principles (GAAP) as the reporting basis for the balance sheet, income statement, and related Call Report schedules, which entails the revision of Call Report instructions that currently depart from GAAP, the addition of a small number of new items to meet supervisory data needs resulting from the adoption of GAAP, and the modification of other existing Call Report items or instructions;

- New items that will enhance the banking agencies' ability to identify, from off site, banks that have either minimal or potentially high interest rate risk in order to allocate examiner resources and set examination priorities;

- New items that will identify banks electing Subchapter S status for federal income tax purposes, support the FDIC's calculation of banks' assessable deposits, and determine bank usage of credit derivatives; and

- Instructional changes and clarifications relating to residential mortgage loan commitments, firm commitments to sell residential mortgage loans, assets deducted when measuring regulatory capital, and other topics.

These Call Report revisions will take effect as of the March 31, 1997, report date, except for the reporting changes related to interest rate risk. In the March 31, 1997, Call Report, banks may report a reasonable estimate for any new or revised item for which the requested information is not readily available.

The Examination Council has deferred the effective date for the revised interest rate risk information until the June 30, 1997, report date in order to provide banks with additional time to make any necessary systems changes. The option to report reasonable estimates for items for which the requested information is not readily available applies to the interest rate risk-related items in the June 30, 1997, Call Report.

On November 4, 1996, acting under the auspices of the Examination Council, the banking agencies requested comment on a proposal to discontinue their acceptance of Call Reports that banks file directly with them in hard copy (paper) form (see FIL-94-96 dated November 22, 1996). Under this proposal, the agencies would, instead, accept only those Call Reports filed with their electronic collection agent, Electronic Data Systems Corporation (EDS). A bank could either file its reports directly with EDS (by using a computer and modem or by sending EDS a computer diskette) or arrange for a third party to first convert its paper reports to automated form and then file the reports with EDS. The agencies would implement the new filing practice as of the June 30, September 30, and December 31, 1997, report dates based on bank size. The proposal's comment period ends on January 3, 1997. Banks will be advised as more information on this proposed filing practice becomes available.

Banks are reminded that Financial Accounting Standards Board (FASB) Statement No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (FAS 125), takes effect on January 1, 1997. Banks must adopt the provisions of FAS 125 for Call Report purposes for transactions occurring after December 31, 1996, except for any provisions of this new accounting standard deferred for implementation by the FASB. FAS 125 also applies to servicing contracts and certain financial assets in existence before January 1, 1997. Thus, the March 31, 1997, Call Report will be the first regulatory report to be completed in accordance with the provisions of FAS 125 for which the FASB has not delayed implementation. Banks should note that FAS 125 establishes a new accounting approach for distinguishing transfers of financial assets that are reported as sales from transfers that are reported as borrowings. Because this new approach will apply to transfers of financial assets beginning in 1997, *including such basic transactions as loan participations*, banks are encouraged to consult with their outside accountants concerning the effect of FAS 125 on their asset transfer activities and the actions needed to implement FAS 125.

Please forward this letter to the person responsible for preparing Call Reports at your bank. For more information or assistance, national banks and FDIC-supervised banks may contact the FDIC's Call Reports Analysis Unit in Washington, DC, toll-free on 1-800-688-3342 or 202-898-6607. Assistance is provided Monday through Friday between 8:00 a.m. and 5:00 p.m. Eastern time. State member banks may contact their district Federal Reserve Bank.

Joe M. Cleaver
Executive Secretary

Attachment

Distribution: Insured Commercial Banks and FDIC-Supervised Savings Banks

December 31, 1996

REVISIONS TO THE REPORTS OF CONDITION AND INCOME (CALL REPORTS) FOR 1997

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December 31, 1996

REVISIONS TO THE REPORTS OF CONDITION AND INCOME (CALL REPORTS) FOR 1997

Unless otherwise indicated, the revisions described below apply to all four versions of the Call Report forms (FFIEC 031, 032, 033, and 034). Where appropriate, samples of the revised schedules, or portions thereof, generally from the FFIEC 034 set of forms, are shown to illustrate the specific changes in reporting requirements.

Deletions and Reductions in Detail

Deletions and reductions in detail, along with modifications of certain related items, will be made to the following Call Report schedules as of March 31, 1997.

Schedule RC -- Balance Sheet:

Items 3.a and 3.b, "Federal funds sold" and "Securities purchased under agreements to resell," will be combined into a single item (item 3). Similarly, items 14.a and 14.b, "Federal funds purchased" and "Securities sold under agreements to repurchase," will be combined into a single item (item 14). In addition, on the FFIEC 031 report form, these Schedule RC items will begin to be reported on a fully consolidated basis (rather than including only the domestic offices of the bank, the domestic offices of the bank's Edge and Agreement subsidiaries, and International Banking Facilities) and corresponding changes will be made to Schedule RC-K -- Quarterly Averages, items 5 and 13, and Schedule RI -- Income Statement, items 1.f and 2.b.

Item 17, "Mortgage indebtedness and obligations under capitalized leases," will be combined with existing item 16, "Other borrowed money."[1] In addition, on the FFIEC 031, 032, and 033 report forms, a corresponding change in definition will apply to Schedule RC-K -- Quarterly Averages, item 14, "Other borrowed money."

Item 22, "Limited-life preferred stock and related surplus," will be combined with existing item 19, "Subordinated notes and debentures."

[1] See the discussion below on "New Call Report Items for Interest Rate Risk" for information on a change in the reporting of remaining maturities of "Other borrowed money" on Schedule RC that takes effect as of June 30, 1997.

Schedule RC-B -- Securities:

Items 6.a and 6.b, "Investments in mutual funds" and "Other equity securities with readily determinable fair values," will be combined into a single item (item 6.a). Current item 6.c, "All other equity securities," will be renumbered as item 6.b.

In addition, Memorandum item 4, "Held-to-maturity debt securities restructured and in compliance with modified terms," will be deleted.

Schedule RC-C, Part I -- Loans and Leases:

Memorandum item 1, "Commercial paper included in Schedule RC-C, part I, above," which is completed only by banks filing the FFIEC 031, 032, and 033 report forms, will be deleted. In addition, the instructions will be revised for all banks to indicate that commercial paper should no longer be reported as a loan in Schedule RC-C, but should be reported as a security in Call Report Schedule RC-B, normally in item 5, "Other debt securities."

Schedule RC-E -- Deposit Liabilities:

Memorandum item 2.d, "Open-account time deposits of $100,000 or more" (in domestic offices), will be combined with existing Memorandum item 2.c, "Time certificates of deposit of $100,000 or more" (in domestic offices). Memorandum item 2.c will be recaptioned "Total time deposits of $100,000 or more."

As a result of this change to Schedule RC-E, corresponding changes will be made to the coverage of the existing items for interest expense on and the quarterly averages for time deposits in Schedules RI and RC-K, respectively. These revisions are discussed below under the respective schedules.

Schedule RC-H -- Selected Balance Sheet Items for Domestic Offices:

On the FFIEC 031 report forms, items 16.a and 16.b, "Investments in mutual funds" and "Other equity securities with readily determinable fair values," will be combined into a single item (item 16.a). Current item 16.c, "All other equity securities," will be renumbered as item 16.b.

Schedule RC-K -- Quarterly Averages:

Consistent with the revision to Schedule RC-E, the coverage of the existing items for the quarterly averages for "Time certificates of deposit of $100,000 or more" and "All other time deposits" (items 9.c and 9.d on the FFIEC 034 report forms; items 11.c and 11.d on the FFIEC 031, 032, and 033 report forms) will be revised by moving open-account time deposits of $100,000 or more from the latter item to the former item. The latter quarterly average item will refer to "Time deposits of less than $100,000" and the caption for the former item will refer to "Time deposits of $100,000 or more."

Schedule RC-L -- Off-Balance Sheet Items:

Items 10.a and 10.b, "Gross commitments to purchase" and "Gross commitments to sell" when-issued securities, will be eliminated as separate items, but these commitments will continue to be reportable in Schedule RC-L. Banks generally will report their when-issued securities commitments as off-balance sheet derivative contracts in items 14 through 17. The notional amount of these commitments will be included in item 14.b, "Forward contracts," generally in column A, "Interest rate contracts," and in items 15 and 16 based on their purpose. On the FFIEC 031, 032, and 033 report forms, the fair values of these commitments will be reported in item 17. However, banks that do not include these commitments as part of their disclosures about off-balance sheet derivatives for other financial reporting purposes will be permitted to report commitments to sell when-issued securities as "Other off-balance sheet assets" in item 13 and commitments to purchase when-issued securities as "Other off-balance sheet liabilities" in item 12, subject to the existing reporting thresholds for these two items. The Glossary entry for "when-issued securities transactions" also will be revised.

Schedule RC-M -- Memoranda:

Item 8.c, "Total assets of unconsolidated subsidiaries and associated companies," will be deleted. Memorandum item 1.b, "Nonreciprocal holdings of banking organizations' capital instruments," which is collected in the December report only, also will be deleted.

Schedule RC-R -- Regulatory Capital:

The separate maturity distributions for "Subordinated Debt and Intermediate Term Preferred Stock" in items 2.a through 2.f, column A, and "Other Limited-Life Capital Instruments" in items 2.a through 2.f, column B, will be replaced by two single separate items (designated items 2.a and 2.b) for the qualifying portion of each of these two types of capital components that is includible in Tier 2 capital.

2. Portion of qualifying limited-life capital instruments (original weighted average maturity of at least five years) that is includible in Tier 2 capital:

a. Subordinated debt and intermediate term preferred stock	**|___|___|___|**
b. Other limited-life capital instruments	**|___|___|___|**

For banks that complete Schedule RC-R in its entirety, item 4.a.(1), "Securities issued by, other claims on, and claims unconditionally guaranteed by, the U.S. Government and its agencies and other OECD central governments," and item 4.a.(2), "All other" assets assigned to the zero percent risk category, will be combined into a single revised item 4.a for all zero percent risk weight assets recorded on the balance sheet. Similarly, item 5.a.(1), "Claims conditionally guaranteed by the U.S. Government and its agencies and other OECD central governments," item 5.a.(2), "Claims collateralized by securities issued by the U.S. Government and its agencies and other OECD central governments; by securities issued by U.S. Government-sponsored agencies; and by cash on deposit," and item 5.a.(3), "All other" assets assigned to the 20 percent risk category, will be combined into a single revised item 5.a for all 20 percent risk weight assets recorded on the balance sheet.

Schedule RI -- Income Statement:

Consistent with the revision to Schedule RC-E, the coverage of the existing items for interest expense on "Time certificates of deposit of $100,000 or more" and "All other time deposits" (items 2.a.(2)(c) and 2.a.(2)(d) on the FFIEC 032, 033, and 034 report forms; items 2.a.(1)(b)(3) and 2.a.(1)(b)(4) on the FFIEC 031 report forms) will be revised by moving the interest expense on open-account time deposits of $100,000 or more from the latter item to the former item. The latter interest expense item will refer to "Time deposits of less than $100,000" and the caption for the former item will refer to interest expense on "Time deposits of $100,000 or more."

As a result of one of the revisions to Schedule RC noted above, item 2.d, "Interest on mortgage indebtedness and obligations under capitalized leases," will be deleted. Interest expense on these types of liabilities will be included in existing item 2.c, "Interest on demand notes issued to the U.S., trading liabilities, and other borrowed money."

On the FFIEC 031, 032, and 033 report forms, item 5.d, "Other foreign transaction gains (losses)," will be eliminated. This item has been used for reporting the net gain or loss from all transactions involving foreign currency or foreign exchange other than trading transactions. Banks (including those that file the FFIEC 034 report forms) should now report these net gains (losses) consistently as part of either "All other noninterest income" (item 5.b.(2) on the FFIEC 034; item 5.f.(2) on the FFIEC 031, 032, and 033) or "Other noninterest expense" (item 7.c).

Items 11.a and 11.b, "Extraordinary items and other adjustments, gross of income taxes," and "Applicable income taxes (on item 11.a)," will be deleted. Only the amount of "Extraordinary items and other adjustments, net of income taxes" (current item 11.c), will continue to be reported in Schedule RI. Current item 11.c will be renumbered as item 11. All extraordinary items and their related tax effects will continue to be separately itemized and described in Schedule RI-E, item 3.

Schedule RI-C -- Applicable Income Taxes by Taxing Authority:

This schedule, which is completed only for the December report, will be eliminated, except for the item for the "deferred portion" of total applicable income taxes (item 4 on the FFIEC 034 report forms; item 5 on the FFIEC 031, 032, and 033 report forms). The item for the "deferred portion" of applicable income taxes will be moved to the Memorandum section of the income statement (Schedule RI) and designated Memorandum item 12. This information will continue to be collected with the December report only.

Schedule RI -- Memoranda

12. Deferred portion of total applicable income taxes included in Schedule RI, items 9 and 11 (to be reported with the December Report of Income) |___|___|___|

Elimination of Call Report Instructions That Differ From Generally Accepted Accounting Principles, Related New Items, and Other Affected Call Report Items and Instructions

As previously announced in November 1995, the Examination Council has approved the adoption of generally accepted accounting principles (GAAP) as the reporting basis for the balance sheet, income statement, and related schedules in the Call Report, effective with the March 31, 1997, report date. Adopting GAAP as the reporting basis in the basic schedules of the Call Report will eliminate existing differences between bank regulatory reporting standards and GAAP, thereby producing greater consistency in the information collected in regulatory reports and general purpose financial statements and reducing reporting burden. However, bank regulatory capital ratios will continue to be calculated in accordance with the agencies' capital standards. These standards and the related Call Report instructions will continue to govern the completion of Schedule RC-R -- Regulatory Capital.

Instructional Changes for Conformity With GAAP

In connection with this move to GAAP, existing Call Report instructions that depart from GAAP, including those enumerated below, will be revised to bring them into conformity with GAAP. The section of the Call Report's General Instructions on the "Applicability of Generally Accepted Accounting Principles to Regulatory Reporting Requirements" will also be revised. Nevertheless, because the Call Report is a bank-level report, each bank is considered an "accounting entity" and normally must prepare its Call Report on a separate entity basis. Furthermore, this section of the General Instructions will continue to state that

> when a bank's primary federal bank supervisory agency's interpretation of how GAAP should be applied to a specified event or transaction (or series of related events or transactions) differs from the bank's interpretation, the supervisory agency may require the bank to reflect the event(s) or transaction(s) in its Reports of Condition and Income in accordance with the agency's interpretation and to amend previously submitted reports.

As this instructional language indicates, this reporting policy is intended to apply when an agency concludes that a bank has not properly applied GAAP given the facts and circumstances surrounding a specific event or transaction.

When discussing the need for a bank to amend previous reports, the General Instructions to the Call Report separately state that a bank's supervisory agency may require amendments if reports contain <u>significant</u> errors. The Glossary entry for "Accounting Changes" in the Call Report instructions also states that a bank <u>may</u> be directed to file amended reports for periods that were <u>significantly</u> affected by a <u>material</u> error. Materiality is a qualitative characteristic of accounting information which the Financial Accounting Standards Board (FASB) defines in Statement of Financial Accounting Concepts No. 2 as

> the magnitude of an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

At the end of each Statement of Financial Accounting Standards, the FASB states that the Statement's provisions "need not be applied to immaterial items." Therefore, when dealing with the recognition and measurement of events and transactions in the Call Report, the General Instructions' reference to "significant" errors should be interpreted to mean errors that are "material" for the reporting bank.

The following Call Report instructions will be revised to eliminate their current differences from GAAP:

(1) The treatment of **assets sold with recourse** in the Glossary entry for "Sales of Assets" and the section of the Glossary entry for "Participations in Pools of Residential Mortgages" on "Privately-issued certificates of participation in pools of residential mortgages." (As discussed below under "Other Call Report Instructions Affected by Adoption of GAAP," the banking agencies' risk-based capital standards refer to the existing Call Report instructions as the source for the definition of asset sales with recourse. The existing Call Report Glossary entry will be recaptioned "Sales of Assets for Risk-Based Capital Purposes" and the relevant portions thereof will be retained to provide guidance for identifying those asset sales that are reportable as recourse transactions in Call Report Schedule RC-R -- Regulatory Capital. A new Glossary entry describing, in a manner consistent with GAAP, the reporting for transfers of financial assets for Call Report balance sheet and income statement purposes will be added to the instructions.)

(2) The treatment of **excess servicing fees** (as that term is used in the accounting standards in effect before January 1, 1997) in the "Income Statement Effect of Sales of Assets" section of the Glossary entry for "Sales of Assets" and in the instruction to Schedule RC-F, item 3, "Excess residential mortgage servicing fees receivable." (Note: The accounting for excess servicing fees under GAAP changes on

January 1, 1997, when FASB Statement No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (FAS 125), takes effect.)

(3) The treatment of **futures, forward, and option contracts** in the Glossary entry for "Futures, Forward, and Standby Contracts."

(4) The general prohibition on the **netting of assets and liabilities** in the Call Report set forth in the Glossary entry for "Offsetting" and in the General Instructions.

(5) The initial valuation of **foreclosed assets** in the Glossary entries for "Foreclosed Assets" and "Troubled Debt Restructurings" and in the instructions to Schedule RC-M, item 8.a.(2), "All other real estate owned."

(6) The maximum amortization period for **intangible assets** set forth in the section of the Glossary entry for "Business Combinations" on "Purchase acquisition" and in the instructions to Schedule RC-M, item 6, "Intangible assets." Consistent with the views expressed by the Securities and Exchange Commission (SEC) in Staff Accounting Bulletins, the revised instructions would indicate that amortization periods in excess of 25 years generally would not be appropriate for Call Report purposes.

(7) The prohibition on the **consolidation of domestic subsidiaries of the reporting bank that are commercial banks, savings banks, or savings associations** as discussed in the section of the General Instructions on "Scope of the 'Consolidated Bank' Required to be Reported in the Submitted Reports."

(8) The treatment of **third party credit card solicitation costs** in the Glossary entry for "Loan Fees."

(9) The maximum interest rate for **capitalizing interest costs** on internally financed projects set forth in the Glossary entry for "Capitalization of Interest Costs."

(10) The treatment of **repurchase agreements to maturity and long-term repurchase agreements** in the Glossary entry for "Repurchase/Resale Agreements."

(11) The treatment of **loan fees charged in connection with international loans** in the Glossary entry for "Loan Fees."

(12) The treatment of **reciprocal balances** in the Glossary entry for "Reciprocal Balances," in the instructions to Schedule RC-A, item 2, "Balances due from depository institutions in the U.S.," for the FFIEC 031, 032, and 033 report forms, and in the instructions to Schedule RC, item 1.a, "Noninterest-bearing balances and currency and coin," for the FFIEC 034 report forms.

(13) The treatment of **securities transactions with settlement periods exceeding regular way settlement time limits** that have been reported as forward contracts according to the instructions to Schedule RC-L, item 14, "Gross amounts (e.g., notional amounts) of off-balance sheet derivatives."

(14) The treatment of the cumulative effect of **changes in accounting principles** that are applied retroactively through the restatement of prior years' financial statements prepared in accordance with GAAP in the "Changes in accounting principles" section of the Glossary entry for "Accounting Changes."

To further aid in reducing reporting burden, new or revised instructions in the following additional areas will permit banks to report certain information in their Call Reports in accordance with prevalent banking industry practice in GAAP financial statements:

(1) Net gains and losses on other real estate owned currently must be reported as "Other noninterest income" and "Other noninterest expense," respectively. Banks may choose to follow the existing instructions or to report net costs of other real estate owned (whether a net debit or a net credit) consistently as "Other noninterest expense."

(2) Net gains and losses on sales of loans and certain other asset categories currently must be reported as "Other noninterest income" and "Other noninterest expense," respectively. Banks may choose to follow the existing instructions or to report these net amounts (whether a net debit or a net credit) consistently as other noninterest income or expense.

(3) Former bank premises held for sale currently must be categorized as "Other real estate owned" on the balance sheet. Banks may choose to follow this existing instruction or to include such property in "Premises and fixed assets" on the balance sheet.

(4) The amortization of mortgage servicing rights currently must be reported as "Other noninterest expense." Banks may choose to follow this existing instruction or to report the amortization as a reduction of mortgage servicing revenue.

(5) The portion of credit card merchant discount passed through the interchange to cardholders' banks currently must be reported as "Other noninterest expense." Banks may choose to follow this existing instruction or to net this portion of the merchant discount against the gross merchant discount reported in "Other fee income."

(6) Contractual interest payments received on partially charged-off nonaccrual loans for which recognition of interest income on a cash basis is appropriate currently must be allocated among interest income, reduction of principal, or recovery of the prior charge-off and reported accordingly. Banks may choose to follow this existing instruction or to report the receipt of this contractual interest in its entirety either as interest income, reduction of principal, or recovery of prior charge-off, depending on the condition of the loan, consistent with its accounting policies for other financial reporting purposes.

(7) The Call Report instructions currently do not provide guidance on the regulatory reporting treatment of a bank's costs associated with the development of software for internal use. Banks should report these costs in a manner consistent with GAAP and in accordance with their accounting policy for other financial reporting purposes. In other words, if these costs are expensed as incurred in other financial reports issued by the bank (or by its parent holding company), they should be reported in the same manner in the Call Report (i.e., as a period cost component of "Other noninterest expense"). This is considered the preferable accounting method. However, if the bank (or its parent holding company) has previously adopted an accounting policy of capitalizing and amortizing these costs for other financial reporting purposes, the bank may use this accounting method for Call Report purposes. A bank that does not currently capitalize these costs should not adopt this method for Call Report purposes.

Banks that have engaged in any of the preceding types of transactions or activities prior to January 1, 1997, and have reported them in the Call Report in accordance with the existing instructions that differ from GAAP are permitted to report them in accordance with GAAP beginning in 1997. Because Call Reports for 1996 and prior years have not been prepared entirely in accordance with GAAP, the effect of this retroactive application of GAAP on the amount of a bank's Call Report undivided profits as of January 1, 1997,[2] net of applicable income taxes, (i.e., the amount of the "catch-up" adjustment) should be reported as a direct adjustment to equity capital in Schedule RI-A, item 9, and itemized and described in Schedule RI-E, item 5.

In a limited number of instances, the Call Report instructions and the banking agencies' supervisory guidance contain specific reporting instructions that fall within the range of acceptable practice under GAAP. These instructions, which have been adopted to achieve safety and soundness objectives or to ensure comparability, will be retained. Should the need arise in the future, the Examination Council and the agencies will, when appropriate, issue other specific reporting guidance that falls within GAAP. Current Call Report instructions providing such specific reporting guidance include the nonaccrual rules in the Glossary entry for "Nonaccrual Status," the treatment of impaired collateral dependent loans in the Glossary entry for "Loan Impairment," the Glossary entry for the "Allowance for Loan and Lease Losses" which references the 1993 Interagency Policy Statement on this subject, the separate entity method of accounting for income taxes of bank subsidiaries of holding companies in the Glossary entry for "Income Taxes," the push down accounting rules in the Glossary entry for "Business Combinations," and the treatment of property dividends in the Glossary entry for "Dividends."

New and Modified Call Report Items Resulting From the Adoption of GAAP

For some of the preceding types of transactions or activities which will be affected by the elimination of Call Report instructions that differ from GAAP, the potential impact of these transactions and activities on the safety and soundness of banks is of concern to the banking agencies. In other cases, the instructional changes may affect the reported amount of a bank's deposits and, thereby, its assessable deposits for deposit insurance and Financing Corporation (FICO) debt service purposes. In order to identify the extent of bank involvement in these areas or the effect on reported deposits, the Examination Council has approved the addition of certain new items to the Call Report and the modification of a number of existing Call Report items, as follows:

Schedule RC-F -- Other Assets -- Existing item 3, "Excess residential mortgage servicing fees receivable," will be replaced by two new items in response to FAS 125. In new item 3.a, banks will report "interest-only strips receivable" held for other than trading purposes (that are not in the form of a security) that represent the contractual right to receive some or all of the interest due on mortgage loans. In new item 3.b, banks will report "interest-only strips receivable" held for other than trading purposes (that are not in the form of a security) that represent the contractual right to receive some or all of the interest due on interest-bearing financial assets other than mortgages. Consistent with FAS 125, these strips receivable would be measured at fair value like available-for-sale securities.[3]

3. Interest-only strips receivable (not in the form of a security) on:	
a. Mortgage loans	|___|___|___|
b. Other financial assets	|___|___|___|

[2] The amount of a bank's Call Report undivided profits as of January 1, 1997, is the amount of undivided profits the bank reported on the balance sheet (Schedule RC, item 26.a) of its December 31, 1996, Call Report (after any amendments to that report).

[3] Banks should report interest-only strips receivable that are in the form of a security as available-for-sale securities in Schedule RC, item 2.b, or as trading assets in Schedule RC, item 5, as appropriate.

Schedule RC-L -- Off-Balance Sheet Items -- Items 9.a through 9.c on residential mortgage loans and agricultural mortgage loans transferred with recourse in transactions that have been treated as sales for Call Report purposes will be replaced. In new items 9.a.(1) and 9.a.(2), banks will report the outstanding principal balance and the amount of retained recourse exposure, respectively, on first lien 1-to-4 family residential mortgages that have been transferred with recourse in transactions reported as sales for Call Report balance sheet purposes. In new items 9.b.(1) and 9.b.(2), banks will report these two amounts on other financial assets (excluding small business obligations) that have been transferred with recourse in transactions reported as sales. Existing items 9.d.(1) and 9.d.(2) on small business obligations transferred with recourse will be retained, but will be renumbered as items 9.c.(1) and 9.c.(2).

9. Financial assets transferred with recourse that have been treated as sold for Call Report purposes:

a. First lien 1-to-4 family residential mortgage loans:

(1) Outstanding principal balance of mortgages transferred as of the report date |___|___|___|

(2) Amount of recourse exposure on these mortgages as of the report date |___|___|___|

b. Other financial assets (excluding small business obligations reported in item 9.c):

(1) Outstanding principal balance of assets transferred as of the report date |___|___|___|

(2) Amount of recourse exposure on these assets as of the report date |___|___|___|

c. Small business obligations transferred with recourse under Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994:

(1) Outstanding principal balance of small business obligations transferred as of the report date |___|___|___|

(2) Amount of retained recourse on these obligations as of the report date |___|___|___|

Schedule RC-M -- Memoranda -- New items 11 and 12 will be added to this schedule, as follows:

(1) Item 11: "Net unamortized realized deferred gains (losses) on off-balance sheet derivative contracts included in assets and liabilities reported in Schedule RC." For available-for-sale securities reported on the balance sheet at fair value, this new item 11 will include any deferred gains (losses) that are part of the amortized cost basis of such securities.

(2) Item 12: "Amount of assets netted against nondeposit liabilities on the balance sheet (Schedule RC) in accordance with generally accepted accounting principles." On the FFIEC 031, this item will also include assets netted against deposits in foreign offices other than insured branches in Puerto Rico and U.S. territories and possessions. This new item 12 would include securities purchased under agreements to resell that have been netted against securities sold under agreements to repurchase under FASB Interpretation No. 41, back-to-back loans involving deposits in foreign offices other than insured branches, receivables and payables arising from unsettled trades, in-substance defeasance transactions grandfathered under FAS 125, and any other assets netted against nondeposit liabilities (and deposits in foreign offices other than insured branches) under FASB Interpretation No. 39. However, the item will

exclude netted on-balance sheet amounts associated with off-balance sheet derivative contracts, deferred tax assets netted against deferred tax liabilities, and assets netted in accounting for pensions.

Schedule RC-O -- Other Data for Deposit Insurance and FICO Assessments --

(1) New item 12 and new Memorandum item 3 will be added to this schedule, as follows:

(a) Item 12, "Amount of assets netted against deposit liabilities in domestic offices on the balance sheet (Schedule RC) in accordance with generally accepted accounting principles." On the FFIEC 031, this item will also include assets netted against deposits in insured branches in Puerto Rico and U.S. territories and possessions. Banks will separately report asset amounts netted against demand deposits and asset amounts netted against time and savings deposits in new items 12.a and 12.b, respectively. These items will exclude data on net reciprocal demand balances and related adjustments reported in Schedule RC-O, item 11.

(b) In new Memorandum item 3, a question will ask whether the reporting institution has been consolidated with a parent bank or savings association in that parent bank's or savings association's Call Report or Thrift Financial Report. If so, the reporting institution must report the legal title and FDIC Certificate Number of the parent bank or savings association.

Memoranda

3. Has the reporting institution been consolidated with a parent bank or savings association in that parent bank's or parent savings association's Call Report or Thrift Financial Report?
If so, report the legal title and FDIC Certificate Number of the parent bank or parent savings association: **FDIC Cert No.**

____ |__|__|__|__|__|

(2) Existing items 11.a through 11.c on reciprocal demand balances will be revised. As indicated above, the current Call Report instructions on reciprocal balances will be revised to conform with GAAP. At present, the instructions require banks to report reciprocal demand balances with commercial banks in the U.S. on a net basis on the balance sheet (Schedule RC) and in the deposit schedule (Schedule RC-E). All other reciprocal deposit relationships are to be reported gross. Because this netting instruction differs from the reciprocal deposit netting provisions in Section 7(a)(4) of the Federal Deposit Insurance Act, Schedule RC-O contains three netting-related items (items 11.a through 11.c) used to adjust reported deposits so they conform with the statute. The Call Report instructions on reciprocal balances, after they are revised to conform with GAAP, will still differ from Section 7(a)(4), but in a different manner than at present. Thus, items 11.a through 11.c of Schedule RC-O will be modified to ensure that banks' assessable deposits continue to be properly measured. In addition, on the FFIEC 031, the coverage of these items will be expanded to include adjustments to demand deposits in insured branches in Puerto Rico and U.S. territories and possessions, rather than demand deposits in domestic offices only. As revised, these three items will be as follows:

11. Adjustments to demand deposits in domestic offices (and in insured branches in Puerto Rico and U.S. territories and possessions) reported

in Schedule RC-E for certain reciprocal demand balances:

a. Amount by which demand deposits would be reduced if the reporting bank's reciprocal demand balances with the domestic offices of U.S. banks and savings associations (and insured branches in Puerto Rico and U.S. territories and possessions) that were reported on a gross basis in Schedule RC-E had been reported on a net basis |___|___|___|

b. Amount by which demand deposits would be increased if the reporting bank's reciprocal demand balances with foreign banks and foreign offices of other U.S. banks (other than insured branches in Puerto Rico and U.S. territories and possessions) that were reported on a net basis in Schedule RC-E had been reported on a gross basis |___|___|___|

c. Amount by which demand deposits would be reduced if cash items in process of collection were included in the calculation of the reporting bank's net reciprocal demand balances with the domestic offices of U.S. banks and savings associations (and insured branches in Puerto Rico and U.S. territories and possessions) in Schedule RC-E |___|___|___|

Other Call Report Instructions Affected by the Adoption of GAAP

Although the treatment of assets sold with recourse will be brought into conformity with GAAP for purposes of the Call Report balance sheet, income statement, and related schedules, the agencies' risk-based capital standards refer to the existing Call Report instructions as the source for the definition of asset sales with recourse. The relevant Call Report instructions are contained in the Glossary entry for "Sales of Assets" with its general rule for determining whether an asset transfer must be reported as a sale or as a financing transaction. Thus, this Glossary entry will be recaptioned "Sales of Assets for Risk-Based Capital Purposes" and its existing general rule will remain applicable for purposes of identifying those assets sold with recourse that are no longer reflected on the asset side of the balance sheet, but whose credit equivalent amounts must be reported by risk weight category in Call Report Schedule RC-R -- Regulatory Capital.

In particular, as a result of the aforementioned change to the instructions for the balance sheet treatment of assets sold with recourse, banks may be able to reflect as an asset previously nonrecognized (for Call Report purposes) contractual cash flows (e.g., excess servicing fees that are placed in so-called "spread accounts") that act as credit enhancements for assets (typically credit card receivables) that have been transferred and securitized.[4] However, asset transfers that qualify for sale treatment under GAAP, but which use such cash flows as credit enhancements and carry them as on-balance sheet assets at a discounted amount, would be treated as sales with recourse under the "Sales of Assets for Risk-Based Capital Purposes" general rule because the bank has retained risk of loss with respect to these asset amounts. In addition, these asset transfers must be reported as off-balance sheet sales with recourse on Schedule RC-L (new item 9.a or 9.b, as appropriate) because of the bank's retention of risk. This means that a bank will have to hold risk-based capital against the full amount of the assets transferred with recourse, but such transfers may qualify for low-level recourse capital treatment.

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[4] As noted earlier, the accounting for excess servicing fees under GAAP will change on January 1, 1997, when FAS 125 takes effect. Under this new accounting standard, amounts that would be deemed excess servicing fees receivable under current accounting standards will be reported instead as either servicing assets or interest-only strips receivable, depending upon the circumstances. The discussion in these paragraphs will also apply to these types of assets if they act as credit enhancements.

When "spread accounts" act as credit enhancements (and no other features of the asset transfer constitute a retention of risk of loss or obligation for payment), the low-level recourse capital treatment limits the required amount of capital to the carrying amount of these contractual cash flows net of any noncapital GAAP recourse liability account associated with the asset transfer. However, the move to GAAP for reporting transfers of financial assets with recourse on the Call Report balance sheet was not intended to produce a significant change in a bank's risk-based capital ratios as calculated from the data reported on its risk-based capital schedule. To ensure this outcome, the Call Report instructions relating to the completion of the regulatory capital schedule will permit banks to apply the low-level recourse capital rule on a net of tax basis to "spread accounts" that act as credit enhancements for asset transfers.[5]

New Call Report Items for Interest Rate Risk

On June 26, 1996, the banking agencies published a Joint Agency Policy Statement on Interest Rate Risk. Under this policy statement, the agencies are pursuing a risk assessment approach for evaluating a bank's capital adequacy for interest rate risk. The policy statement explicitly notes that the agencies intend to "use various quantitative screens and filters to identify banks that may have high exposures or complex risk profiles, to allocate examiner resources, and to set examination priorities. These tools rely on Call Report data and various economic indicators and data." Thus, in adopting this policy statement, the agencies anticipated making revisions to the existing maturity and repricing data in the Call Report because these data are not adequate for the quantitative screens and filters the agencies are developing as they implement the policy statement.

Therefore, *beginning with the Call Report for June 30, 1997,* the FFIEC is modifying the existing reporting requirements pertaining to interest rate risk and adding certain new items. The agencies have chosen to make only those modifications to the Call Report that afford the greatest potential benefit to off-site risk identification and resource allocation. These reporting changes are discussed below. Moreover, these Call Report revisions are a small fraction of the proposed data collection requirements contained in the "Supervisory Policy Statement Concerning a Supervisory Framework for Measuring and Assessing Banks' Interest Rate Risk Exposure" which the agencies proposed in August 1995 and which the June 1996 policy statement replaced.

Because these Call Report changes will not take effect until June 1997, commercial banks will report the existing Call Report items that provide maturity and repricing data in March 1997.[6] FDIC-supervised savings banks will complete their supplemental interest rate risk schedule (Schedule RC-J) in March 1997, except for the weighted average cost and yield factors and the memorandum items on principal payments received which will be eliminated for that quarter. Supplemental Schedule RC-J for savings banks will then be eliminated in June 1997.

The specific changes that will take effect as of the June 30, 1997, report date are as follows:

<u>Schedule RC -- Balance Sheet:</u>

[5] The FFIEC notes that an interagency recourse working group is reviewing the risk-based capital treatment of all asset transfers, including transfers that use "spread accounts" as credit enhancements, to determine whether any changes should be proposed in the regulatory capital treatment for these transactions.

[6] These items are Schedule RC-B, Memorandum items 2.a through 2.c and 6; Schedule RC-C, part I, Memorandum items 2.a through 2.d on the FFIEC 034, Memorandum items 3.a through 3.d on the FFIEC 031, 032, and 033; and Schedule RC-E, Memorandum items 5.a through 5.c and 6.a through 6.c.

Item 16.b, "Other borrowed money with a remaining maturity of more than one year," will be split into two separate items for borrowings with remaining maturities of more than one year through three years (new item 16.b) and more than three years (new item 16.c).

Schedule RC-B -- Securities:

Memorandum item 2, "Maturity and repricing data for debt securities," will be revised and will begin to be completed by FDIC-supervised savings banks:

First, in revised Memorandum items 2.a and 2.b, banks will begin to separately report maturity and repricing data for "Non-mortgage debt securities" and "Mortgage pass-through securities," with fixed rate and floating rate securities reported on a combined basis. However, the current instructions on how these securities should be reported generally will not change. Banks will still report the amortized cost of held-to-maturity securities and the fair value of available-for-sale debt securities in the appropriate Memorandum items. Fixed rate securities will continue to be reported based on their remaining maturity, i.e., the amount of time remaining from the report date until the final contractual maturity of the security without regard to the security's repayment schedule, if any. Floating rate securities will continue to be reported based on their repricing frequency, i.e., how often the contract permits the interest rate on the debt security to be changed without regard to the length of time between the report date and the date the rate can next change.

In addition, the existing "Over one year through five years" time band will be split into two separate bands: "Over one year through three years" and "Over three years through five years." The existing "Over five years" time band will also be split into two separate bands: "Over five years through fifteen years" and "Over fifteen years."

Second, new Memorandum item 2.c will cover those mortgage-backed securities other than pass-through securities, e.g., CMOs, REMICs, and stripped mortgage-backed securities, that are reported in Schedule RC-B, item 4.b. A two-way breakdown of these instruments by expected weighted average life would be reported: those with an expected weighted average life of "Three years or less" and those with an expected weighted average life of "Over three years."

Under the Examination Council's Supervisory Policy Statement on Securities Activities, prior to purchase and at subsequent testing dates, banks must test mortgage derivative products to determine whether they are "high-risk" or "nonhigh-risk." These tests include one for expected weighted average life, although certain mortgage derivative products are not subject to this test. For purposes of Memorandum item 2.c, mortgage derivative products subject to the expected weighted average life test should be reported based on the average life determined at their most recent testing date or more current information, if available. For mortgage derivative products not subject to this test, banks should report based on the most recent average life information obtained within the twelve months preceding the report date.

Third, because fixed rate debt securities will no longer be reported separately by remaining maturity in revised Memorandum item 2, current Memorandum item 6, "Floating rate debt securities with a remaining life of one year or less," will be expanded to cover all debt securities, will be renumbered as Memorandum item 2.d, and will begin to be completed by FDIC-supervised savings banks.

Memoranda

2. Maturity and repricing data for debt securities (excluding those in

nonaccrual status):

a. Non-mortgage debt securities with a remaining maturity or repricing frequency of (sum of Memorandum items 2.a.(1) through 2.a.(6) must equal total non-mortgage debt securities from Schedule RC-B, sum of items 1, 2, 3, and 5, columns A and D, minus nonaccrual non-mortgage debt securities included in Schedule RC-N, item 9, column C):

(1)	**Three months or less**	|___|___|___|
(2)	**Over three months through 12 months**	|___|___|___|
(3)	**Over one year through three years**	|___|___|___|
(4)	**Over three years through five years**	|___|___|___|
(5)	**Over five years through 15 years**	|___|___|___|
(6)	**Over 15 years**	|___|___|___|

b. Mortgage pass-through securities with a remaining maturity or repricing frequency of (sum of Memorandum items 2.b.(1) through 2.b.(6) must equal total mortgage pass-through securities from Schedule RC-B, item 4.a, columns A and D, minus nonaccrual mortgage pass-through securities included in Schedule RC-N, item 9, column C):

(1)	**Three months or less**	|___|___|___|
(2)	**Over three months through 12 months**	|___|___|___|
(3)	**Over one year through three years**	|___|___|___|
(4)	**Over three years through five years**	|___|___|___|
(5)	**Over five years through 15 years**	|___|___|___|
(6)	**Over 15 years**	|___|___|___|

c. Other mortgage-backed securities (include CMOs, REMICs, and stripped MBS) with an expected average life of (sum of Memorandum items 2.c.(1) and 2.c.(2) must equal total other mortgage-backed securities from Schedule RC-B, item 4.b, columns A and D, minus nonaccrual other mortgage-backed securities included in Schedule RC-N, item 9, column C):

(1)	**Three years or less**	|___|___|___|
(2)	**Over three years**	|___|___|___|

d. Total debt securities with a remaining maturity of one year or less (included in Memorandum items 2.a through 2.c above) |___|___|___|

<u>Schedule RC-C, Part I -- Loans and Leases:</u>

The Memorandum item for "Maturity and repricing data for loans and leases" (Memorandum item 2 on the FFIEC 034 report forms; Memorandum item 3 on the FFIEC 031, 032, and 033 report forms) will be revised and will begin to be completed by FDIC-supervised savings banks. Revised subitems a. and b. will cover maturity and repricing data for "Loans secured by real estate" and "Other loans and leases," with fixed rate and floating rate instruments reported on a combined basis. However, as with the revised items for debt securities, the current instructions on how loans and leases should be reported generally will not change. Fixed rate loans and leases will continue to be reported based on their remaining contractual maturity. Floating rate loans will continue to be reported based on their repricing frequency. In addition, the same changes in time bands will be made as were described above for debt securities under Schedule RC-B.

Because fixed rate loans and leases will no longer be reported separately by remaining maturity in this revised Memorandum item, the current Memorandum item for "Floating rate loans with a remaining maturity of one year or less" (current Memorandum item 2.d on the FFIEC 034 report forms; Memorandum item 3.d on the

FFIEC 031, 032, and 033 report forms) will be expanded to cover all loans and leases; will be renumbered as Memorandum item 2.c on the FFIEC 034 report forms and as Memorandum item 3.c on the FFIEC 031, 032, and 033 report forms; and will begin to be completed by FDIC-supervised savings banks.

New Memorandum items will be added for "Loans secured by nonfarm nonresidential real estate with a remaining maturity or repricing frequency of over five years" and "Commercial and industrial loans with a remaining maturity or repricing frequency of over three years" (Memorandum items 2.d and 2.e on the FFIEC 034 report forms; Memorandum items 3.d and 3.e on the FFIEC 031, 032, and 033 report forms).

Memoranda (item numbers are from the FFIEC 034 report forms)

2. Maturity and repricing data for loans and leases (excluding those in nonaccrual status):

a. Loans secured by real estate with a remaining maturity or repricing frequency of (sum of Memorandum items 2.a.(1) through 2.a.(6) must equal total loans secured by real estate from Schedule RC-C, part I, sum of items 1.a through 1.e, minus total nonaccrual real estate loans from Schedule RC-N, item 1, column C):

(1) Three months or less	|___|___|___|
(2) Over three months through 12 months	|___|___|___|
(3) Over one year through three years	|___|___|___|
(4) Over three years through five years	|___|___|___|
(5) Over five years through 15 years	|___|___|___|
(6) Over 15 years	|___|___|___|

b. Other loans and leases with a remaining maturity or repricing frequency of (sum of Memorandum items 2.b.(1) through 2.b.(6) must equal total other loans and leases from Schedule RC-C, part I, sum of items 2 through 9, minus total nonaccrual other loans and leases from Schedule RC-N, sum of items 2 through 5, column C):

(1) Three months or less	|___|___|___|
(2) Over three months through 12 months	|___|___|___|
(3) Over one year through three years	|___|___|___|
(4) Over three years through five years	|___|___|___|
(5) Over five years through 15 years	|___|___|___|
(6) Over 15 years	|___|___|___|

c. Total loans and leases with a remaining maturity of one year or less (included in Memorandum items 2.a and 2.b above) |___|___|___|

d. Loans secured by nonfarm nonresidential properties with a remaining maturity or repricing frequency of over five years (included in Memorandum items 2.a.(5) and 2.a.(6) above) |___|___|___|

e. Commercial and industrial loans with a remaining maturity or repricing frequency of over three years (included in Memorandum items 2.b.(4) through 2.b.(6) above) |___|___|___|

<u>Schedule RC-E -- Deposit Liabilities:</u>

Memorandum items 5 and 6, "Maturity and repricing data for time deposits of less than $100,000" and "Maturity and repricing data for time deposits of $100,000 or more," will be revised and will begin to be completed by FDIC-supervised savings banks.

Memorandum item 5.a for fixed rate deposits of less than $100,000 and Memorandum item 5.b for floating rate deposits of less than $100,000 will be reported on a combined basis in revised Memorandum item 5.a. Memorandum items 6.a and 6.b covering time deposits of $100,000 or more will be combined in the same manner in revised Memorandum item 6.a. As with the revised items for debt securities and loans and leases, the current instructions on how time deposits should be reported generally will not change. Fixed rate time deposits will continue to be reported based on their remaining contractual maturity. Floating rate time deposits will continue to be reported based on their repricing frequency.

For time deposits of less than $100,000 (reported in revised Memorandum item 5.a), the existing "Over one year" time band will be split into two separate time bands: "Over one year through three years" and "Over three years." For time deposits of $100,000 or more (reported in revised Memorandum item 6.a), the existing "Over one year through five years" and "Over five years" time bands will be changed to "Over one year through three years" and "Over three years."

Because fixed rate time deposits would no longer be reported separately by remaining maturity in these revised Memorandum items, current Memorandum items 5.c and 6.c, "Floating rate time deposits of less than $100,000 with a remaining maturity of one year or less" and "Floating rate time deposits of $100,000 or more with a remaining maturity of one year or less," will each be expanded to cover all time deposits of that respective size and will be renumbered as Memorandum items 5.b and 6.b.

Memoranda

5. Maturity and repricing data for time deposits of less than $100,000 (sum of Memorandum items 5.a.(1) through 5.a.(4) must equal Memorandum item 2.b above):
- **a. Time deposits of less than $100,000 with a remaining maturity or repricing frequency of:**
  - **(1) Three months or less** |___|___|___|
  - **(2) Over three months through 12 months** |___|___|___|
  - **(3) Over one year through three years** |___|___|___|
  - **(4) Over three years** |___|___|___|
- **b. Time deposits of less than $100,000 with a remaining maturity of one year or less (included in Memorandum items 5.a.(1) through 5.a.(4) above)** |___|___|___|

6. Maturity and repricing data for time deposits of $100,000 or more (sum of Memorandum items 6.a.(1) through 6.a.(4) must equal Memorandum item 2.c above):
- **a. Time deposits of $100,000 or more with a remaining maturity or repricing frequency of:**
  - **(1) Three months or less** |___|___|___|
  - **(2) Over three months through 12 months** |___|___|___|
  - **(3) Over one year through three years** |___|___|___|
  - **(4) Over three years** |___|___|___|
- **b. Time deposits of $100,000 or more with a remaining maturity of one year or less (included in Memorandum items 6.a.(1) through 6.a.(4) above)** |___|___|___|

Schedule RC-L -- Off-Balance Sheet Items:

A new item 16.c, column A, will be added for the total gross notional amount of "Interest rate swaps where the bank has agreed to pay a fixed rate." This item applies only to those interest rate swaps held for purposes other than trading.

Schedule RC-M -- Memoranda:

One new item will be added to all four versions of the Call Report forms and a second new item will be added only to the FFIEC 031, 032, 033 report forms. First, all banks with capitalized mortgage servicing assets, the carrying value of which is currently reported in item 6.a of this schedule, will begin to report the estimated fair value of these mortgage servicing assets in new item 6.a.(1). Second, on the FFIEC 031, 032, and 033 report forms, banks that service for others more than $10 million of loans other than 1-to-4 family residential mortgage loans and have a servicing volume for these loans that exceeds 10 percent of total assets as of the report date must complete new item 13, "Outstanding principal balance of loans other than 1-to-4 family residential mortgage loans that are serviced for others."

All banks:
FFIEC 031, 032, and 033 only:

13. Outstanding principal balance of loans other than 1-to-4 family residential mortgage loans that are serviced for others (to be completed if this balance is more than $10 million and exceeds 10 percent of total assets) |___|___|___|

Other New Items

The Examination Council has approved the addition of a small number of other new items to the Call Report effective as of the March 31, 1997, report date. As discussed below, these new items pertain to the Subchapter S election for federal income tax purposes, the reporting of "Adjusted Attributable Deposit Amounts" by Oakar institutions, and credit derivatives.

Subchapter S Election for Federal Income Tax Purposes

The Small Business Job Protection Act of 1996, enacted on August 20, 1996, amended Subchapter S of the Internal Revenue Code to allow banks, savings associations, and their parent holding companies to elect Subchapter S corporation status for federal income tax purposes beginning in 1997 if they meet certain eligibility criteria. A Subchapter S corporation is treated as a pass-through entity for federal income tax purposes, similar to a partnership, and generally is not subject to any tax at the corporate level. This tax treatment will affect a Subchapter S bank's reported earnings and dividends and the banking agencies will need to be able to identify these institutions from the standpoint of off-site monitoring and pre-examination planning. Accordingly, in new Memorandum item 11 to Schedule RI -- Income Statement, a "yes/no" question will ask whether the reporting bank has a Subchapter S election in effect for the current tax year.

Schedule RI -- Memoranda

	YES	NO
11. Does the reporting bank have a Subchapter S election in effect for federal income tax purposes for the current tax year?		

Reporting of "Adjusted Attributable Deposit Amounts" by Oakar Institutions

On December 10, 1996, the FDIC published a final rule amending certain provisions of its assessment regulations that pertain to so-called Oakar institutions, i.e., institutions that belong to one insurance fund (primary fund), but hold deposits that are treated as insured by the other insurance fund (secondary fund). The final rule calls for the FDIC to take over from Oakar institutions the responsibility for calculating the "Adjusted Attributable Deposit Amount" (AADA) resulting from previous assumptions of secondary-fund deposits. To support the FDIC's calculation of this amount, the Examination Council will replace the existing item for AADAs in Schedule RC-O -- Other Data for Deposit Insurance and FICO Assessments (item 8) with two items that Oakar institutions currently report on a separate FDIC form that will be eliminated and with one new item. These Schedule RC-O items, which are illustrated below, generally would exclude deposits in foreign offices.

8. To be completed by banks with "Oakar deposits."

a. Deposits purchased or acquired from other FDIC-insured institutions during the quarter (exclude deposits purchased or acquired from foreign offices other than insured branches in Puerto Rico and U.S. territories and possessions):

(1) Total deposits purchased or acquired from other FDIC-insured institutions during the quarter |___|___|___|

(2) Amount of purchased or acquired deposits reported in item 8.a.(1) above attributable to a secondary fund (i.e., BIF members report deposits attributable to SAIF; SAIF members report deposits attributable to BIF) |___|___|___|

b. Total deposits sold or transferred during the quarter (exclude sales or transfers by the reporting bank of deposits in foreign offices other than insured branches in Puerto Rico and U.S. territories and possessions) |___|___|___|

Credit Derivatives

Credit derivatives are off-balance sheet arrangements that allow one party, the beneficiary, to transfer the credit risk of a "reference asset" to another party, the guarantor. The market for this new type of instrument is expected to grow significantly over the next few years. Each of the three banking agencies issued supervisory guidance on credit derivatives during 1996.

In order to identify the extent of bank involvement with these instruments, both on an individual institution basis and for the industry, the Examination Council is adding two new items to Schedule RC-L -- Off-Balance Sheet Items. The first item, item 10.a, will be for the notional amount of all credit derivatives on which the reporting bank is the guarantor. The second item, item 10.b, will be for the notional amount of all credit derivatives on which the reporting bank is the beneficiary. Banks should include the notional amounts of credit default swaps, total rate of return swaps, and other credit derivative instruments.

10. Notional amount of credit derivatives:

a. Credit derivatives on which the reporting bank is the guarantor	**|___|___|___|**
b. Credit derivatives on which the reporting bank is the beneficiary	**|___|___|___|**

The notional amount of credit derivatives should not be reported as interest rate, foreign exchange, equity derivative, or commodity derivative contracts in Schedule RC-L or Schedule RC-R -- Regulatory Capital. Banks engaging in credit derivative transactions should refer to the supervisory guidance issued by their primary federal regulatory agency for information on how they should treat credit derivatives for risk-based capital purposes.

Other Instructional Changes

The Examination Council also has approved some other instructional or reporting changes for 1997. These changes cover the reporting of assets that are deducted when measuring regulatory capital, residential mortgage loan commitments, firm commitments to sell residential mortgage loans, the number of full-time equivalent employees and their compensation expense, loans and leases held for sale, and assets indirectly representing premises and fixed assets. A more detailed discussion of these instructional matters follows.

<u>Reporting of assets that are deducted when measuring regulatory capital</u> -- At present, those banks that are required to complete Schedule RC-R -- Regulatory Capital, in its entirety must report as 100 percent risk-weight assets in item 7, column A, those on-balance sheet assets that are deducted from their assets and capital as part of their regulatory capital calculations. These assets include goodwill, core deposit intangibles, disallowed mortgage servicing rights, disallowed deferred tax assets, and reciprocal holdings of bank capital instruments. It is misleading to report these assets in item 7, column A, as if they were subject to a 100 percent risk weight. Instead, it would be more appropriate for these assets to be reported in item 8, column A, of the regulatory capital schedule along with the asset amounts that are excluded from the risk-based capital calculation. Furthermore, the agencies' optional regulatory capital worksheet treats these deducted assets in this manner. Therefore, the instructions for items 7 and 8, column A, of Schedule RC-R and the caption for item 8, column A, will be revised so that these deducted assets are reported in item 8, column A.

<u>Residential mortgage loan commitments</u> -- Banks currently report unused commitments in Schedule RC-L, items 1.a through 1.e, according to the type of commitment. Item 1.a applies to revolving, open-end lines of credit secured by 1-to-4 family residential properties (e.g., home equity lines). All other commitments secured by 1-to-4 family residential mortgages are reportable in item 1.e, "Other unused commitments." However, because neither the caption to item 1.e nor the instructions to this item specifically refer to such residential mortgage loan commitments, banks have asked where commitments of this type should be reported in Schedule RC-L. Therefore, the instructions to item 1.e will be clarified by stating that the item includes commitments to extend credit (other than revolving, open-end lines) secured by 1-to-4 family residential properties for which the bank has charged a commitment fee or other consideration, or otherwise has a legally binding commitment to extend credit.

<u>Firm commitments to sell residential mortgage loans</u> -- The instructions to Schedule RC-L, item 14.b, column A, "Interest rate forwards," direct banks to report forward contracts committing the bank to purchase or sell financial instruments and whose predominant risk characteristic is interest rate risk. Questions have been raised about whether firm commitments to sell loans secured by 1-to-4 family residential properties should be reported as interest rate forwards. For Call Report purposes, those residential mortgage loan sales

commitments that have a specific interest rate, delivery date, and dollar amount should be considered forward contracts. The instructions to Schedule RC-L, item 14.b, column A, will be revised accordingly.

Reporting the number of full-time equivalent employees and their compensation expense -- Banks report the number of their full-time equivalent employees in an income statement memorandum item (Schedule RI, Memorandum item 5 on the FFIEC 034; Memorandum item 4 on the FFIEC 031, 032, and 033). The salaries and employee benefits of bank employees are reported in Schedule RI, item 7.a. The instruction to this item also directs banks to exclude from "salaries and employee benefits" amounts paid to individuals who are not salaried officers and employees of the bank. However, for business reasons, some banking organizations recently have established employment arrangements under which most or all of the persons who work for or at a specific bank are, in form, employed by an affiliate of the bank rather than by the bank itself. Because of the wording of the current Call Report instructions, certain banks that participate in these employment arrangements have been reporting that they have no employees and no "salaries and employee benefits." These employment arrangements should be reported in accordance with their substance rather than their form in the Call Report. Hence, the relevant Call Report instructions will be revised to explain that a bank should include as employees individuals who, in form, are employed by an affiliate but who, in substance, do substantially all of their work for that reporting bank. This instructional revision is not intended to require banking organizations to segregate the compensation component of other intercompany cost allocations and calculate the related pro rata number of full-time equivalent employees.

Loans and leases held for sale -- Banks currently must include their loans and leases held for sale as part of their loan and lease portfolio and must report the carrying value of these loans and leases in Schedule RC-C, part I, Memorandum item 5, "Loans and leases held for sale."[7] However, the General Instructions to Schedule RC-C incorrectly indicate that a bank should include its loans and leases held for sale in its loan and lease portfolio only if it reports these loans and leases in its portfolio for other financial reporting purposes. These General Instructions will be corrected to eliminate this discrepancy. Banks should note that loans and leases held for short-term trading purposes and marked-to-market through the income statement should continue to be reported as trading assets in Schedule RC, item 5, and should not be considered "loans and leases held for sale."

Assets indirectly representing premises and fixed assets -- The instructions to Schedule RC -- Balance Sheet, item 6, "Premises and fixed assets," direct banks to include loans and advances to individuals, partnerships, and nonmajority-owned corporations for the purpose of purchasing or holding land, buildings, or fixtures occupied or used by the bank in that asset category rather than in Schedule RC, item 4, "Loans and lease financing receivables." The requirement to reclassify these loans and report them on the balance sheet as part of bank premises will be eliminated.

[7] In accordance with GAAP, loans and leases held for sale must be reported at the lower of cost or market value as of the report date. The amount by which cost exceeds market value, if any, must be accounted for as a valuation allowance.