

NOTE: Strike the Glossary entry for "Mortgage Servicing Rights" on page A-39 (dated 3-96), remove pages A-45 (dated 5-89) through A-57 (dated 6-91), and replace them with these revised pages.

Premiums and Discounts (cont.):

rate, i.e., a rate comparable to that on new loans of similar risk. The difference between the face amount and the recorded value of the note is a premium or discount. This discount or premium shall be accounted for as an adjustment of the interest income or expense over the life of the note using the interest method described above.

For further information, see APB Opinion No. 21, "Interest on Receivables and Payables."

Purchase Acquisition: See "business combinations."

Put Option: See "derivative contracts."

Real Estate ADC Arrangements: See "acquisition, development, or construction (ADC) arrangements."

Real Estate, Loan Secured By: See "loan secured by real estate."

Reciprocal Balances: Reciprocal balances arise when two depository institutions maintain deposit accounts with each other; that is, when a reporting bank has both a due to and a due from balance with another depository institution.

For purposes of the balance sheet of the Report of Condition, reciprocal balances between the reporting bank and other depository institutions may be reported on a net basis when a right of setoff exists. See the Glossary entry for "offsetting" for the conditions that must be met for a right of setoff to exist.

Renegotiated "Troubled" Debt: See "troubled debt restructurings."

Reorganizations: See "business combinations."

Repurchase/Resale Agreements: A repurchase agreement is a transaction involving the sale of assets by

one party to another, subject to an agreement by the seller to repurchase the assets at a specified date or in specified circumstances. A resale agreement (also known as a reverse repurchase agreement) is a transaction involving the purchase of assets by one party from another, subject to an agreement by the purchaser to resell the assets at a specified date or in specified circumstances.

General rule -- Consistent with the AICPA's Audit and Accounting Guide for Banks and Savings Institutions, repurchase and resale agreements involving assets are either reported as borrowings and loans or sales and repurchase commitments based on whether the selling institution maintains control over the future economic benefits associated with the underlying asset. If the repurchase agreement requires the selling institution to repurchase the identical asset sold, then, generally, the institution has retained control over the future economic benefits and should report the transaction as a borrowing.

(1) Repurchase agreements involving securities:

- (a) Securities sold under agreements to repurchase are treated as borrowings and reported in Schedule RC, item 14, "Federal funds purchased and securities sold under agreements to repurchase," if the repurchase agreement requires the bank to repurchase the identical security sold, or a security that meets the definition of "substantially the same" in the case of a dollar repurchase agreement. (See the discussion below of dollar repurchase agreements, which are also called dollar rolls.)
- (b) Securities sold under agreements to repurchase are reported as a sale of the securities and a commitment to purchase securities if the repurchase agreement does not require the bank to repurchase the identical security sold, or a security that meets the definition of "substantially the same" in the case of a dollar repurchase agreement.

Repurchase/Resale Agreements (cont.):

- (2) Repurchase agreements involving assets other than securities:
- (a) Assets, other than securities, sold under agreements to repurchase are treated as borrowings and reported as follows if the repurchase agreement requires the bank to repurchase the identical asset sold:
 - (i) If the repurchase agreement matures in one business day (or is under a continuing contract) and is in immediately available funds, it should be reported in Schedule RC, item 14, "Federal funds purchased and securities sold under agreements to repurchase."
 - (ii) If the repurchase agreement matures in more than one business day or is not in immediately available funds, it should be reported in Schedule RC, item 16, "Other borrowed money."
 - (b) Assets, other than securities, sold under agreements to repurchase are treated as sales of assets and commitments to purchase assets if the repurchase agreement does not require the bank to repurchase the identical asset sold.

Similarly, resale agreements involving securities are to be reported in Schedule RC, item 3, as "Federal funds sold and securities purchased under agreements to resell," if the agreement requires the bank to resell the identical security purchased, or a security that meets the definition of substantially the same in the case of a dollar roll, as outlined above. Resale agreements involving securities are to be reported as a purchase of securities and a commitment to sell securities if the resale agreement does not require the bank to resell the identical security purchased, or a security that meets the definition of substantially the same in the case of a dollar roll. Resale agreements involving assets other than securities are to be reported (1) in Schedule RC, item 3, "Federal funds sold and securities purchased under agreements to resell," if the agreement matures in one business day (or is under a continuing contract) and is in immediately available funds; or (2) in Schedule RC, item 4.a, "Loans and leases, net of unearned income," if the agreement requires the bank to resell the identical asset purchased. Resale agreements involving assets other than securities are to be reported as a purchase of assets and a commitment to sell assets if the resale agreement does not require the bank to resell the identical asset sold. Resale agreements classified as loans are also to be reported in Schedule RC-C, part I, in the appropriate loan category.

Participations in pools of securities are to be reported in the same manner as security repurchase/resale transactions.

Dollar repurchase agreements (also called dollar rolls) -- As stated in the AICPA's Audit and Accounting Guide for Banks and Savings Institutions, dollar repurchase agreements are agreements to sell and repurchase similar but not identical securities. The dollar roll market consists primarily of agreements that involve mortgage-backed securities (MBS). Dollar rolls differ from regular repurchase agreements in that the securities sold and repurchased, which are usually of the same issuer, are represented by different certificates, are collateralized by different but similar mortgage pools (for example, single-family residential mortgages), and generally have different principal amounts. The most common types of dollar rolls are fixed-coupon and yield-maintenance agreements:

- (1) Fixed-coupon dollar repurchase agreements -- A fixed-coupon dollar repurchase agreement is a transaction involving the sale of securities by one party to another, subject to an agreement that, at a specified date or in specified circumstances, the purchaser will deliver securities for repurchase by the seller that are "substantially the same" (as defined in the Audit and Accounting Guide) (e.g., same obligor, form, contractual interest rate, and weighted-average maturity) as the securities sold. These transactions are to be reported as borrowings or financings of securities as discussed above. However, a fixed-coupon agreement that contains a right-of-substitution clause or that provides an option to the buyer-lender to deliver back a certificate priced to result in a significantly different yield should be accounted for as purchases or sales of securities.
- (2) Yield maintenance dollar repurchase agreement -- A yield maintenance dollar repurchase agreement is a transaction involving the sale of securities by one party to another, subject to

Repurchase/Resale Agreements (cont.):

an agreement that, at a specified date or in specified circumstances, the purchaser will deliver securities for repurchase by the seller that may bear a different contract interest rate than the securities sold, but that will provide the selling institution with a yield similar to the yield on the securities sold. These transactions are to be reported as purchases or sales of securities.

Reserve Balances, Pass-through: See "pass-through reserve balances."

Sales of Assets for Risk-Based Capital Purposes: This entry provides guidance for determining whether sales of loans, securities, receivables, and other assets are subject to the agencies' risk-based capital requirements and are reportable in Schedule RC-L, Off-Balance Sheet Items, and Schedule RC-R, Regulatory Capital. For information on the reporting of transfers of financial assets for purposes of the balance sheet, income statement, and related schedules, see the Glossary entry for "transfers of financial assets."

Under the agencies' risk-based capital standards, assets sold with recourse, if not already included on the balance sheet, are risk-weighted by using a two-step process. First, the full outstanding amount of assets sold with recourse must be converted to an on-balance sheet credit equivalent amounts using a 100 percent credit conversion factor, except for low level recourse transactions and small business obligations transferred with recourse under Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994. (The reporting treatment of these specific types of asset sales with recourse is discussed in the General Instructions for Schedule RC-R.) Second, the credit equivalent amount is assigned to the appropriate risk weight category according to the obligor or, if relevant, the guarantor or the nature of the collateral.

For purposes of reporting in Schedule RC-R, some transactions involving the "sale" of assets are not subject to the risk-based capital requirements and others are subject to these requirements and must be treated as "asset sales with recourse." Under the following general rule, the risk-based capital treatment required for any particular transfer of assets depends upon whether the "seller" retains risk of loss in connection with the transfer of the assets.

General rule -- A transferring institution should treat a transfer of loans, securities, receivables, or other assets that qualifies for sale treatment under generally accepted accounting principles as a sale of the transferred assets that is not subject to risk-based capital only if the transferring institution:

- (1) retains no risk of loss from the assets transferred resulting from any cause and
- (2) has no obligation to any party for the payment of principal or interest on the assets transferred resulting from:
 - (a) default on principal or interest by the obligor of the underlying instrument or from any other deficiencies in the obligor's performance,
 - (b) changes in the market value of the assets after they have been transferred,
 - (c) any contractual relationship between the seller and purchaser incident to the transfer that, by its terms, could continue even after final payment, default, or other termination of the assets transferred, or
 - (d) any other cause.

If risk of loss or obligation for payment of principal or interest is retained by, or may fall back upon, the seller in an asset transfer that qualifies for sale treatment under generally accepted accounting principles, the transaction must be considered an "asset sale with recourse" for purposes of reporting risk-based capital information in Schedule RC-R. The transaction must also be reported as an asset transfer with recourse in Schedule RC-L, item 9.

Assets transferred in transactions that do not qualify as sales under generally accepted accounting principles should continue to be reported as assets on the Call Report balance sheet and are subject to the agencies' regulatory capital requirements.

Sales of Assets for Risk-Based Capital Purposes (cont.):

Exception to the general rule -- Contractual provisions in sales of assets that

- (1) provide for the return of the assets to the seller in instances of incomplete documentation or fraud, or
- (2) allow the purchaser a specific limited period of time to determine that the assets transferred are in fact as represented by the seller and to return deficient paper to the seller

will not by themselves and in the absence of any other recourse provision or retention of risk cause the transfer to be treated as an "asset sale with recourse" for purposes of Schedule RC-R.

Interpretations and illustrations of the general rule:

- (1) For any given transfer, the determination of whether risk is retained by the transferring institution is to be based upon the substance of the transfer agreement or other relevant documents or informal commitments and understandings, or subsequent actions of the parties to the transactions, not upon the form or particular terminology used. The presence of a bona fide "sale with recourse" provision would establish the transaction as an asset sale with recourse for purposes of risk-based capital and Schedule RC-R. However, the absence of a recourse provision, the absence of the term "recourse," even the presence of a statement to the effect that there is no recourse or, in the case of a participation, the use of the terms "pass-through" or "pure pass-through" will not by themselves establish a transaction as a sale that is not subject to risk-based capital. If other conditions and provisions of the transfer are such as to leave the transferor with risk of loss as described in the general rule, the transfer is an asset sale with recourse for purposes of risk-based capital and Schedule RC-R.
- (2) If assets are sold subject to specific contractual terms that limit the seller's risk to a percentage of the value of the assets sold or to a specific dollar amount, the entire outstanding amount of the assets sold represents an asset sale with recourse for risk-based capital purposes. For example, if assets are sold subject to a ten percent recourse provision (i.e., the seller's risk is limited to ten percent of the value of the assets sold), the total outstanding amount of the assets sold is subject to risk-based capital, not just the ten percent limit, unless the low level recourse rule (discussed in the General Instructions to Schedule RC-R) applies.

However, if the risk retained by the seller is limited to some fixed percentage of any losses that might be incurred and there are no other provisions resulting in retention of risk, either directly or indirectly, by the seller, the maximum amount of possible loss for which the selling bank is at risk (the stated percentage times the amount of assets to which the percentage applies) is subject to risk-based capital and reportable in Schedule RC-R and the remaining amount of the assets transferred would be treated as a sale that is not subject to the risk-based capital requirements. For example, a seller would treat a sale of \$1,000,000 in assets, with a recourse provision that the seller and buyer proportionately share in losses incurred on a ten percent and 90 percent basis, and with no other retention of risk by the seller, as a \$100,000 asset sale with recourse and a \$900,000 sale not subject to risk-based capital.

- (3) Among the transfers where risk of loss has been retained by the seller and that should be considered by the seller as asset sales with recourse for purposes of Schedule RC-R are arrangements such as the following (this list is illustrative of the principles involved in the application of the general rule and is not all-inclusive) --
 - (a) the sale of an asset with a realistic bona fide put option allowing the purchaser, at its option, to return the asset to the seller;
 - (b) the sale of an asset guaranteed by a standby letter of credit issued by the seller;
 - (c) the sale of an asset guaranteed by a standby letter of credit issued by any other party in which risk, either directly or indirectly, rests with the seller;
 - (d) the sale of an asset guaranteed by an insurance contract in which the seller, either directly or indirectly, indemnifies or otherwise protects the insurer in any manner against loss;

Sales of Assets for Risk-Based Capital Purposes (cont.):

- (e) the sale of a short-term loan under a long-term credit commitment (a so-called "strip participation"); and
 - (f) sales and securitizations of assets which use contractual cash flows (e.g., interest-only strips receivable and so-called "spread accounts"), retained subordinated interests, or retained securities (e.g., collateral invested amounts and cash collateral accounts) as credit enhancements. If the low-level recourse rule applies to these credit enhancements, the maximum contractual dollar amount of the bank's recourse exposure is generally limited to the amount carried as an asset on the balance sheet in accordance with generally accepted accounting principles.
- (4) A transfer where the seller retains risk as a result of a difference in terms between the instrument of transfer and the asset transferred, regardless of the other characteristics of the sale or participation, should be treated by the seller as an asset sale with recourse for purposes of Schedule RC-R. For example, any transfer in which there is a difference in maturity between the underlying asset and the instrument of transfer should be treated as an asset sale with recourse.

However, the sale of a loan or other asset subject to an agreement under which the seller will pass through to the purchaser a rate of interest that differs from the stated rate of interest on the transferred asset would not, for this reason alone, require the transaction to be treated as an asset sale with recourse for risk-based capital purposes provided (1) the seller's obligation to pass interest through to the purchaser is contingent upon the continued interest payment performance of the underlying obligor of the transferred asset (i.e., the seller has no obligation to pass interest through if the obligor defaults in whole or in part on interest or principal) and (2) none of the other characteristics of the sale or participation results in risk to the seller.

- (5) The general rule applies to all transfers of assets (other than those specifically covered in the exception), including sales of a single asset or of a pool of assets and sales of participations in a single asset or in a pool of assets (whether of similar or dissimilar instruments). In participations that are not "syndications" (as described in the Glossary item for that term), the seller of the participations should handle the transfer of shares to participants in accordance with the general rule on sales of assets for risk-based capital purposes, even though the assets being participated were acquired or accumulated for the express purpose of issuing participations and even though the participation was prearranged with the purchasers of the participations. However, the rule does not apply to the initial operation and distribution of participations in the form of syndications, since in a syndication there is no transfer of assets involved of the type to which the general rule on sales of assets for risk-based capital purposes is addressed. Any subsequent transfers of shares, or parts of shares, in a syndicated loan would be subject to the general rule.
- (6) The general rule (and interpretations and exception) is also applicable to asset transfers that are made to special or limited purpose entities that are not technically affiliated with the seller. Regardless of the legal structure of the transaction, if risk of loss is retained by the seller, either contractually or otherwise, either directly or indirectly, the seller should treat the transaction as an asset sale with recourse for purposes of risk-based capital and Schedule RC-R even if the sale to the special purpose entity is stated as being without recourse.

Savings Deposits: See "deposits."

Securities, Participations in Pools of: See "repurchase/resale agreements."

Servicing Assets and Liabilities: The accounting and reporting standards for servicing assets and liabilities are set forth in FASB Statement No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" and FASB Statement No. 65, "Accounting for Certain Mortgage Banking Activities" as amended by Statement No. 125. A summary of the relevant sections of these accounting standard follows. For further information, see FASB Statements No. 125 and No. 65 and the Glossary entry for "Transfers of Financial Assets."

Servicing of mortgage loans, credit card receivables, or other financial assets includes, but is not limited to, collecting principal, interest, and escrow payments from borrowers; paying taxes and insurance from escrowed funds; monitoring delinquencies; executing foreclosure if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, trustees, and others

Servicing Assets and Liabilities (cont.):

providing services; and accounting for and remitting principal and interest payments to the holders of beneficial interests in the financial assets. Servicers typically receive certain benefits from the servicing contract and incur the costs of servicing the assets.

Servicing is inherent in all financial assets; it becomes a distinct asset or liability only when contractually separated from the underlying financial assets by sale or securitization of the assets with servicing retained or by a separate purchase or assumption of the servicing. When a bank undertakes an obligation to service financial assets, it must recognize a servicing asset or liability for that servicing contract unless it securitizes the assets, retains all of the resulting securities, and classifies the securities as held-to-maturity debt securities. Servicing assets result from contracts to service financial assets for which the benefits of servicing (revenues from contractually specified servicing fees, late charges, and other ancillary sources) are expected to more than adequately compensate the servicer for performing the servicing. Servicing liabilities result from contracts to service financial assets for which the benefits of servicing are not expected to adequately compensate the servicer for performing the servicing. Contractually specified servicing fees are all amounts that, per contract, are due to the servicer in exchange for servicing the financial asset and would no longer be received by a servicer if the beneficial owners of the serviced assets or their trustees or agents were to exercise their actual or potential authority under the contract to shift the servicing to another servicer. Adequate compensation is the amount of benefits of servicing that would fairly compensate a substitute servicer should one be required including the profit that would be demanded by a substitute servicer in the marketplace.

When a bank sells or securitizes financial assets and retains the servicing asset, the bank shall allocate the cost of the financial assets to the servicing assets and the financial assets (without the servicing) based on their relative fair values. If it is not practicable to estimate the fair values of the servicing assets and the financial assets (without the servicing), the entire cost shall be allocated to the financial assets (without the servicing) and no cost shall be allocated to the servicing assets. If a bank incurs a servicing liability in a sale or securitization, the servicing liability should initially be measured at fair value. If a bank securitizes assets, retains all of the resulting securities, and classifies the securities as held-to-maturity debt securities, no separate servicing asset or liability shall be recorded. If a bank purchases servicing assets or assumes servicing liabilities in a transaction other than a sale or securitization of the financial assets being serviced, the asset or liability shall be recorded at fair value. For purchased servicing assets, the fair value is presumptively the price paid to acquire the servicing.

All servicing assets and liabilities carried on the books of reporting banks shall be amortized in proportion to, and over the period of, estimated net servicing income (servicing revenue in excess of servicing costs) or net servicing loss (servicing costs in excess of servicing revenue). The book value of servicing assets and liabilities should be reviewed at least quarterly. If the book value of a stratum of a servicing asset exceeds its fair value, the servicing asset is considered to be impaired and the book value shall be reduced to fair value through a valuation allowance for that stratum. The servicing assets shall be stratified into groups based on one or more of the predominant risk characteristics of the underlying financial assets for purposes of determining fair value. If the fair value of a servicing liability increases above the book value, the increased obligation shall be recognized as a loss in current earnings. The fair value of servicing assets (liabilities) is the amount at which the assets (liabilities) could be bought (incurred) or sold (settled) in a bona fide transaction between willing parties.

For each servicing contract in existence before January 1, 1997, previously recognized servicing rights and "excess servicing" receivables that do not exceed contractually specified servicing fees shall be combined, net of any previously recognized servicing obligations under that contract, as a servicing asset or liability as of January 1, 1997. The servicing asset or liability should subsequently be accounted for as described above. Previously recognized servicing receivables that exceed contractually specified servicing fees shall be reclassified as interest-only strips receivable.

For purposes of these reports, servicing assets resulting from contracts to service loans secured by real estate (as defined for Schedule RC-C, Part I, item 1, in the Glossary entry for "Loans secured by real estate") should be reported in Schedule RC-M, item 6.a, "Mortgage servicing assets." Servicing assets resulting from contracts to service all other financial assets should be reported in Schedule RC-M, item 6.b.(2), "All other identifiable intangible assets."

Settlement Date Accounting: See "trade date and settlement date accounting."

Shell Branches: Shell branches are limited service branches that do not conduct transactions with residents, other than with other shell branches, in the country in which they are located. Transactions at shell branches are usually initiated and effected by their head office or by other related branches outside the country in which the shell branches are located, with records and supporting documents maintained at the initiating offices. Examples of such locations are the Bahamas and the Cayman Islands.

Short Position: When a bank sells an asset that it does not own, it has established a short position. If on the report date a bank is in a short position, it shall report its liability to purchase the asset in Schedule RC, item 15.b, "Trading liabilities." In this situation, the right to receive payment shall be reported in Schedule RC-F, item 4, "Other" assets. Short positions shall be reported gross. Short trading positions shall be revalued consistent with the method used by the reporting bank for the valuation of its trading assets.

Significant Subsidiary: See "subsidiaries."

Standby Contract: See "derivative contracts."

Standby Letter of Credit: See "letter of credit."

STRIPS: See "coupon stripping, Treasury receipts, and STRIPS."

Subordinated Notes and Debentures: A subordinated note or debenture is a form of debt issued by a bank or a consolidated subsidiary. When issued by a bank, a subordinated note or debenture is not insured by a federal agency, is subordinated to the claims of depositors, and has an original weighted average maturity of five years or more. Such debt shall be issued by a bank with the approval of, or under the rules and regulations of, the appropriate federal bank supervisory agency and is to be reported in Schedule RC, item 19, "Subordinated notes and debentures."

When issued by a subsidiary, a note or debenture may or may not be explicitly subordinated to the deposits of the parent bank and is to be reported in Schedule RC, item 16, "Other borrowed money," or item 19, "Subordinated notes and debentures," as appropriate.

Those subordinated notes and debentures that are to be reported in Schedule RC, item 19, include mandatory convertible debt.

Subsidiaries: The treatment of subsidiaries in the Reports of Condition and Income depends upon the degree of ownership held by the reporting bank.

A **majority-owned subsidiary** of the reporting bank is a subsidiary in which the parent bank directly or indirectly owns more than 50 percent of the outstanding voting stock.

A **significant subsidiary** of the reporting bank is a majority-owned subsidiary that meets any one or more of the following tests:

- (1) The bank's direct and indirect investment in and advances to the subsidiary equals five percent or more of the total equity capital of the parent bank.

NOTE: For the purposes of this test, the amount of direct and indirect investments and advances is either (a) the amount carried on the books of the parent bank or (b) the parent's proportionate share in the total equity capital of the subsidiary, whichever is greater.

- (2) The parent bank's proportional share (based on equity ownership) of the subsidiary's gross operating income or revenue amounts to five percent or more of the gross operating income or revenue of the consolidated parent bank.
- (3) The subsidiary's income or loss before income taxes amounts to five percent or more of the parent bank's income or loss before income taxes.
- (4) The subsidiary is, in turn, the parent of one or more subsidiaries which, when consolidated with the subsidiary, constitute a significant subsidiary as defined in one or more of the above tests.

Subsidiaries (cont.):

An **associated company** is a corporation in which the bank, directly or indirectly, owns 20 to 50 percent of the outstanding voting stock **and** over which the bank exercises significant influence. This 20 to 50 percent ownership is presumed to carry "significant" influence unless the bank can demonstrate the contrary to the satisfaction of the appropriate federal supervisory authority.

A **corporate joint venture** is a corporation owned and operated by a group of banks or other businesses ("joint venturers"), no one of which has a majority interest, as a separate and specific business or project for the mutual benefit of the joint venturers. Each joint venturer may participate, directly or indirectly, in the management of the joint venture. An entity that is a majority-owned subsidiary of one of the joint venturers is not a corporate joint venture.

The equity ownership in majority-owned subsidiaries that are not consolidated on the Reports of Condition and Income (e.g., subsidiaries held on a temporary basis) and in associated companies is accounted for using the equity method of accounting and is reported in Report of Condition Schedule RC-M, item 8.b, and in Schedule RC, item 8, "Investments in unconsolidated subsidiaries and associated companies."

Ownership in a corporate joint venture is to be treated in the same manner as an associated company (defined above) only to the extent that the equity share represents significant influence over management. Otherwise, equity holdings in a joint venture are treated as holdings of corporate stock and income is recognized only when distributed in the form of dividends.

Suspense Accounts: Suspense accounts are temporary holding accounts in which items are carried until

they can be identified and their disposition to the proper account can be made. Such accounts may also be known as interoffice or clearing accounts. The balances of suspense accounts as of the report date should not automatically be reported as "Other assets" or "Other liabilities." Rather, the items included in these accounts should be reviewed and material amounts should be reported in the appropriate accounts of the Reports of Condition and Income.

Syndications: A syndication is a participation, usually involving shares in a single loan, in which several

participants agree to enter into an extension of credit under a bona fide binding agreement that provides that, regardless of any event, each participant shall fund and be at risk only up to a specified percentage of the total extension of credit or up to a specified dollar amount. In a syndication, the participants agree to the terms of the participation prior to the execution of the final agreement and the contract is executed by the obligor and by all the participants, although there is usually a lead institution organizing or managing the credit. Large commercial and industrial loans, large loans to finance companies, and large foreign loans may be handled through such syndicated participations.

Each participant in the syndicate, including the lead bank, records its own share of the participated loan and the total amount of the loan is not entered on the books of one bank to be shared through transfers of loans. Thus, the initial operation and distribution of this type of participation does not require a determination as to whether a transfer that should be accounted for as a sale has occurred. However, any subsequent transfers of shares, or parts of shares, in the syndicated loan would be subject to the provisions of FASB Statement No. 125 governing whether these transfers should be accounted for as a sale or a secured borrowing. (See the Glossary entry for "transfers of financial assets.")

Telephone Transfer Account: See "deposits."

Term Federal Funds: See "federal funds transactions."

Time Deposits: See "deposits."

Trade Date and Settlement Date Accounting: For purposes of the Reports of Condition and Income, the preferred method for reporting transactions in held-to-maturity securities, available-for-sale securities, and trading assets (including money market instruments) other than off-balance sheet derivative contracts (see the Glossary entry for "derivative contracts") is on the basis of trade date accounting. However, if the reported amounts under settlement date accounting would not be materially different from those under trade date accounting, settlement date accounting is acceptable. Whichever method a bank elects should be used consistently, unless the bank has elected settlement date accounting and subsequently decides to change to the preferred trade date method.

Trade Date and Settlement Date Accounting (cont.):

Under trade date accounting, assets purchased shall be recorded in the appropriate asset category on the trade date and the bank's obligation to pay for those assets shall be reported in Schedule RC-G, item 4, "Other liabilities." Conversely, when an asset is sold, it shall be removed on the trade date from the asset category in which it was recorded, and the proceeds receivable resulting from the sale shall be reported in Schedule RC-F, item 4, "Other assets." Any gain or loss resulting from such transaction shall also be recognized on the trade date. On the settlement date, disbursement of the payment or receipt of the proceeds will eliminate the respective "Other liability" or "Other asset" entry resulting from the transaction.

Under settlement date accounting, assets purchased are not recorded until settlement date. On the trade date, no entries are made. Upon receipt of the assets on the settlement date, the asset is reported in the proper asset category and payment is disbursed. The selling bank, on the trade date, would make no entries. On settlement date, the selling bank would reduce the appropriate asset category and reflect the receipt of the payment. Any gain or loss resulting from such transaction would be recognized on the settlement date.

Trading Account: Banks that (a) regularly underwrite or deal in securities, interest rate contracts, foreign

exchange rate contracts, other off-balance sheet commodity and equity contracts, other financial instruments, and other assets for resale, (b) acquire or take positions in such items principally for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements, or (c) acquire or take positions in such items as an accommodation to customers or for other trading purposes shall report such assets or positions as trading assets or liabilities.

All trading assets should be segregated from a bank's other assets and reported in Schedule RC, item 5, "Trading assets." In addition, for banks with \$1 billion or more in total assets or with \$2 billion or more in notional amount of off-balance sheet derivative contracts, the types of assets and liabilities in the trading account should be detailed in Schedule RC-D, "Trading Assets and Liabilities." A bank's failure to establish a separate account for assets that are used for trading purposes does not prevent such assets from being designated as trading for purposes of these reports. For further information, see the FFIEC Supervisory Policy Statement on Securities Activities and FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities."

All trading account assets should be reported at their fair value with unrealized gains and losses recognized in current income. When a security or other asset is acquired, a bank should determine whether it intends to hold the asset for trading or for investment (e.g., for securities, available-for-sale or held-to-maturity). A bank should not record a newly acquired asset in a suspense account and later determine whether it was acquired for trading or investment purposes. Regardless of how a bank categorizes a newly acquired asset, management should document its decision.

All trading liabilities should be segregated from other transactions and reported in Schedule RC, item 15.b, "Trading liabilities." The trading liability account includes the fair value of off-balance sheet derivative contracts held for trading that are in loss positions and short sales of securities and other assets. Trading account liabilities should be reported at fair value with unrealized gains and losses recognized in current income in a manner similar to trading account assets.

Given the nature of the trading account, transfers into or from the trading category should be rare. Transfers between a trading account and any other account of the bank must be recorded at fair value at the time of the transfer. For a security transferred from the trading category, the unrealized holding gain or loss at the date of the transfer will already have been recognized in earnings and should not be reversed. For a security transferred into the trading category, the unrealized holding gain or loss at the date of the transfer should be recognized in earnings.

For purposes of these reports, short sales of securities or other assets are treated as trading transactions because such sales are entered into with the intent to profit from short-term price movements. Nonetheless, the obligation incurred in a short sale should not be netted against trading assets, but should be recorded as a liability in Schedule RC, item 15.b, "Trading liabilities," and in Schedule RC-D, item 13, "Liability for short positions." (See the Glossary entry for "short position.")

Transaction Account: See "deposits."

Transfers of Financial Assets: The accounting and reporting standards for transfers of financial assets are set forth in FASB Statement No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." These standards are based on consistent application of a financial components approach that focuses on control. Under the financial components approach, after the reporting bank transfers financial assets, it recognizes the financial and servicing assets it controls and the liabilities it has incurred, removes financial assets from the balance sheet when control has been surrendered, and removes liabilities from the balance sheet when extinguished. A summary of these accounting and reporting standards follows. For further information, see FASB Statement No. 125 and the Glossary entries for "Extinguishments of Liabilities" and "Servicing Assets and Liabilities."

Statement No. 125 generally applies to transfers of financial assets occurring after December 31, 1996. However, Statement No. 125 applies to repurchase agreement, dollar-roll, securities lending, and similar transactions occurring after December 31, 1997. In addition, the provisions of Statement No. 125 governing the accounting for collateral are effective for transactions occurring after December 31, 1997. Banks should apply Statement No. 125 prospectively after its effective dates, with earlier or retroactive application not permitted, except for the provisions of this accounting standard applicable to servicing contracts in existence before January 1, 1997 (see the Glossary entry for "Servicing Assets and Liabilities"), and financial assets subject to prepayment held on or acquired after January 1, 1997 (discussed below in this Glossary entry).

A **financial asset** is cash, evidence of an ownership interest in another entity, or a contract that conveys to the bank a contractual right either to receive cash or another financial instrument from another entity or to exchange other financial instruments on potentially favorable terms with another entity. Most of the assets on a bank's balance sheet are financial assets, including balances due from depository institutions, securities, federal funds sold, securities purchased under agreements to resell, loans and lease financing receivables, and interest-only strips receivable.¹ However, servicing assets are not financial assets. Financial assets also include financial futures contracts, forward contracts, interest rate swaps, interest rate caps, interest rate floors, and certain option contracts.

Determining Whether a Transfer Should be Accounted for as a Sale or a Secured Borrowing -- A bank should account for a transfer of its financial assets (or a transfer of all or a portion of one of its financial assets) in which it surrenders control over those financial assets as a sale to the extent that it receives consideration other than beneficial interests in the transferred assets in exchange. According to FASB Statement No. 125, a transferring bank has surrendered control over transferred assets, and therefore has sold the assets, if and only if all three of the following conditions are met:

- (1) The transferred assets have been isolated from the transferring bank, i.e., put presumptively beyond the reach of the transferring bank and its creditors, even in bankruptcy or other receivership.
- (2) Either (a) each transferee (i.e., the entity that receives all or a portion of one or more financial assets from the transferring bank) obtains the right, free of conditions that constrain it from taking advantage of that right, to pledge or exchange the transferred assets or (b) the transferee is a qualifying special-purpose entity and the holders of beneficial interests in that entity have the right, free of conditions that constrain the holders from taking advantage of that right, to pledge or exchange those interests.
- (3) The transferring bank does not maintain effective control over the transferred assets through (a) an agreement that both entitles and obligates it to repurchase or redeem the transferred assets before their maturity or (b) an agreement that entitles the transferring bank to repurchase or redeem transferred assets that are not readily obtainable.

If a transfer of financial assets in exchange for cash or other consideration (other than beneficial interests in the transferred assets) does not satisfy the criteria for sale treatment, the transfer should be accounted for as a secured borrowing with pledge of collateral.

¹ Statement No. 125 defines an interest-only strip receivable as the contractual right to receive some or all of the interest due on a bond, mortgage loan, collateralized mortgage obligation, or other interest-bearing financial asset.

Transfers of Financial Assets (cont.):

Accounting for a Transfer That Qualifies as a Sale -- Upon the completion of a transfer of financial assets that satisfies all three of the conditions to be accounted for as a sale, the purchaser(s) must recognize on the balance sheet all assets obtained and any liabilities incurred and initially measure them at fair value. The aggregate fair value is presumed to be the price paid by the purchaser(s). As for the selling bank, it must:

- (1) Remove all assets sold from the balance sheet while continuing to carry on its balance sheet any retained interest in the transferred assets, including, if applicable, servicing assets, retained undivided interests, and beneficial interests in assets transferred to a qualifying special-purpose entity in a securitization. The selling bank must allocate the amount at which the transferred assets were carried on the balance sheet at the date of the transfer between the assets sold and the retained interests, if any, based on their relative fair values at that date.
- (2) Recognize on the balance sheet all cash, derivative financial instruments, and other assets obtained and all servicing liabilities and other liabilities incurred in consideration as proceeds of the sale. Derivatives include put or call options held or written (e.g., guarantee or recourse obligations), forward commitments (e.g., commitments to deliver additional receivables in some securitizations), and swaps (e.g., provisions that convert interest rates from fixed to variable).
- (3) Initially measure the assets obtained and liabilities incurred in a sale at fair value. However, if it is not practicable to estimate the fair value of an asset obtained, the selling bank must record the asset at zero. If it is not practicable to estimate the fair value of a liability incurred, the selling bank must not recognize any gain on the sale. The liability should be recorded on the balance sheet at the greater of:
 - (a) The amount, if any, by which the fair values of the assets obtained in the sale less the fair values of the liabilities incurred in the sale exceeds the sum of the carrying values of the assets transferred, or
 - (b) The amount of loss that is probable of occurring in accordance with FASB Statement No. 5, "Accounting for Contingencies," as interpreted by FASB Interpretation No. 14, "Reasonable Estimation of the Amount of a Loss." Under that interpretation, when the reasonable estimate of the loss is a range and some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount should be considered probable. When no amount within the range is a better estimate than any other amount, the minimum amount in the range should be considered probable.
- (4) Recognize in income any gain or loss on the sale.

Banks should refer to FASB Statement No. 125 for implementation guidance for accounting for transfers of partial interests, transfers of certain lease receivables, securities lending transactions, repurchase agreements including "dollar rolls," "wash sales," loan syndications, loan participations (discussed below), risk participations in bankers acceptances, factoring arrangements, and transfers of receivables with recourse. However, this accounting standard does not provide guidance on the accounting for most assets and liabilities recorded on the balance sheet following a transfer accounted for as a sale. As a result, after their initial measurement or carrying amount allocation, these assets and liabilities should be accounted for in accordance with the existing generally accepted accounting principles applicable to them.

Loan Participations -- Statement No. 125 applies to loan participations occurring after December 31, 1996, including transfers by the originating lender to a participating institution that take place after that date under loan participation agreements that originated before January 1, 1997. If the loan participation agreement gives a participating institution the right to pledge or exchange the participations and the other conditions for the surrender of control have been met, the originating lender should account for transfers to the participating institution as sales of financial assets.

An originating lender's right of first refusal on a bona fide offer to the participating institution from a third party, a requirement for a participating institution to obtain the originating lender's permission that shall not be unreasonably withheld, or a prohibition on the participating institution's sale of the participation to the originating lender's competitor is a limitation on the participating institution's rights, but is presumed not to constrain a participant from exercising its right to pledge or exchange

Transfers of Financial Assets (cont.):

the participation. However, if the participation agreement constrains the participating institution from pledging or exchanging its participation, the originating lender has not relinquished control over the loan and should account for the transfers as secured borrowings.

Financial Assets Subject to Prepayment -- Financial assets such as interest-only strips receivable and certain loans, debt securities, other receivables, and retained interests in securitizations can be contractually prepaid or otherwise settled in such a way that the holder of the financial asset would not recover substantially all of its recorded investment. After their initial recording on the balance sheet, financial assets of this type must be subsequently measured at fair value like available-for-sale securities or trading securities. This reporting treatment applies to financial assets with this prepayment risk characteristic that are held on or acquired after January 1, 1997. As a result, interest-only strips receivable in the form of a security and other debt securities with this prepayment risk characteristic that are held on that date and categorized as held-to-maturity securities on the balance sheet must be recategorized as available-for-sale or trading, but this recategorization would not call into question a bank's intent to hold other debt securities to maturity.

Traveler's Letter of Credit: See "letter of credit."

Treasury Receipts: See "coupon stripping, Treasury receipts, and STRIPS."

Treasury Stock: Treasury stock is stock that the bank has issued and subsequently acquired, but that has not been retired or resold. As a general rule, treasury stock, whether carried at cost or at par value, is a deduction from a bank's total equity capital. For purposes of the Reports of Condition and Income, Schedule RC, item 26.a, "Undivided profits and capital reserves," should be reported net of the carrying value of treasury stock.

"Gains" and "losses" on the sale, retirement, or other disposal of treasury stock are not to be reported in Schedule RI, Income Statement, but should be reflected in Schedule RI-A, item 5, "Sale, conversion, acquisition, or retirement of capital stock, net." Such gains and losses, as well as the excess of the cost over the par value of treasury stock carried at par, are generally to be treated as adjustments to Schedule RC, item 25, "Surplus."

NOTE: National banks are generally prohibited by 12 USC 83 from purchasing shares of their own stock.

For further information, see Accounting Research Bulletin No. 43, as amended by APB Opinion No. 6.

Troubled Debt Restructurings: The accounting standards for troubled debt restructurings are set forth in

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 summary of this amended accounting standard follows. For further information, see FASB Statements No. 15 and No. 114.

A troubled debt restructuring is a restructuring 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. The restructuring of a loan or other debt instrument (hereafter referred to collectively as a "loan") may include (1) the transfer from the borrower to the bank of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of the loan (see the Glossary entry for "foreclosed assets" for further information), (2) a modification of the loan terms, or (3) a combination of the above. A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not to be reported as a restructured loan.

The recorded amount of a loan is the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest.

In cases where the new terms of the restructured troubled debt provide for a reduction of either interest or principal (referred to as a modification of terms), the institution should measure any loss on the restructuring in accordance with the guidance concerning impaired loans set forth in the Glossary entry for "loan impairment," except that a troubled debt restructuring involving a modification of terms before the effective date of FASB Statement No. 114 may continue to be accounted for and disclosed

Troubled Debt Restructurings (cont.):

in accordance with FASB Statement No. 15 as long as the restructured loan is not impaired based on the terms of the restructuring agreement. See the Glossary entry for "nonaccrual status" for a discussion of the conditions under which a nonaccrual asset which has undergone a troubled debt restructuring (including those that involve a multiple note structure) may be returned to accrual status.

A troubled debt restructuring in which a bank receives physical possession of the borrower's assets, regardless of whether formal foreclosure or repossession proceedings take place, should be accounted for in accordance with paragraph 34 of FASB Statement No. 15, as amended. Thus, in such situations, the loan should be treated as if assets have been received in satisfaction of the loan and reported as described in the Glossary entry for "foreclosed assets."

Despite the granting of some type of concession by a bank to a borrower, a troubled debt restructuring may still result in the recorded amount of the loan bearing a market yield, i.e., an effective interest rate that at the time of the restructuring is greater than or equal to the rate that the bank is willing to accept for a new extension of credit with comparable risk. This may arise as a result of reductions in the recorded amount of the loan prior to the restructuring (e.g., by charge-offs). All loans that have undergone troubled debt restructurings and that are in compliance with their modified terms must be reported as restructured loans in Schedule RC-C, part I, Memorandum item 1 (on the FFIEC 034) or 2 (on the FFIEC 031, 032, and 033). However, a restructured loan that is in compliance with its modified terms and yields a market rate 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 restructuring may include both a modification of terms and the acceptance of property in partial satisfaction of the loan. The accounting for such a restructuring is a two step process. First, the recorded amount of the loan is reduced by the fair value less cost to sell of the property received. Second, the institution should measure any impairment on the remaining recorded balance of the restructured loan in accordance with the guidance concerning impaired loans set forth in FASB Statement No. 114.

A restructuring may involve the substitution or addition of a new debtor for the original borrower. The treatment of these situations depends upon their substance. Restructurings in which the substitute or additional debtor controls, is controlled by, or is under common control with the original borrower, or performs the custodial function of collecting certain of the original borrower's funds, should be accounted for as modifications of terms. Restructurings in which the substitute or additional debtor does not have a control or custodial relationship with the original borrower should be accounted for as a receipt of a "new" loan in full or partial satisfaction of the original borrower's loan. The "new" loan should be recorded at its fair value.

A credit analysis should be performed for a restructured loan in conjunction with its restructuring to determine its collectibility and estimated credit loss. When available information confirms that a specific restructured loan, or a portion thereof, is uncollectible, the uncollectible amount should be charged off against the allowance for loan and lease losses at the time of the restructuring. As is the case for all loans, the credit quality of restructured loans should be regularly reviewed. The bank should periodically evaluate the collectibility of the restructured loan so as to determine whether any additional amounts should be charged to the allowance for loan and lease losses or, if the restructuring involved an asset other than a loan, to another appropriate account.

U.S. Banks: See "banks, U.S. and foreign."

U.S. Territories and Possessions: United States territories and possessions include American Samoa, Guam, the Northern Mariana Islands, the U.S. Virgin Islands, and the U.S. trust territories.

Valuation Allowance: In general, a valuation allowance is an account established against a specific asset

category or to recognize a specific liability, with the intent of absorbing some element of estimated loss. Such allowances are created by charges to expense in the Report of Income and are netted from the asset accounts to which they relate for presentation in the Report of Condition. Provisions establishing or augmenting such allowances are to be reported as "Other noninterest expense" except for the provision for loan and lease losses and the provision for allocated transfer risk for which separate, specifically designated income statement items have been established on Schedule RI.

When-Issued Securities Transactions: Transactions involving securities described as "when-issued" or "when-as-and-if-issued" are, for the purposes of these reports, to be treated as conditional transactions in a security authorized for issuance but not yet actually issued. Purchases and sales of when-issued securities for which settlement date has not occurred as of the report date are not to be reflected in the balance sheet, Schedule RC, until settlement date. The par value of securities purchased or sold on a when-issued basis and for which settlement date has not occurred as of the report date are reportable on a gross basis in Schedule RC-L, Off-Balance Sheet Items, except that banks may net purchases and sales of the identical security with the same party. Banks should report commitments to purchase and sell when-issued securities as forward contracts in Schedule RC-L, item 14.b, unless the reporting bank does not include these commitments as part of its disclosures about off-balance sheet derivatives for other financial reporting purposes. In that case, commitments to sell when-issued securities should be reported as "Other off-balance sheet assets" in Schedule RC-L, item 13, and commitments to purchase when-issued securities should be reported as "Other off-balance sheet liabilities" in Schedule RC-L, item 12, subject to the existing reporting thresholds for these two items.

Trading in when-issued securities normally begins when the U.S. Treasury or some other issuer of securities announces a forthcoming issue. (In some cases, trading may begin in anticipation of such an announcement and should also be reported as described herein.) Such transactions are contingent upon the actual issuance of the security. Since the exact price and terms of the security are unknown before the auction date, trading prior to that date is on a "yield" basis. On the auction date the exact terms and price of the security become known and when-issued trading continues until settlement date, when the securities are delivered and the issuer paid. On settlement date, the securities purchased by the bank shall be reported in the appropriate securities category in Schedule RC-B, Securities, and in the balance sheet, Schedule RC, item 2, or as trading assets in the balance sheet, Schedule RC, item 5.

Yield Maintenance Dollar Repurchase Agreement: See "repurchase/resale agreements."