

## **Reporting Guidance for the Optional Transition Mechanism for Risk-Based Capital Requirements Associated with the Implementation of FAS 166 and FAS 167**

In June 2009, the FASB issued Statement No. 166, *Accounting for Transfers of Financial Assets* (FAS 166), and Statement No. 167, *Amendments to FASB Interpretation No. 46(R)* (FAS 167),<sup>1</sup> which change the way entities account for certain transactions with, and investments in, special purpose entities (SPEs), including many securitization transactions. FAS 166 revises FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, by, among other things, eliminating the concept of a “qualifying special-purpose entity.” FAS 167 revises FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*, by changing how a company determines when it must consolidate an SPE that is a “variable interest entity” (VIE). Under FAS 167, a banking organization must perform on an ongoing basis a qualitative assessment to determine whether its variable interest or interests give it a “controlling financial interest” in a VIE. If a banking organization’s variable interest or interests provide it with the power to direct the most significant activities of the VIE, and the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE, the banking organization is the primary beneficiary of, and therefore must consolidate, the VIE.

On January 28, 2010, the Federal banking agencies<sup>2</sup> published in the *Federal Register* a final rule amending their risk-based capital guidelines (FAS 166/167 Rule).<sup>3</sup> This rule eliminates the exclusion from risk-weighted assets related to asset-backed commercial paper programs (ABCP exclusion) and permits banking organizations to phase in the effects of eliminating the ABCP exclusion and FAS 167 consolidation on risk-weighted assets and the allowance for loan and lease losses (ALLL) includable in Tier 2 capital.<sup>4</sup>

### Reporting Guidance for the Transition for Risk-Weighted Assets

Under the FAS 166/167 Rule, for the first two quarters after the date a banking organization is required to implement FAS 166 and FAS 167 (exclusion period), including for the two calendar quarter-end regulatory report dates within the exclusion period, the banking organization may choose to exclude from risk-weighted assets those assets held by VIEs where the following conditions are met: (1) the VIE existed prior to the date the banking organization implemented FAS 166 and FAS 167 (implementation date); (2) the banking organization did not consolidate the VIE on its balance sheet for calendar quarter-end regulatory report dates prior to the implementation date; (3) the banking organization must consolidate the VIE on its balance sheet beginning as of the implementation date as a result of implementing FAS 167; and (4) the

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<sup>1</sup> FAS 166 has been codified in Accounting Standards Codification (ASC) 860, “Transfers and Servicing.” FAS 167 has been codified in ASC 810, “Consolidation.”

<sup>2</sup> Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; and Office of Thrift Supervision.

<sup>3</sup> 12 *Federal Register* 4636 (January 28, 2010).

<sup>4</sup> See FAS 166/167 Rule at 4649. The FAS 166/167 Rule eliminated a provision implemented in 2004 that allowed banking organizations to exclude the assets of consolidated ABCP VIEs from risk-weighted assets (ABCP exclusion).

banking organization that applies this exclusion to any VIE must apply the exclusion to all VIEs that qualify for the exclusion.

During the exclusion period, a banking organization also may exclude from risk-weighted assets those assets held by VIEs that are consolidated ABCP programs (ABCP program VIEs), provided that the banking organization is the sponsor of the ABCP program and the banking organization consolidated the ABCP program VIE onto its balance sheet under GAAP and excluded the VIE's assets from its risk-weighted assets prior to the implementation date pursuant to the ABCP exclusion. A banking organization that applies this exclusion to any ABCP program VIE must apply the exclusion to all ABCP program VIEs that qualify for the exclusion.

A banking organization that chooses to apply the optional transition mechanism may not exclude from risk-weighted assets the assets of any VIEs to which the banking organization has provided recourse through credit enhancement beyond any contractual obligation to support assets it has sold (i.e., implicit recourse).

As explained more fully in the examples below, to determine the amount of risk-weighted assets during the exclusion period, a banking organization that elects to exclude assets held in VIEs during this period would still need to calculate risk-weighted assets for those excluded assets by risk weighting the banking organization's contractual exposures to these VIEs, such as direct-credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, on the implementation date. The banking organization would be expected to calculate risk-weighted assets for its contractual exposures using a methodology similar to the methodology used to calculate the risk weights of exposures to ABCP programs pursuant to the ABCP exclusion.

The amount of risk-weighted assets held in VIEs on the implementation date that are excluded under the FAS 166/167 Rule as described above is the exclusion amount. During the third and fourth quarters after the implementation date (phase-in period), including for the two calendar quarter-end regulatory report dates within those quarters, a banking organization that has adopted the optional transition provisions for the first two quarters may exclude from risk-weighted assets 50 percent of the exclusion amount. Under no circumstances, however, may the banking organization include in risk-weighted assets an amount less than the aggregate risk-weighted assets it held based on its contractual exposures to these VIEs as of the implementation date, had the VIEs not been consolidated. This floor on risk-weighted assets ensures that, notwithstanding these transition provisions, a banking organization always calculates risk-weighted assets in a manner that at a minimum reflects its contractual risk exposure to its consolidated VIEs as of the implementation date.

Banking organizations that choose to implement the optional transition provisions described above should report exclusion amounts in asset items 34 through 43 of Call Report Schedule RC-R, column B, "Items not subject to risk weighting," as appropriate.

## Examples

The following are examples of the application of the optional transition provisions for risk-weighted assets for a bank with a calendar year fiscal year that is required to implement FAS 166 and FAS 167 on January 1, 2010. In each example, based on the qualitative assessment it performed in accordance with FAS 167 as of January 1, 2010, the sponsoring bank has determined that it is the primary beneficiary of its sponsored VIE and, therefore, it must consolidate the VIE effective as of that date.

### **Example 1 - Fixed Pool/Normal Pay Down**

On December 31, 2009, a bank-sponsored VIE holds a fixed pool of \$100 of assets that would be risk weighted at 100 percent if consolidated onto the sponsoring bank's balance sheet.<sup>5</sup> The VIE has issued \$95 of certificates to outside investors and the sponsoring bank holds dollar-for-dollar capital against a \$5 residual interest. On January 1, 2010, the VIE is consolidated onto the bank's balance sheet pursuant to FAS 167. The residual interest is eliminated from the balance sheet during the consolidation. If the conditions for excluding a VIE's assets from risk-weighted assets during the exclusion and phase-in periods are met and the bank chooses to apply the optional transition mechanism in the FAS 166/167 Rule, the following adjustments would be made to asset items 34 through 43 of Call Report Schedule RC-R:

#### **On January 1, 2010:**

A. Step 1: The bank determines the consolidated VIE's assets that are reportable in the balance sheet categories of Schedule RC-R, items 34 to 43, column A, as if a Call Report were prepared as of January 1, 2010.

- ❖ Assets reportable in column A include \$100 in assets attributable to the consolidated VIE. The risk-weighted amount of these assets, which would also be \$100 because (for purposes of this example) the assets would be accorded a 100 percent risk weight, is the exclusion amount.

B. Step 2: Pursuant to the transition mechanism, the bank would report in column B of Schedule RC-R, "Items not subject to risk weighting," the entire amount of the VIE's assets (as of the implementation date, i.e., January 1, 2010).

- ❖ The bank would report \$100 of assets in column B of Schedule RC-R.

C. Step 3: The bank determines the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

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<sup>5</sup> This example, as well as Examples 2 and 3, involve assets of VIEs to which a 100 percent risk weight applies when these assets are consolidated onto the sponsoring bank's balance sheet. If the risk weight applicable to some or all of a consolidated VIE's assets is less than 100 percent (e.g., 50 percent), the sponsoring bank would need to make certain adjustments to the method of reporting in asset items 34 through 43 of Schedule RC-R described in Examples 1, 2, and 3 to achieve the relief provided under the optional transition mechanism in the FAS 166/167 Rule because of this lower risk weight and its effect, for example, on the measurement of the exclusion amount as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$5 residual interest (i.e., the bank adds \$62.50 ( $\$5 * 12.50$ ) to risk-weighted assets). The bank would report (\$62.50) in column B and \$62.50 in column F of Schedule RC-R. This example does not use an institution-specific factor to risk-weight the residual interest.

**On March 31, 2010**, due to normal amortization, assume the VIE's assets decline to \$90.

D. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A, "Totals (from Schedule RC)."

- ❖ Assets reported in column A include \$90 attributable to the consolidated VIE.

E. Step 2: Pursuant to the transition mechanism, the bank reports the entire \$90 of assets attributable to the consolidated VIE (as of March 31, 2010) in column B, "Items not subject to risk weighting," of Schedule RC-R.

- ❖ The bank reports \$90 of assets in Schedule RC-R, column B, in the same asset category or categories in which the assets were reported in column A.

F. Step 3: The bank adds the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$5 residual interest (i.e., the bank adds \$62.50 ( $\$5 * 12.50$ ) to risk-weighted assets). The bank reports (\$62.50) in column B and \$62.50 in column F of Schedule RC-R. The bank reports these amounts in the asset category among items 34 through 43 of Schedule RC-R in which all or the most significant portion of the consolidated VIE's assets were reported in column A.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of March 31, 2010:

$$\begin{aligned} \text{Column B plus column F} &= \$90 + (\$62.50) + 62.50 = \$90 \\ \text{Column A} &= \$90 \end{aligned}$$

**On June 30, 2010**, due to normal amortization, assume the VIE's assets decline to \$80.

G. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A.

- ❖ Assets reported in column A include \$80 attributable to the consolidated VIE.

H. Step 2: Pursuant to the transition mechanism, the bank reports the entire \$80 in Schedule RC-R, column B, "Items not subject to risk weighting."

- ❖ The bank reports \$80 of assets in Schedule RC-R, column B, in the same asset category or categories in which the assets were reported in column A.

I. Step 3: The bank adds the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$5 residual interest (i.e., the bank adds \$62.50 ( $\$5 * 12.50$ ) to risk-weighted assets). The bank reports (\$62.50) in column B and \$62.50 in column F of Schedule RC-R. The bank reports these amounts in the asset category among items 34 through 43 of Schedule RC-R in which all or the most significant portion of the consolidated VIE's assets were reported in column A.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of June 30, 2010:

$$\begin{aligned}\text{Column B plus column F} &= \$80 + (\$62.50) + 62.50 = \$80 \\ \text{Column A} &= \$80\end{aligned}$$

**On September 30, 2010**, due to normal amortization, assume the VIE's assets decline to \$70. Because (for purposes of this example) these assets would be accorded a 100 percent risk weight, the VIE's risk-weighted assets would also be \$70.

J. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A.

- ❖ Assets reported in column A include \$70 attributable to the consolidated VIE.

K. Step 2: The bank determines whether the contractual exposure floor applies by comparing (a) the amount the bank would report in risk-weighted assets for the consolidated VIE after excluding 50 percent of the exclusion amount to (b) the risk-weighted asset amount of the bank's contractual exposure to the VIE on the implementation date (January 1, 2010) (i.e., is (J minus 50 percent of A) greater than or less than or equal to C). If (J minus 50 percent of A) is greater than C, the bank should use Step 3A below. If (J minus 50 percent of A) is less than or equal to C, the bank should use Step 3B below.

- ❖ In this example, the amount of the VIE's risk-weighted assets as of September 30, 2010, less one-half of the \$100 exclusion amount ( $\$70 - \$50 = \$20$ ) is less than the risk-weighted asset amount of the bank's contractual exposure to the VIE (i.e., the residual interest) on January 1, 2010 ( $\$5 * 12.50 = \$62.50$ ). Therefore, the bank applies Step 3B.

L. Step 3A: The bank makes an adjustment to the on-balance-sheet assets reported in Schedule RC-R that excludes from risk-weighted assets 50 percent of the exclusion amount,

which is the risk-weighted asset amount of the consolidated assets at the implementation date (i.e., January 1, 2010). For purposes of Schedule RC-R, the amount of assets reported in column A that is attributable to the consolidated VIE would be reported in column F because (in this example) they are 100 percent risk-weight assets. The bank would also report 50 percent of the exclusion amount as a positive number in column B, "Items not subject to risk-weighting," and as a negative number in column F.

Step 3B (floor): As in Step C, the bank reports the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$5 residual interest (i.e., the bank adds \$62.50 ( $\$5 * 12.50$ ) to risk-weighted assets). For purposes of Schedule RC-R, the \$70 in assets reported in column A that are attributable to the consolidated VIE would also be reported in column B, "Items not subject to risk-weighting." The bank would then report (\$62.50) in column B and \$62.50 in column F for its contractual exposure to the VIE on January 1, 2010.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of September 30, 2010:

$$\begin{aligned} \text{Column B plus column F} &= \$70 + (\$62.50) + 62.50 = \$70 \\ \text{Column A} &= \$70 \end{aligned}$$

**On December 31, 2010**, due to normal amortization, assume the VIE's assets decline to \$60. Because (for purposes of this example) these assets would be accorded a 100 percent risk weight, the VIE's risk-weighted assets would also be \$60.

M. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A.

- ❖ Assets reported in column A include \$60 attributable to the consolidated VIE.

N. Step 2: The bank determines whether the contractual exposure floor applies by comparing (a) the total amount the bank would report in risk-weighted assets for the consolidated VIE after excluding 50 percent of the exclusion amount to (b) the risk-weighted asset amount of the bank's contractual exposure to the VIE on the implementation date (January 1, 2010) (i.e., is (M minus 50 percent of A) greater than or less than or equal to C). If (M minus 50 percent of A) is greater than C, the bank should use Step 3A below. If (M minus 50 percent of A) is less than or equal to C, the bank should use Step 3B below.

- ❖ In this example, the amount of the VIE's risk-weighted assets as of December 31, 2010, less one-half of the \$100 exclusion amount on January 1, 2010 ( $\$60 - \$50 = \$10$ ) is less than the risk-weighted asset amount of the bank's contractual exposure to

the VIE (i.e., the residual interest) on January 1, 2010 ( $\$5 * 12.50 = 62.50$ ). Therefore, the bank applies Step 3B.

O. Step 3A: The bank makes an adjustment to the on-balance sheet assets reported in Schedule RC-R that excludes from risk-weighted assets 50 percent of the exclusion amount. For purposes of Schedule RC-R, the amount of assets reported in column A that is attributable to the consolidated VIE would be reported in column F because (in this example) they are 100 percent risk-weight assets. The bank would also report 50 percent of the exclusion amount as a positive number in column B, "Items not subject to risk-weighting," and as a negative number in column F.

Step 3B (floor): As in Step C, the bank reports the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$5 residual interest (i.e., the bank adds \$62.50 ( $\$5 * 12.50$ ) to risk-weighted assets). For purposes of Schedule RC-R, the \$60 in assets reported in column A that are attributable to the consolidated VIE would also be reported in column B, "Items not subject to risk-weighting." The bank would then report (\$62.50) in column B and \$62.50 in column F for its contractual exposure to the VIE on January 1, 2010.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of December 31, 2010:

$$\begin{aligned} \text{Column B plus column F} &= \$60 + (\$62.50) + \$62.50 = \$60 \\ \text{Column A} &= \$60 \end{aligned}$$

Quarterly results for the risk-weighted assets (RWA) attributable to the consolidated VIE:

	RWA Using Transition Mechanism	RWA Without Using Transition Mechanism
March 31, 2010, Call Report	\$62.5	\$90
June 30, 2010, Call Report	\$62.5	\$80
September 30, 2010, Call Report	\$62.5	\$70
December 31, 2010, Call Report	\$62.5	\$60

NOTE: The FAS 166/167 Rule does not prohibit a bank from opting out of the transition mechanism. As a result, for the December 31, 2010, Call Report date the bank would likely

choose not to apply the transition mechanism for risk-weighted assets. (If the bank chose not to apply the transition mechanism for December 31, 2010, it would also be unable to apply the transition mechanism for the allowance for loan and lease losses for that date.)

### **Example 2 - Revolving Trust/Stable Asset Amount**

On December 31, 2009, a bank-sponsored revolving VIE holds \$100 of assets that would be risk weighted at 100 percent if consolidated onto the sponsoring bank's balance sheet. The VIE has issued \$97 of certificates to outside investors and the sponsoring bank holds dollar-for-dollar capital against a \$3 residual interest. On January 1, 2010, the VIE is consolidated onto the bank's balance sheet pursuant to FAS 167. The residual interest is eliminated from the balance sheet during the consolidation. If the VIE qualifies for the optional transition mechanism and the bank chooses to apply this mechanism, the following adjustments would be made to asset items 34 through 43 of Call Report Schedule RC-R:

#### **On January 1, 2010:**

A. Step 1: The bank determines the consolidated VIE's assets that are reportable in the balance sheet categories of Schedule RC-R, items 34 to 43, column A, as if a Call Report were prepared as of January 1, 2010.

- ❖ Assets reportable in column A include \$100 attributable to the consolidated VIE. The risk-weighted amount of these assets, which would also be \$100 because (for purposes of this example) the assets would be accorded a 100 percent risk weight, is the exclusion amount.

B. Step 2: Pursuant to the transition mechanism, the bank would report the entire amount of the VIE's assets (as of the implementation date, i.e., January 1, 2010) in Schedule RC-R, column B, "Items not subject to risk-weighting."

- ❖ The bank would report \$100 of assets in Schedule RC-R, column B.

C. Step 3: The bank adds the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$3 residual interest (i.e., the bank adds \$37.50 ( $\$3 * 12.50$ ) to risk-weighted assets. The bank would report (\$37.50) in column B and \$37.50 in column F of Schedule RC-R. This example does not use an institution-specific factor to risk-weight the residual interest.

#### **On March 31, 2010,** assume the VIE's assets remain at \$100.

D. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A, "Totals (from Schedule RC)."

- ❖ Assets reported in column A include \$100 attributable to the consolidated VIE.

E. Step 2: Pursuant to the transition mechanism, the bank reports the entire \$100 of assets attributable to the consolidated VIE (as of March 31, 2010) in Schedule RC-R, column B, “Items not subject to risk-weighting.”

- ❖ The bank reports \$100 of assets in Schedule RC-R, column B, in the same asset category or categories in which the assets were reported in column A.

F. Step 3: The bank determines the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$3 residual interest (i.e., the bank adds \$37.50 ( $\$3 * 12.50$ ) to risk-weighted assets). The bank reports (\$37.50) in column B and \$37.50 in column F of Schedule RC-R. The bank reports these amounts in the asset category in which all or the most significant portion of the consolidated VIE’s assets were reported in column A.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of March 31, 2010:

$$\begin{aligned} \text{Column B plus column F} &= \$100 + (\$37.50) + 37.50 = \$100 \\ \text{Column A} &= \$100 \end{aligned}$$

**On June 30, 2010**, assume the VIE’s assets remain at \$100.

G. Step 1: The bank includes the consolidated VIE’s assets in the appropriate balance sheet asset categories of Schedule RC-R, column A.

- ❖ Assets reported in column A include \$100 attributable to the consolidated VIE.

H. Step 2: Pursuant to the transition mechanism, the bank reports the entire \$100 of assets attributable to the consolidated VIE (as of June 30, 2010) in Schedule RC-R, column B, “Items not subject to risk-weighting.”

- ❖ The bank reports \$100 of assets in Schedule RC-R, column B, in the same asset category or categories in which the assets were reported in column A.

I. Step 3: The bank adds the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$3 residual interest (i.e., the bank adds \$37.50 ( $\$3 * 12.50$ ) to risk-weighted assets). The bank reports (\$37.50) in column B and \$37.50 in column F of Schedule RC-R. The bank reports these amounts in the asset category in which all or the most significant portion of the consolidated VIE’s assets were reported in column A.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of June 30, 2010:

$$\begin{aligned}\text{Column B plus column F} &= \$100 + (\$37.50) + 37.50 = \$100 \\ \text{Column A} &= \$100\end{aligned}$$

**On September 30, 2010**, assume the VIE's assets remain at \$100. Because (for purposes of this example) these assets would be accorded a 100 percent risk weight, the VIE's risk-weighted assets would also be \$100.

J. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A.

- ❖ Assets reported in column A include \$100 attributable to the consolidated VIE.

K. Step 2: The bank determines whether the contractual exposure floor applies by comparing (a) the amount the bank would include in risk-weighted assets for the consolidated VIE after excluding 50 percent of the exclusion amount to (b) the risk-weighted asset amount of the bank's contractual exposure to the VIE on the implementation date (January 1, 2010) (i.e., is (J minus 50 percent of A) greater than or less than or equal to C). If (J minus 50 percent of A) is greater than C, the bank should use Step 3A below. If (J minus 50 percent of A) is less or equal to than C, the bank should use Step 3B below.

- ❖ In this example, the amount of the VIE's risk-weighted assets as of September 30, 2010, less one-half of the \$100 exclusion amount on January 1, 2010 ( $\$100 - \$50 = \$50$ ) is greater than the risk-weighted asset amount of the bank's contractual exposure to the VIE (i.e., the residual interest) on January 1, 2010 ( $\$3 * 12.50 = \$37.50$ ). Therefore, the bank applies Step 3A.

L. Step 3A: The bank makes an adjustment to the on-balance-sheet assets reported in Schedule RC-R that excludes from risk-weighted assets 50 percent of the exclusion amount, which is the risk-weighted asset amount of the consolidated assets at the implementation date (i.e., January 1, 2010). For purposes of Schedule RC-R, the amount of assets reported in column A that is attributable to the consolidated VIE would be reported in column F because (in this example) they are 100 percent risk-weight assets. The bank would also report 50 percent of the exclusion amount as a positive number in column B, "Items not subject to risk-weighting," and as a negative number in column F.

Step 3B (floor): As in Step C, the bank reports the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ Using Step 3A, the bank subtracts \$50 (50 percent of the exclusion amount from A above) from risk-weighted assets. The bank accomplishes this by reporting the \$100

of assets attributable to the consolidated VIE in column F. The bank would then report \$50 in column B, and (\$50) in column F for 50 percent of the exclusion amount of \$100, which was determined as of January 1, 2010.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of September 30, 2010:

$$\begin{aligned}\text{Column B plus column F} &= \$50 + \$100 + (\$50) = \$100 \\ \text{Column A} &= \$100\end{aligned}$$

**On December 31, 2010**, assume the VIE's assets remain at \$100. Because (for purposes of this example) these assets would be accorded a 100 percent risk weight, the VIE's risk-weighted assets would also be \$100.

M. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A.

❖ Assets reported in column A include \$100 attributable to the consolidated VIE.

N. Step 2: The bank determines whether the contractual exposure floor applies by comparing (a) the total amount the bank would report in risk-weighted assets for the consolidated VIE after excluding 50 percent of the exclusion amount to (b) the risk-weighted asset amount of the bank's contractual exposure to the VIE on the implementation date (January 1, 2010) (i.e., is (M minus 50 percent of A) greater than or less than or equal to C). If (M minus 50 percent of A) is greater than C, the bank should use Step 3A below. If (M minus 50 percent of A) is less than or equal to C, the bank should use Step 3B below.

❖ In this example, the amount of the VIE's risk-weighted assets as of December 31, 2010, less one-half of the \$100 exclusion amount on January 1, 2010 ( $\$100 - \$50 = \$50$ ) is greater than the risk-weighted asset amount of the bank's contractual exposure to the VIE (i.e., the residual interest) on January 1, 2010 ( $\$3 * 12.50 = \$37.50$ ). Therefore, the bank applies Step 3A.

O. Step 3A: The bank makes an adjustment to the on-balance sheet assets reported in Schedule RC-R that excludes from risk-weighted assets 50 percent of the exclusion amount, which is the risk-weighted asset amount of the consolidated assets at the implementation date (i.e., January 1, 2010). For purposes of Schedule RC-R, the amount of assets reported in column A that is attributable to the consolidated VIE would be reported in column F because (in this example) they are 100 percent risk-weight assets. The bank would also report 50 percent of the exclusion amount as a positive number in column B, "Items not subject to risk-weighting," and as a negative number in column F.

Step 3B (floor): As in Step C, the bank reports the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ Using Step 3A, the bank subtracts \$50 (50 percent of the exclusion amount from A above) from risk-weighted assets. The bank accomplishes this by reporting the \$100 of assets attributable to the consolidated VIE in column F. The bank would then report \$50 in column B, and (\$50) in column F for 50 percent of the exclusion amount of \$100, which was determined as of January 1, 2010.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of December 31, 2010:

$$\begin{aligned} \text{Column B plus column F} &= \$50 + \$100 + (\$50) = \$100 \\ \text{Column A} &= \$100 \end{aligned}$$

Quarterly results for the risk-weighted assets (RWA) attributable to the consolidated VIE:

	RWA Using Transition Mechanism	RWA Without Using Transition Mechanism
March 31, 2010, Call Report	\$37.50	\$100
June 30, 2010, Call Report	\$37.50	\$100
September 30, 2010, Call Report	\$50	\$100
December 31, 2010, Call Report	\$50	\$100

### **Example 3 - Revolving Trust/Early Amortization**

On December 31, 2009, a bank-sponsored revolving VIE holds \$100 of assets that would be risk weighted at 100 percent if consolidated onto the sponsoring bank's balance sheet. The VIE has issued \$97 of certificates to outside investors and the sponsoring bank holds dollar-for-dollar capital against a \$3 residual interest. On January 1, 2010, the VIE is consolidated onto the bank's balance sheet pursuant to FAS 167. The residual interest is eliminated from the balance sheet during the consolidation. If the VIE qualifies for the optional transition mechanism and the bank chooses to apply this mechanism, the following adjustments would be made to asset items 34 through 43 of Call Report Schedule RC-R:

#### **On January 1, 2010:**

A. Step 1: The bank determines the consolidated VIE's assets that are reportable in the balance sheet categories of Schedule RC-R, items 34 through 43, column A, as if a Call Report were prepared as of January 1, 2010.

- ❖ Assets reportable in column A include \$100 attributable to the consolidated VIE. The risk-weighted amount of these assets, which would also be \$100 because (for purposes of this example) the assets would be accorded a 100 percent risk weight, is the exclusion amount.

B. Step 2: Pursuant to the transition mechanism, the bank would report the entire amount of the consolidated VIE's assets (as of the implementation date, i.e., January 1, 2010) in Schedule RC-R, column B, "Items not subject to risk-weighting."

- ❖ The bank would report \$100 of assets in Schedule RC-R, column B.

C. Step 3: The bank determines the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$3 residual interest (i.e., the bank adds \$37.50 ( $\$3 * 12.50$ ) to risk-weighted assets. The bank would report (\$37.50) in column B and \$37.50 in column F of Schedule RC-R. This example does not use an institution-specific factor to risk-weight the residual interest.

**On March 31, 2010**, assume the VIE's assets decline to \$75.

D. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A, "Totals (from Schedule RC)."

- ❖ Assets reported in column A include \$75 attributable to the consolidated VIE.

E. Step 2: Pursuant to the transition mechanism, the bank reports the entire \$75 of assets attributable to the consolidated VIE (as of March 31, 2010) in Schedule RC-R, column B, "Items not subject to risk-weighting."

- ❖ The bank reports \$75 of assets in Schedule RC-R, column B, in the same asset category or categories in which the assets were reported in column A.

F. Step 3: The bank adds the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$3 residual interest (i.e., the bank adds \$37.50 ( $\$3 * 12.50$ ) to risk-weighted assets). The bank reports (\$37.50) in column B and \$37.50 in column F of Schedule RC-R. The bank reports these amounts in the asset category in which all or the most significant portion of the consolidated VIE's assets were reported in column A.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of March 31, 2010:

$$\begin{aligned}\text{Column B plus column F} &= \$75 + (\$37.50) + 37.50 = \$75 \\ \text{Column A} &= \$75\end{aligned}$$

**On June 30, 2010**, assume the VIE's assets have declined to \$50.

G. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A.

- ❖ Assets reported in column A include \$50 attributable to the consolidated VIE.

H. Step 2: Pursuant to the transition mechanism, the bank reports the entire \$50 of assets attributable to the consolidated VIE (as of June 30, 2010) in Schedule RC-R, column B, "Items not subject to risk-weighting."

- ❖ The bank reports \$50 of assets in Schedule RC-R, column B, in the same asset category or categories in which the assets were reported in column A.

I. Step 3: The bank determines the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual interest) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$3 residual interest (i.e., the bank adds \$37.50 ( $\$3 * 12.50$ ) to risk-weighted assets). The bank reports (\$37.50) in column B and \$37.50 in column F of Schedule RC-R. The bank reports these amounts in the asset category in which all or the most significant portion of the consolidated VIE's assets were reported in column A.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of June 30, 2010:

$$\begin{aligned}\text{Column B plus column F} &= \$50 + (\$37.50) + 37.50 = \$50 \\ \text{Column A} &= \$50\end{aligned}$$

**On September 30, 2010**, assume the VIE's assets have declined to \$25. Because (for purposes of this example) these assets would be accorded a 100 percent risk weight, the VIE's risk-weighted assets would also be \$25.

J. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A.

- ❖ Assets reported in column A include \$25 attributable to the consolidated VIE.

K. Step 2: The bank determines whether the contractual exposure floor applies by comparing (a) the amount the bank would include in risk-weighted assets for the consolidated VIE after excluding 50 percent of the exclusion amount to (b) the risk-weighted asset amount of the bank's contractual exposure to the VIE on the implementation date (January 1, 2010) (i.e., is (J minus 50 percent of A) greater than or less than or equal to C). If (J minus 50 percent of A) is greater than C, the bank should use Step 3A below. If (J minus 50 percent of A) is less than or equal to C, the bank should use Step 3B below.

- ❖ In this example, the amount of the VIE's risk-weighted assets as of September 30, 2010, less one-half of the \$100 exclusion amount on January 1, 2010 ( $\$25 - \$50 = -\$25$ ) is less than the risk-weighted asset amount of the bank's contractual exposure to the VIE (i.e., the residual interest) on January 1, 2010 ( $\$3 * 12.50 = \$37.50$ ). Therefore, the bank applies Step 3B.

L. Step 3A: The bank makes an adjustment to the on-balance sheet assets reported in Schedule RC-R that excludes from risk-weighted assets 50 percent of the exclusion amount, which is the risk-weighted asset amount of the consolidated assets at the implementation date (i.e., January 1, 2010). For purposes of Schedule RC-R, the amount of assets reported in column A that is attributable to the consolidated VIE would be reported in column F because (in this example) they are 100 percent risk-weight assets. The bank would also report 50 percent of the exclusion amounts as a positive number in column B, "Items not subject to risk-weighting," and as a negative number in column F.

Step 3B (floor): As in Step C, the bank reports the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual amount) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$3 residual interest (i.e., the bank adds \$37.50 ( $\$3 * 12.50$ ) to risk-weighted assets). For purposes of Schedule RC-R, the \$25 in assets reported in column A that are attributable to the consolidated VIE would also be reported in column B, "Items not subject to risk-weighting." The bank would then report (\$37.50) in column B and \$37.50 in column F for its contractual exposure to the VIE on January 1, 2010.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of September 30, 2010:

$$\begin{aligned} \text{Column B plus column F} &= \$25 + (\$37.50) + \$37.50 = \$25 \\ \text{Column A} &= \$25 \end{aligned}$$

**On December 31, 2010**, assume the VIE's assets have declined to \$1. Because (for purposes of this example) these assets would be accorded a 100 percent risk weight, the VIE's risk-weighted assets would also be \$1.

M. Step 1: The bank includes the consolidated VIE's assets in the appropriate balance sheet asset categories of Schedule RC-R, column A.

- ❖ Assets reported in column A include \$1 attributable to the consolidated VIE.

N. Step 2: The bank determines whether the contractual exposure floor should apply by comparing (a) the total amount the bank would report in risk-weighted assets for the consolidated VIE after excluding 50 percent of the exclusion amount as of the implementation date to (b) the risk-weighted asset amount of the bank's contractual exposure to the VIE on the implementation date (January 1, 2010) (i.e., is (M minus 50 percent of A) greater than or less than or equal to C). If (M minus 50 percent of A) is greater than C, the bank should use Step 3A below. If (M minus 50 percent of A) is less than or equal to C, the bank should use Step 3B below.

- ❖ In this example, the amount of the VIE's risk-weighted assets as of December 31, 2010, less one-half of the \$100 exclusion amount on January 1, 2010 ( $\$1 - \$50 = -\$49$ ) is less than the risk-weighted asset amount of the bank's contractual exposure to the VIE (i.e., the residual interest) on January 1, 2010 ( $\$3 * 12.50 = 37.50$ ). Therefore, the bank applies Step 3B.

O. Step 3A: The bank makes an adjustment to the on-balance sheet assets reported in Schedule RC-R that excludes from risk-weighted assets 50 percent of the exclusion amount, which is the risk-weighted asset amount of the consolidated assets at the implementation date (i.e., January 1, 2010). For purposes of Schedule RC-R, the amount of assets reported in column A that is attributable to the consolidated VIE would be reported in column F because (in this example) they are 100 percent risk-weight assets). The bank would also report 50 percent of the exclusion amount as a positive number in column B, "Items not subject to risk-weighting," and as a negative number in column F.

Step 3B (floor): As in Step C, the bank reports the risk-weighted asset amount of its contractual exposure to the VIE (i.e., the residual amount) as of the implementation date (i.e., January 1, 2010).

- ❖ The bank holds dollar-for-dollar capital against the \$3 residual interest (i.e., the bank adds \$37.50 ( $\$3 * 12.50$ ) to risk-weighted assets). For purposes of Schedule RC-R, the \$1 in assets reported in column A that are attributable to the consolidated VIE would also be reported in column B, "Items not subject to risk-weighting." The bank would then report (\$37.50) in column B and \$37.50 in column F for its contractual exposure to the VIE on January 1, 2010.

For asset items 34 through 43 of Schedule RC-R, the sum of columns B through F must equal the balance sheet asset amount reported in column A. For the consolidated VIE in this example as of December 31, 2010:

$$\begin{aligned} \text{Column B plus column F} &= \$1 + (\$37.50) + \$37.50 = \$1 \\ \text{Column A} &= \$1 \end{aligned}$$

Quarterly results for the risk-weighted assets (RWA) attributable to the consolidated VIE:

	RWA Using Transition Mechanism	RWA Without Using Transition Mechanism
March 31, 2010, Call Report	\$37.50	\$75
June 30, 2010, Call Report	\$37.50	\$50
September 30, 2010, Call Report	\$37.50	\$25
December 31, 2010, Call Report	\$37.50	\$1

NOTE: The FAS 166/167 Rule does not prohibit a bank from opting out of the transition mechanism. As a result, for the September 30, 2010, and December 31, 2010, Call Report dates the bank would likely choose not to apply the transition mechanism for risk-weighted assets. (If the bank chose not to apply the transition mechanism for September 30 and December 31, 2010, it would also be unable to apply the transition mechanism for the allowance for loan and lease losses for these dates.)

Reporting Guidance for the Transition for the Allowance for Loan and Lease Losses (for banking organizations adopting the transition mechanism for risk-weighted assets described above)

During the exclusion period, including for the two calendar quarter-end regulatory report dates within the exclusion period, a banking organization that opts to exclude the assets of consolidated VIEs from risk-weighted assets as described above may also include without limit in Tier 2 capital the full amount of the ALLL calculated as of the implementation date that is attributable to the assets it excluded from risk-weighted assets (inclusion amount). A banking organization should include the inclusion amount in Schedule RC-R, item 14, "Allowance for loan and lease losses includible in Tier 2 capital." That is, the ALLL included in Tier 2 capital pursuant to this transition mechanism during the exclusion period would not be subject to the 1.25 percent of risk-weighted assets limit (1.25 percent limit) on the ALLL in Tier 2 capital contained in the agencies' general risk-based capital rules.

During the phase-in period, including for the two calendar quarter-end regulatory report dates within the phase-in period, a banking organization that has adopted the transition mechanism for risk-weighted assets during the phase-in period may include in Tier 2 capital without limit 50 percent of the inclusion amount. The banking organization's ALLL in excess of 50 percent of the inclusion amount may be included in Tier 2 capital subject to the 1.25 percent limit.

As with the transition mechanism for risk-weighted assets, a banking organization may not apply the transition mechanism for the ALLL to VIEs to which it has provided recourse through credit enhancement beyond any contractual obligation to support assets it has sold (i.e., implicit

recourse). Therefore, a banking organization must count toward the 1.25 percent limit all ALLL it includes in Tier 2 capital that is associated with assets of a VIE to which it has provided implicit recourse.

Notwithstanding the transition mechanism for the ALLL, the maximum amount of Tier 2 capital that is allowable in a bank's qualifying total capital is 100 percent of Tier 1 capital.

The following is an example of the application of the transition for the allowance for loan and lease losses:

### **Example - ALLL Relief**

On December 31, 2009, a revolving VIE holds \$100 of assets. The VIE issues \$97 of certificates to outside investors and the sponsoring bank holds a \$3 residual interest. If the VIE qualifies for and the bank chooses the optional transition mechanism:

**On January 1, 2010**, the VIE is consolidated at amortized cost onto the bank's balance sheet pursuant to FAS 167. The residual interest is eliminated from the balance sheet during consolidation. For purposes of this example, assume the bank applies its ALLL methodology and determines that it must hold a \$4 allowance against the \$100 of the consolidated VIE's assets, which are held-for-investment loans. Also assume that this \$4 allowance is part of the bank's overall ALLL of \$20, which would be reported on the bank's balance sheet in Schedule RC, item 4.c, "Allowance for loan and lease losses," as if a Call Report were prepared as of January 1, 2010.

A. The bank would report in Schedule RC-R, item 14, "Allowance for loan and lease losses includible in Tier 2 capital," and thereby include in Tier 2 capital, the entire \$4 of the ALLL attributable to the newly consolidated assets regardless of the regulatory limit on the ALLL (generally, the ALLL that can be included in Tier 2 capital is limited to 1.25 percent of total risk-weighted assets). The remaining \$16 of the bank's ALLL that is not attributable to the consolidated assets would still be subject to the 1.25 percent limit.

- ❖ The bank includes \$4 of the ALLL in Tier 2 capital, regardless of the 1.25 percent limit. This \$4 ALLL is the inclusion amount.

**On March 31, 2010**, due to amortization, assume the VIE's assets decline to \$75 and the ALLL attributable to these consolidated held-for-investment loans declines to \$3. The bank's overall ALLL remains \$20, which includes this \$3.

B. The bank includes in Tier 2 capital the inclusion amount calculated in A above, regardless of the 1.25 percent limit. This amount is included in the amount reported in Schedule RC-R, item 14, "Allowance for loan and lease losses includible in Tier 2 capital." The remainder of the bank's overall ALLL, i.e., the overall ALLL less the inclusion amount calculated in A above also is includible in Tier 2 capital (and is reported in Schedule RC-R, item 14); however, it is subject to the 1.25 percent limit.

- ❖ The bank adds the entire \$4 inclusion amount of the ALLL to Tier 2 capital, regardless of the 1.25 percent limit. The remaining \$16 of the bank's overall ALLL is includible in Tier 2 capital subject to the 1.25 percent limit.

**On June 30, 2010**, due to amortization, assume the VIE's assets decline to \$50 and the ALLL attributable to these consolidated held-for-investment loans declines to \$2.50. The bank's overall ALLL increases to \$21, which includes this \$2.50.

C. The bank includes in Tier 2 capital the inclusion amount calculated in A above, regardless of the 1.25 percent limit. This amount is included in the amount reported in Schedule RC-R, item 14, "Allowance for loan and lease losses includible in Tier 2 capital." The remainder of the bank's overall ALLL, i.e., the overall ALLL less the inclusion amount calculated in A above also is includible in Tier 2 capital (and is reported in Schedule RC-R, item 14); however, it is subject to the 1.25 percent limit.

- ❖ The bank adds the entire \$4 inclusion amount of the ALLL to Tier 2 capital, regardless of the 1.25 percent limit. The remaining \$17 of the bank's overall ALLL is includible in Tier 2 capital subject to the 1.25 percent limit.

**On September 30, 2010**, due to amortization, assume the VIE's assets decline to \$25 and the ALLL attributable to these consolidated held-for-investment loans declines to \$2.25. The bank's overall ALLL declines to \$20.50, which includes this \$2.25.

D. The bank includes in Tier 2 capital one-half of the inclusion amount calculated in A above, regardless of the 1.25 percent limit. This amount is included in the amount reported in Schedule RC-R, item 14, "Allowance for loan and lease losses includible in Tier 2 capital." The amount of the bank's overall ALLL in excess of one-half of the inclusion amount calculated in A above also is includible in Tier 2 capital (and is reported in Schedule RC-R, item 14); however, it is subject to the 1.25 percent limit.

- ❖ The bank includes \$2 of the ALLL (i.e., one-half of the \$4 inclusion amount) in Tier 2 capital, regardless of the 1.25 percent limit. The remaining \$18.50 of the bank's overall ALLL is includible in Tier 2 capital subject to the 1.25 percent limit.

**On December 31, 2010**, due to amortization, assume the VIE's assets decline to \$1 and the ALLL attributable to these consolidated held-for-investment loans declines to \$0.25. The bank's overall ALLL declines to \$20.25, which includes this \$0.25.

E. The bank includes in Tier 2 capital one-half of the inclusion amount calculated in A above, regardless of the 1.25 percent limit. This amount is included in the amount reported in Schedule RC-R, item 14, "Allowance for loan and lease losses includable in Tier 2 capital." The amount of the bank's overall ALLL in excess of one-half of the inclusion amount calculated in A above also is includible in Tier 2 capital (and is reported in Schedule RC-R, item 14); however, it is subject to the 1.25 percent limit.

- ❖ The bank includes \$2 of the ALLL (i.e., one-half of the \$4 inclusion amount) in Tier 2 capital, regardless of the 1.25 percent limit. The remaining \$18.25 of the bank's overall ALLL is includible in Tier 2 capital subject to the 1.25 percent limit.

Quarterly results for the ALLL under the transition mechanism:

	VIE's Assets	ALLL Not Subject to 1.25 Percent Limit and Includible in Tier 2 Capital Using Transition Mechanism
March 31, 2010, Call Report	\$75	\$4
June 30, 2010, Call Report	\$50	\$4
September 30, 2010, Call Report	\$25	\$2
December 31, 2010, Call Report	\$1	\$2

NOTE: The ALLL not subject to the 1.25 percent limit and includible in Tier 2 capital may exceed the VIE's assets (and the ALLL attributable to these assets) under certain circumstances during the transition period.