FFIEC 031 AND FFIEC 041

CALL REPORT

INSTRUCTION BOOK UPDATE

SEPTEMBER 2017

FILING INSTRUCTIONS

NOTE: This update for the instruction book for the FFIEC 031 and FFIEC 041 Call Reports is designed for two-sided (duplex) printing. The pages listed in the column below headed "Remove Pages" are no longer needed in the *Instructions for Preparation of Consolidated Reports of Condition and Income* (FFIEC 031 and FFIEC 041) and should be removed and discarded. The pages listed in the column headed "Insert Pages" are included in this instruction book update and should be filed promptly in your instruction book for the FFIEC 031 and FFIEC 041 Call Reports.

Remove Pages	**Insert Pages**
RC-L-9 – RC-L-10 (9-16)	RC-L-9 – RC-L-10 (9-17)
RC-R-51 – RC-R-52 (3-15)	RC-R-51 – RC-R-52 (9-17) *
RC-R-97 – RC-R-98 (9-16)	RC-R-97 – RC-R-98 (9-17)
RC-S-3 – RC-S-4 (6-14)	RC-S-3 – RC-S-4 (9-17) *
RC-S-7 – RC-S-8 (3-17)	RC-S-7 – RC-S-8 (9-17)
A-1 – A-2 (3-17)	A-1 – A-2 (9-17) *
A-2c (6-15)	A-2c (9-17) *
A-3 – A-4 (6-12)	A-3 – A-4 (9-17) *
A-57 – A-58 (3-17)	A-57 – A-58 (9-17) *
A-73 – A-76 (6-10, 3-17)	A-73 – A-76 (9-17)

* The updates to these pages are limited solely to the insertion of hyperlinks to other documents.

Item No.	Caption and Instructions
11 (cont.)	An agent bank with risk is a bank that, by agreement, participates in another bank's merchant credit card acceptance program. An agent bank with risk assumes liability for chargebacks for all or a portion of the loss for the merchants' sales activity. For purposes of items 11.a and 11.b, banks should include credit card sales transactions involving bank credit cards, e.g., MasterCard and Visa. For banks with total assets of $10 billion or more, the year-to-date sales volume may be reported to the nearest million dollars, with zeros reported for the thousands, rather than to the nearest thousand dollars.
11.a	**Sales for which the reporting bank is the acquiring bank.** Report the year-to-date volume of sales (in U.S. dollars) generated through the bank's merchant processing activities where the reporting bank is the acquiring bank. This will include amounts processed for merchants contracted directly by the acquiring bank, amounts processed for agent banks with risk, and amounts processed for third parties (e.g., independent sales organizations and member service providers). Banks that are required to report sales data to the credit card associations of which they are members (e.g., MasterCard and Visa) should measure sales volume in the same manner for purposes of this item.
11.b	**Sales for which the reporting bank is the agent bank with risk.** Report the year-to-date volume of sales (in U.S. dollars) generated through the bank's merchant processing activities where the reporting bank is acting as an agent bank with risk. Include all sales transactions for which the acquiring bank with whom the reporting bank contracted may hold the bank responsible.
12	**Gross amounts (e.g., notional amounts) of derivatives.** Report in the appropriate column and subitem the gross par value (stated in U.S. dollars) (e.g., for futures, forwards, and option contracts) or the notional amount (stated in U.S. dollars) (e.g., for forward rate agreements and swaps), as appropriate, of all contracts that meet the definition of a derivative and must be accounted for in accordance with ASC Topic 815, Derivatives and Hedging (formerly FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended). Include both freestanding derivative contracts and embedded derivatives that must be accounted for separately from their host contract under ASC Topic 815. Report each contract according to its underlying risk exposure: (a) interest rate, (b) foreign exchange, (c) equity, or (d) commodity and other. Contracts with multiple risk characteristics should be classified based upon the predominant risk characteristics at the origination of the derivative. However, exclude from Schedule RC-L, items 12 through 15, all credit derivatives, which should be reported in Schedule RC-L, item 7, above. The notional amount or par value to be reported for a derivative contract with a multiplier component is the contract's effective notional amount or par value. For example, a swap contract with a stated notional amount of $1,000,000 whose terms called for quarterly settlement of the difference between 5% and LIBOR multiplied by 10 has an effective notional amount of $10,000,000. All transactions within the consolidated bank should be reported on a net basis. No other netting of contracts is permitted for purposes of this item. Therefore, do not net: (1) obligations of the reporting bank to purchase from third parties against the bank's obligations to sell to third parties, (2) written options against purchased options, or (3) contracts subject to bilateral netting agreements.

Item No. **Caption and Instructions**

12 (cont.) For each column, the sum of items 12.a through 12.e must equal the sum of items 13 and 14.

Column Instructions

Column A, Interest Rate Contracts: Interest rate contracts are contracts related to an interest-bearing financial instrument or whose cash flows are determined by referencing interest rates or another interest rate contract (e.g., an option on a futures contract to purchase a Treasury bill). These contracts are generally used to adjust the bank's interest rate exposure or, if the bank is an intermediary, the interest rate exposure of others. Interest rate contracts include interest rate futures, single currency interest rate swaps, basis swaps, forward rate agreements, and interest rate options, including caps, floors, collars, and corridors.

Exclude contracts involving the exchange of one or more foreign currencies (e.g., cross-currency swaps and currency options), which are to be reported in column B as foreign exchange contracts. In addition, exclude contracts not involving the exchange of foreign currency whose predominant risk characteristic is foreign exchange risk, which are also to be reported in column B as foreign exchange contracts.

Unsettled securities transactions that exceed the regular way settlement time limit that is customary in each relevant market must be reported as forward contracts in Schedule RC-L, item 12.b.

Column B, Foreign Exchange Contracts: Foreign exchange contracts are contracts to purchase foreign (non-U.S.) currencies and U.S. dollar exchange in the forward market, i.e., on an organized exchange or in an over-the-counter market. A purchase of U.S. dollar exchange is equivalent to a sale of foreign currency. Foreign exchange contracts include cross-currency interest rate swaps where there is an exchange of principal, forward foreign exchange contracts (usually settling three or more business days from trade date), and currency futures and currency options. Exclude spot foreign exchange contracts, which are to be reported in Schedule RC-L, item 8.

Only one side of a foreign currency transaction is to be reported. In those transactions where foreign (non-U.S.) currencies are bought or sold against U.S. dollars, report only that side of the transaction that involves the foreign (non-U.S.) currency. For example, if the reporting bank enters into a futures contract which obligates the bank to purchase U.S. dollar exchange against which it sells Japanese yen, then the bank would report (in U.S. dollar equivalent values) the amount of Japanese yen sold in Schedule RC-L, item 12.a. In cross-currency transactions, which involve the purchase and sale of two non-U.S. currencies, only the purchase side is to be reported.

All amounts in column B are to be reported in U.S. dollar equivalent values.

Column C, Equity Derivative Contracts: Equity derivative contracts are contracts that have a return, or a portion of their return, linked to the price of a particular equity or to an index of equity prices, such as the Standard and Poor's 500.

The contract amount to be reported for equity derivative contracts is the quantity, e.g., number of units, of the equity instrument or equity index contracted for purchase or sale multiplied by the contract price of a unit.

Part II. (cont.)

General Instructions for Schedule RC-R, Part II. (cont.)

In the case where a bank has a securitization exposure with a balance sheet value of $100, it would report $100 in both columns A and B. If the bank applies the SSFA and calculates a risk-weighted asset exposure of $20 for that securitization, the bank would report $20 in column T. Since it is using the SSFA for all its securitization exposures, the bank must report $0 in column U.

	(Column A) Totals	(Column B) Adjustments to Totals Reported in Column A	(Column Q) Exposure Amount	(Column T) Total Risk-Weighted Asset Amount by Calculation Methodology	(Column U)	
			1250%	SSFA	Gross-Up	
9. On-balance sheet securitization exposures						
a. Held-to-maturity securities	$100	$100	$0	$20	$0	9.a.

A bank, at its discretion, could also use both the 1,250 percent risk weight for some securitization exposures and either the SSFA or Gross-Up Approach for other securitization exposures. For example, Bank Z has three securitization exposures, each valued at $100 on the balance sheet. Bank Z chooses to apply the 1,250 percent risk weight to one exposure and use the Gross-Up Approach to calculate risk-weighted assets for the other two exposures. Assume that the risk-weighted asset amount under the Gross-Up Approach is $20 for each exposure.

The bank would report the following:

	(Column A) Totals	(Column B) Adjustments to Totals Reported in Column A	(Column Q) Exposure Amount	(Column T) Total Risk-Weighted Asset Amount by Calculation Methodology	(Column U)	
			1250%	SSFA	Gross-Up	
9. On-balance sheet securitization exposures						
a. Held-to-maturity securities	$300	$200	$100	$0	$40	9.a.

The $200 reported under column B reflects the balance sheet amounts of the two securitization exposures risk weighted using the Gross-Up Approach. This ensures that the sum of columns B and Q continues to equal the amount reported in column A. The $40 under column U reflects the risk-weighted asset amount of the sum of the two securitization exposures that were risk weighted using the Gross-Up Approach. This $40 is included in risk-weighted assets before deductions in item 28 of Schedule RC-R, Part II.

Banks That Are Subject to the Market Risk Capital Rule

The banking agencies' regulatory capital rules require all banks with significant market risk to measure their market risk exposure and hold sufficient capital to mitigate this exposure. In general, a bank is subject to the market risk capital rule if its consolidated trading activity, defined as the sum of trading assets and liabilities as reported in its Call Report for the previous quarter, equals: (1) 10 percent or more of the bank's total assets as reported in its Call Report for the previous quarter, or (2) $1 billion or more. However, a bank’s primary federal supervisory authority may exempt or include the bank if necessary or appropriate for safe and sound banking practices.

A bank that is subject to the market risk capital rule must hold capital to support its exposure to general market risk arising from fluctuations in interest rates, equity prices, foreign exchange rates, and commodity prices and its exposure to specific risk associated with certain debt and equity positions.

Part II. (cont.)

General Instructions for Schedule RC-R, Part II. (cont.)

A covered position is a trading asset or trading liability (whether on- or off-balance sheet), as reported on Schedule RC-D, that is held for any of the following reasons:

(1) For the purpose of short-term resale;
(2) With the intent of benefiting from actual or expected short-term price movements;
(3) To lock in arbitrage profits; or
(4) To hedge another covered position.

Covered positions include all positions in a bank's trading account and foreign exchange and commodity positions, whether or not in the trading account. Covered positions generally should not be risk weighted as part of the bank's credit risk-weighted assets. However, foreign exchange positions that are outside of the trading account and all over-the-counter derivatives as well as cleared transactions and unsettled transactions continue to have a counterparty credit risk capital charge. Those positions are included in both risk-weighted assets for credit risk and the bank's covered positions for market risk.

Additionally, the trading asset or trading liability must be free of any restrictive covenants on its tradability or the bank must be able to hedge the material risk elements of the trading asset or trading liability in a two-way market. A covered position also includes a foreign exchange or commodity position, regardless of whether the position is a trading asset or trading liability (excluding structural foreign currency positions if supervisory approval has been granted to exclude such positions).

A covered position does not include:

(1) An intangible asset (including any servicing asset);
(2) A hedge of a trading position that is outside the scope of the bank's hedging strategy (required by the market risk capital rule);
(3) Any position that, in form or substance, acts as a liquidity facility that provides support to ABCP;
(4) A credit derivative recognized as a guarantee for risk-weighted asset calculation purposes under the regulatory capital rules for credit risk;
(5) An equity position that is not publicly traded (other than a derivative that references a publicly traded equity);
(6) A position held with the intent to securitize; or
(7) A direct real estate holding.

A bank subject to the market risk capital rule must maintain an overall minimum 8.0 percent ratio of total qualifying capital (the sum of Tier 1 capital and Tier 2 capital, net of all deductions) to the sum of risk-weighted assets and market risk-weighted assets. Banks should refer to the regulatory capital rules of their primary federal supervisory authority for specific instructions on the calculation of the measure for market risk.

Adjustments for Financial Subsidiaries

Section 121 of the Gramm-Leach-Bliley Act allows national banks and insured state banks to establish entities known as financial subsidiaries. (Savings associations are not authorized under the Gramm-Leach-Bliley Act to have financial subsidiaries.) One of the statutory requirements for establishing a financial subsidiary is that a national bank or insured state bank must deduct any investment in a financial subsidiary from the bank's assets and tangible equity. Therefore, under the revised regulatory capital rules, a bank must deduct the aggregate amount of its outstanding equity investment in a financial subsidiary, including the retained earnings of the subsidiary, from its common equity tier 1 capital elements in Schedule RC-R, Part I, item 10.b. In addition, the assets and liabilities of the subsidiary may not be consolidated with those of the parent bank for regulatory capital purposes.

Part II. (cont.)

Item No.	Caption and Instructions
13 (cont.)	• Performance standby letters of credit and transaction-related contingent items that must be risk weighted according to the Country Risk Classification (CRC) methodology o *In column C–0% risk weight; column G–20% risk weight*; *column H–50% risk weight; column I–100% risk weight; column J–150% risk weight. Assign these exposures to risk-weight categories based on the CRC methodology described above in the General Instructions for Part II.* Include: o The credit equivalent amount of the portion of performance standby letters of credit, performance bids, bid bonds, and warranties reported in Schedule RC-L, item 3, that have been conveyed to foreign banks.
14	**Commercial and similar letters of credit with an original maturity of one year or less.** Report in column A the face amount of those commercial and similar letters of credit, including self-liquidating trade-related contingent items that arise from the movement of goods, reported in Schedule RC-L, item 4, with an original maturity of one year or less that do not meet the definition of a *securitization exposure* as described in §.2 of the regulatory capital rules. Report those commercial letters of credit with an original maturity exceeding one year that do not meet the definition of a *securitization exposure* in Schedule RC-R, Part II, item 18.b. • *In column B*, report 20 percent of the face amount reported in column A. • *In column C–0% risk weight*, include the credit equivalent amount of the portion of commercial or similar letters of credit with an original maturity of one year or less reported in Schedule RC-L, item 4, that are secured by collateral or has a guarantee that qualifies for the zero percent risk weight. • *In column G–20% risk weight*, include the credit equivalent amount of the portion of commercial and similar letters of credit, including self-liquidating, trade-related contingent items that arise from the movement of goods, with an original maturity of one year or less, reported in Schedule RC-L, item 4, that have been conveyed to U.S. depository institutions. Also include the credit equivalent amount of the portion of commercial or similar letters of credit with an original maturity of one year or less reported in Schedule RC-L, item 4, that are secured by collateral or has a guarantee that qualifies for the 20 percent risk weight. • *In column H–50% risk weight*, include the credit equivalent amount of the portion of commercial or similar letters of credit with an original maturity of one year or less reported in Schedule RC-L, item 4, that are secured by collateral or has a guarantee that qualifies for the 50 percent risk weight. • *In column I–100% risk weight*, include the portion of the credit equivalent amount reported in column B that is not included in columns C through H and J. Also include the credit equivalent amount of the portion of commercial or similar letters of credit with an original maturity of one year or less reported in Schedule RC-L, item 4, that are secured by collateral or has a guarantee that qualifies for the 100 percent risk weight.

Part II. (cont.)

Item No. Caption and Instructions

14 (cont.)
- Commercial and similar letters of credit that must be risk weighted according to the Country Risk Classification (CRC) methodology
  - o *In column C–0% risk weight; column G–20% risk weight*; *column H–50% risk weight; column I–100% risk weight; column J–150% risk weight. Assign these exposures to risk-weight categories based on the CRC methodology described above in the General Instructions for Part II.* Include:
  - o The credit equivalent amount of commercial and similar letters of credit, including self-liquidating, trade-related contingent items that arise from the movement of goods, with an original maturity of one year or less, reported in Schedule RC-L, item 4, that have been conveyed to foreign banks.

15 **Retained recourse on small business obligations sold with recourse.** Report in column A the amount of retained recourse on small business obligations reported in Schedule RC-S, Memorandum item 1.b, that do not meet the definition of a *securitization exposure* as described in §.2 of the regulatory capital rules.

For retained recourse on small business obligations sold with recourse that qualify as securitization exposures, please see §.42(h) of the regulatory capital rule for purposes of risk weighting and report these exposures in Schedule RC-R, Part II, item 10.

Under Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994, a "qualifying institution" that transfers small business loans and leases on personal property (small business obligations) with recourse in a transaction that qualifies as a sale under generally accepted accounting principles (GAAP) must maintain risk-based capital only against the amount of recourse retained, provided the institution establishes a recourse liability account that is sufficient under GAAP. Only loans and leases to businesses that meet the criteria for a small business concern established by the Small Business Administration under Section 3(a) of the Small Business Act (15 U.S.C. 632 et seq.) are eligible for this favorable risk-based capital treatment.

In general, a "qualifying institution" is one that is well capitalized without regard to the Section 208 provisions. If a bank ceases to be a qualifying institution or exceeds the retained recourse limit set forth in banking agency regulations implementing Section 208, all new transfers of small business obligations with recourse would not be treated as sales. However, the reporting and risk-based capital treatment described above will continue to apply to any transfers of small business obligations with recourse that were consummated during the time the bank was a "qualifying institution" and did not exceed the limit.

- *In column B*, report 100 percent of the amount reported in column A.

- *In column C–0% risk weight*, include the credit equivalent amount of the portion of retained recourse on small business obligations sold with recourse reported in Schedule RC-S, Memorandum item 1.b, that are secured by collateral or has a guarantee that qualifies for the zero percent risk weight.

- *In column G–20% risk weight*, include the credit equivalent amount of the portion of retained recourse on small business obligations sold with recourse reported in Schedule RC-S, Memorandum item 1.b, that are secured by collateral or has a guarantee that qualifies for the 20 percent risk weight.

Item Instructions

Bank Securitization Activities

NOTE: After the effective date of the amendments to ASC Topic 860, Transfers and Servicing, and ASC Subtopic 810-10, Consolidation – Overall, resulting from Accounting Standards Update (ASU) No. 2009-16 (formerly FASB Statement No. 166, "Accounting for Transfers of Financial Assets") and ASU No. 2009-17 (formerly FASB Statement No. 167, "Amendments to FASB Interpretation No. 46(R)"), respectively, a bank should report information in Schedule RC-S, items 1 through 8, only for those securitizations for which the transferred assets qualify for sale accounting or are otherwise not carried as assets on the bank's consolidated balance sheet. Thus, if a securitization transaction that qualified for sale accounting prior to the effective date of the amendments to ASC Topic 860 and ASC Subtopic 810-10 must be brought back onto the reporting bank's consolidated balance sheet upon adoption of these statements, the bank would no longer report information about the securitization in Schedule RC-S, items 1 through 8.

Item No. Caption and Instructions

1 Outstanding principal balance of assets sold and securitized by the reporting bank with servicing retained or with recourse or other seller-provided credit enhancements. Report in the appropriate column the principal balance outstanding as of the report date of loans, leases, and other assets which the reporting bank has sold and securitized while:

(1) retaining the right to service these assets, or

(2) when servicing has not been retained, retaining recourse or providing other seller-provided credit enhancements to the securitization structure.

Include in column C the amount outstanding of any credit card fees and finance charges that the reporting bank has securitized and sold in connection with its securitization and sale of credit card receivable balances.

Include the principal balance outstanding of loans the reporting bank has (1) pooled into securities that have been guaranteed by the Government National Mortgage Association (Ginnie Mae) and (2) sold with servicing rights retained.

Exclude the principal balance of loans underlying seller's interests owned by the reporting bank; report the amount of seller's interests in Schedule RC-S, item 6. Also exclude small business obligations transferred with recourse under Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994, which are to be reported in Schedule RC-S, Memorandum item 1, below.

Do ***not*** report in this item the outstanding balance of 1-4 family residential mortgages sold to the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) that the government-sponsored agency in turn securitizes. Report 1-4 family residential mortgages sold to Fannie Mae or Freddie Mac with recourse or other seller-provided credit enhancements in Schedule RC-S, item 11, column A, and report the maximum credit exposure arising from the enhancements in item 12, column A. If servicing has been retained on the 1-4 family residential mortgages, report the outstanding principal balance of the mortgages in Schedule RC-S, Memorandum item 2.a or 2.b depending on whether the servicing is performed with or without recourse or other servicer-provided credit enhancements. If the bank has both retained the servicing and provided credit enhancements, report the principal balance of the 1-4 family residential mortgages in Schedule RC-S, item 11, column A, and in Memorandum item 2.a.

Item No.	Caption and Instructions
1 (cont.)	Exclude securitizations that the reporting bank has accounted for as secured borrowings because the transactions do not meet the criteria for sale accounting under generally accepted accounting principles. The securitized loans, leases, and other assets should continue to be carried as assets on the reporting bank's balance sheet.
2	**Maximum amount of credit exposure arising from recourse or other seller-provided credit enhancements provided to structures reported in item 1.** Report in the appropriate subitem the maximum contractual credit exposure remaining as of the report date under recourse arrangements and other seller-provided credit enhancements provided by the reporting bank to securitization structures reported in Schedule RC-S, item 1, above. Do not report as the remaining maximum contractual exposure a reasonable estimate of the probable loss under the recourse arrangements or credit enhancement provisions or the fair value of any liability incurred under such provisions. Furthermore, do not reduce the remaining maximum contractual exposure by the amount of any associated recourse liability account. Report exposure amounts gross rather than net of any tax effects, e.g., any associated deferred tax liability. Do not include unused portions of commitments that function as liquidity facilities (report such unused commitments in Schedule RC-S, item 3).
2.a	**Credit-enhancing interest-only strips.** Report in the appropriate column the carrying value of credit-enhancing interest-only strips included as securities in Schedules RC-B, as other assets in Schedule RC-F, or as trading assets in Schedule RC, item 5, that the reporting bank has retained as credit enhancements in connection with the securitization structures reported in Schedule RC-S, item 1, above.
2.b	**Subordinated securities and other residual interests.** Report in the appropriate column the carrying value of subordinated securities and other residual interests carried as on-balance sheet assets that the reporting bank has retained in connection with the securitization structures reported in Schedule RC-S, item 1, above. Exclude retained credit-enhancing interest-only strips, which are to be reported in Schedule RC-S, item 2.a, above.
2.c	**Standby letters of credit and other enhancements.** Report in the appropriate column the unused portion of standby letters of credit and the maximum contractual amount of recourse or other credit exposure not in the form of an on-balance sheet asset that the reporting bank has provided or retained in connection with the securitization structures reported in Schedule RC-S, item 1, above.
3	**Reporting bank's unused commitments to provide liquidity to structures reported in item 1.** Report in the appropriate column the unused portions of commitments provided by the reporting bank to the securitization structures reported in Schedule RC-S, item 1, above that function as liquidity facilities.
4	**Past due loan amounts included in item 1.** Report in the appropriate subitem the outstanding principal balance of loans, leases, and other assets reported in Schedule RC-S, item 1, above that are 30 days or more past due as of the report date. For purposes of determining whether a loan, lease, or other asset reported in item 1 above is past due, the reporting criteria to be used are the same as those for columns A and B of Schedule RC-N.
4.a	**30-89 days past due.** Report in the appropriate column the outstanding principal balance of loans, leases, and other assets reported in Schedule RC-S, item 1, above that are 30 to 89 days past due as of the report date.
4.b	**90 days or more past due.** Report in the appropriate column the outstanding principal balance of loans, leases, and other assets reported in Schedule RC-S, item 1, above that are 90 days or more past due as of the report date.

Item No. Caption and Instructions

10 **Reporting bank's unused commitments to provide liquidity to other institutions' securitization structures.** Report in the appropriate column the unused portions of commitments provided by the reporting bank that function as liquidity facilities to securitization structures sponsored by or otherwise established by other institutions or entities, i.e., securitizations not reported in Schedule RC-S, item 1, above. Exclude the amount of unused commitments to provide liquidity to asset-backed commercial paper conduits (report this amount in Schedule RC-S, Memorandum item 3.b, if applicable).

Bank Asset Sales

11 **Assets sold with recourse or other seller-provided credit enhancements and not securitized by the reporting bank.** Report in the appropriate column the unpaid principal balance as of the report date of loans, leases, and other assets, which the reporting bank has sold with recourse or other seller-provided credit enhancements, but which were not securitized by the reporting bank. Include loans, leases, and other assets that the reporting bank has sold with recourse or other seller-provided credit enhancements to other institutions or entities, whether or not the purchaser has securitized the loans and leases purchased from the bank. Include 1-4 family residential mortgages that the reporting bank has sold to the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) with recourse or other seller-provided credit enhancements.

Exclude small business obligations transferred with recourse under Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994, which are to be reported in Schedule RC-S, Memorandum item 1, below.

12 **Maximum amount of credit exposure arising from recourse or other seller-provided credit enhancements provided to assets reported in item 11.** Report in the appropriate column the maximum contractual credit exposure remaining as of the report date under recourse arrangements or other seller-provided credit enhancements provided by the reporting bank in connection with its sales of the loans, leases, and other assets reported in Schedule RC-S, item 11, above. Report the unused portion of standby letters of credit, the carrying value of retained interests, and the maximum contractual amount of recourse or other credit exposure arising from other on- and off-balance sheet credit enhancements that the reporting bank has provided. Do not report as the remaining maximum contractual exposure a reasonable estimate of the probable loss under the recourse arrangements or credit enhancement provisions or the fair value of any liability incurred under such provisions. Furthermore, do not reduce the remaining maximum contractual exposure by the amount of any associated recourse liability account. Report exposure amounts gross rather than net of any tax effects, e.g., any associated deferred tax liability.

Memoranda

Item No.	Caption and Instructions

1 **Small business obligations transferred with recourse under Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994.** Report in the appropriate subitem the outstanding principal balance of and recourse exposure on small business loans and leases on personal property (small business obligations) which the bank has transferred with recourse during the time the bank was a "qualifying institution" and did not exceed the retained recourse limit set forth in banking agency regulations implementing Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994. Transfers of small business obligations with recourse that were consummated during such a time should be reported as sales for Call Report purposes if the transactions are treated as sales under generally accepted accounting principles (GAAP) and the institution establishes a recourse liability account that is sufficient under GAAP.

1.a **Outstanding principal balance.** Report the principal balance outstanding as of the report date for small business obligations which the bank has transferred with recourse while it was a "qualifying institution" and did not exceed the retained recourse limit.

1.b **Amount of retained recourse on these obligations as of the report date.** Report the maximum contractual amount of recourse the bank has retained on the small business obligations whose outstanding principal balance was reported in Schedule RC-S, Memorandum item 1.a, above, not a reasonable estimate of the probable loss under the recourse provision and not the fair value of the liability incurred under this provision. Furthermore, the remaining maximum contractual exposure should not be reduced by the amount of any associated recourse liability account. The amount of recourse exposure to be reported should not include interest payments the bank has advanced on delinquent obligations. For small business obligations transferred with full (unlimited) recourse, the amount of recourse exposure to be reported is the outstanding principal balance of the obligations as of the report date. For small business obligations transferred with limited recourse, the amount of recourse exposure to be reported is the maximum amount of principal the transferring bank would be obligated to pay the holder of the obligations in the event the entire outstanding principal balance of the obligations transferred becomes uncollectible.

2 **Outstanding principal balance of assets serviced for others.** Report in the appropriate subitem the outstanding principal balance of loans and other financial assets the bank services for others, regardless of whether the servicing involves whole loans and other financial assets or only portions thereof, as is typically the case with loan participations. An institution should report the outstanding principal balance of assets for which it is the contractual servicer of record without regard to any subservicing agreements applicable to the assets.

Include (1) the principal balance of loans and other financial assets owned by others for which the reporting bank has purchased the servicing (i.e., purchased servicing) and (2) the principal balance of loans and other financial assets that the reporting bank has either originated or purchased and subsequently sold, whether or not securitized, but for which it has retained the servicing duties and responsibilities (i.e., retained servicing). If the bank services a portion of a loan or other financial asset for one or more other parties and owns the remaining portion of the loan or other financial asset, report only the principal balance of the portion of the asset serviced for others.

A bank should report in Memorandum items 2.a through 2.d retained servicing only for those transferred assets or portions of transferred assets properly reported as sold in accordance with applicable generally accepted accounting principles as well as purchased servicing.

GLOSSARY

The definitions in this Glossary apply to the Consolidated Reports of Condition and Income and are not necessarily applicable for other regulatory or legal purposes. Similarly, the accounting discussions in this Glossary are those relevant to the preparation of these reports and are not intended to constitute a comprehensive presentation on bank accounting. For purposes of this Glossary, the Financial Accounting Standards Board (FASB) Accounting Standards Codification is referred to as the "ASC."

Acceptances: See "bankers acceptances."

Accounting Changes: Changes in accounting principles – The accounting principles that banks have adopted for the preparation of their Consolidated Reports of Condition and Income should be changed only if (a) the change is required by a newly issued accounting pronouncement or (b) the bank can justify the use of an allowable alternative accounting principle on the basis that it is preferable when there are two or more generally accepted accounting principles for a type of event or transaction. If a bank changes from the use of one acceptable accounting principle to one that is more preferable at any time during the calendar year, it must report the income or expense item(s) affected by the change for the entire year on the basis of the newly adopted accounting principle regardless of the date when the change is actually made. However, a change from an accounting principle that is neither accepted nor sanctioned by bank supervisors to one that is acceptable to supervisors is to be reported as a correction of an error as discussed below.

New accounting pronouncements that are adopted by the FASB (or such other body officially designated to establish accounting principles) generally include transition guidance on how to initially apply the pronouncement. In general, the pronouncements require (or allow) a bank to use one of the following approaches, collectively referred to as "retrospective application":

- Apply a different accounting principle to one or more previously issued financial statements; or
- Make a cumulative-effect adjustment to retained earnings, assets, and/or liabilities at the beginning of the period as if that principle had always been used.

Because each Consolidated Report of Income covers a single discrete period, only the second approach under retrospective application is permitted in the Consolidated Reports of Condition and Income. Therefore, when an accounting pronouncement requires the application of either of the approaches under retrospective application, banks must report the effect on the amount of retained earnings at the beginning of the year in which the new pronouncement is first adopted for purposes of the Consolidated Reports of Condition and Income (net of applicable income taxes, if any) as a direct adjustment to equity capital in Schedule RI-A, item 2, and describe the adjustment in Schedule RI-E, item 4.

In the Consolidated Reports of Condition and Income in which a change in accounting principle is first reflected, the bank is encouraged to include an explanation of the nature and reason for the change in accounting principle in Schedule RI-E, item 7, "Other explanations," or in the "Optional Narrative Statement Concerning the Amounts Reported in the Reports of Condition and Income."

Changes in accounting estimates – Accounting and the preparation of financial statements involve the use of estimates. As more current information becomes known, estimates may be changed. In particular, accruals are derived from estimates based on judgments about the outcome of future events and changes in these estimates are an inherent part of accrual accounting.

Reasonable changes in accounting estimates do not require the restatement of amounts of income and expenses and assets, liabilities, and capital reported in previously submitted Consolidated Reports of Condition and Income. Computation of the cumulative effect of these changes is also not ordinarily necessary. Rather, the effect of such changes is handled on a prospective basis. That is, beginning in

Accounting Changes (cont.):

the period when an accounting estimate is revised, the related item of income or expense for that period is adjusted accordingly. For example, if the bank's estimate of the remaining useful life of certain bank equipment is increased, the remaining undepreciated cost of the equipment would be spread over its revised remaining useful life. Similarly, immaterial accrual adjustments to items of income and expenses, including provisions for loan and lease losses and income taxes, are considered changes in accounting estimates and would be taken into account by adjusting the affected income and expense accounts for the year in which the adjustments were found to be appropriate.

However, large and unusual changes in accounting estimates may be more properly treated as constituting accounting errors, and if so, must be reported accordingly as described below.

Corrections of accounting errors – A bank may become aware of an error in a Consolidated Report of Condition or Consolidated Report of Income after it has been submitted to the appropriate federal bank regulatory agency through either its own or its regulator's discovery of the error. An error in the recognition, measurement, or presentation of an event or transaction included in a report for a prior period may result from:

- A mathematical mistake;
- A mistake in applying accounting principles; or
- The oversight or misuse of facts that existed when the Consolidated Reports of Condition and Income for prior periods were prepared.

According to SEC Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108) (Topic 1.N. in the Codification of Staff Accounting Bulletins), the effects of prior year errors or misstatements ("carryover effects") should be considered when quantifying misstatements identified in current year financial statements. SAB 108 describes two methods for accumulating and quantifying misstatements. These methods are referred to as the "rollover" and "iron curtain" approaches:

- The rollover approach "quantifies a misstatement based on the amount of the error originating in the current year income statement" only and ignores the "carryover effects" of any related prior year misstatements. The primary weakness of the rollover approach is that it fails to consider the effects of correcting the portion of the current year balance sheet misstatement that originated in prior years.

- The iron curtain approach "quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement's year(s) of origination." The primary weakness of the iron curtain approach is that it does not consider the correction of prior year misstatements in the current year financial statements to be errors because the prior year misstatements were considered immaterial in the year(s) of origination. Thus, there could be a material misstatement in the current year income statement because the correction of the accumulated immaterial amounts from prior years is not evaluated as an error.

Because of the weaknesses in these two approaches, SAB 108 states that the impact of correcting all misstatements on current year financial statements should be accomplished by quantifying an error under both the rollover and iron curtain approaches and by evaluating the error measured under each approach. When either approach results in a misstatement that is material, after considering all relevant quantitative and qualitative factors, an adjustment to the financial statements would be required. Guidance on the consideration of all relevant factors when assessing the materiality of misstatements is provided in SEC Staff Accounting Bulletin No. 99, *Materiality* (SAB 99) (Topic 1.M. in the Codification of Staff Accounting Bulletins).

Acquisition, Development, or Construction (ADC) Arrangements: An ADC arrangement is an arrangement in which a bank provides financing for real estate acquisition, development, or construction purposes and participates in the expected residual profit resulting from the ultimate sale or other use of the property. ADC arrangements should be reported as loans, real estate joint ventures, or direct investments in real estate in accordance with ASC Subtopic 310-10, Receivables – Overall (formerly AICPA Practice Bulletin 1, Appendix, Exhibit I, "ADC Arrangements").

12 USC 29 limits the authority of national banks to hold real estate. National banks should review real estate ADC arrangements carefully for compliance. State member banks are not authorized to invest in real estate except with the prior approval of the Federal Reserve Board under Federal Reserve Regulation H (12 CFR Part 208). In certain states, nonmember banks may invest in real estate.

Under the agencies' regulatory capital rules, the term high volatility commercial real estate (HVCRE) exposure is defined, in part, to mean a credit facility that, prior to conversion to permanent financing, finances or has financed the acquisition, development, or construction of real property. (See §.2 of the regulatory capital rules and the instructions for Schedule RC-R, Part II, item 4.b.) Institutions should note that the meaning of the term ADC as used in the definition of HVCRE exposure in the regulatory capital rules differs from the meaning of ADC arrangement for accounting purposes in ASC Subtopic 310-10 as described above in this Glossary entry. For example, an institution's participation in the expected residual profit from a property is part of the accounting definition of an ADC arrangement, but whether the institution participates in the expected residual profit is not a consideration for purposes of determining whether a credit facility is an HVCRE exposure for regulatory capital purposes. Thus, a loan can be treated as an HVCRE exposure for regulatory capital purposes even though it does not provide for the institution to participate in the property's expected residual profit.

Agreement Corporation: See "Edge and Agreement corporation."

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Allowance for Loan and Lease Losses: Each bank must maintain an allowance for loan and lease losses (allowance) at a level that is appropriate to cover estimated credit losses associated with its loan and lease portfolio, i.e., loans and leases that the bank has intent and ability to hold for the foreseeable future or until maturity or payoff. Each bank should also maintain, as a separate liability account, an allowance at a level that is appropriate to cover estimated credit losses associated with off-balance sheet credit instruments such as off-balance sheet loan commitments, standby letters of credit, and guarantees. This separate allowance should be reported in Schedule RC-G, item 3, "Allowance for credit losses on off-balance sheet credit exposures," not as part of the "Allowance for loan and lease losses" in Schedule RC, item 4.c.

With respect to the loan and lease portfolio, the term "estimated credit losses" means an estimate of the current amount of loans and leases that it is probable the bank will be unable to collect given facts and circumstances as of the evaluation date. Thus, estimated credit losses represent net charge-offs that are likely to be realized for a loan or pool of loans. These estimated credit losses should meet the criteria for accrual of a loss contingency (i.e., through a provision to the allowance) set forth in generally accepted accounting principles (GAAP).

As of the end of each quarter, or more frequently if warranted, the management of each bank must evaluate, subject to examiner review, the collectibility of the loan and lease portfolio, including any recorded accrued and unpaid interest (i.e., not already reversed or charged off), and make entries to maintain the balance of the allowance for loan and lease losses on the balance sheet at an appropriate level. Management must maintain reasonable records in support of their evaluations and entries. Furthermore, each bank is responsible for ensuring that controls are in place to consistently determine the allowance for loan and lease losses in accordance with GAAP (including ASC Subtopic 450-20, Contingencies – Loss Contingencies (formerly FASB Statement No. 5, "Accounting for Contingencies") and ASC Topic 310, Receivables (formerly FASB Statement No. 114, "Accounting by Creditors for Impairment of a Loan"), the bank's stated policies and procedures, management's best judgment and relevant supervisory guidance.

Additions to, or reductions of, the allowance account resulting from such evaluations are to be made through charges or credits to the "provision for loan and lease losses" (provision) in the Report of Income. When available information confirms that specific loans and leases, or portions thereof, are uncollectible, these amounts should be promptly charged off against the allowance. All charge-offs of loans and leases shall be charged directly to the allowance. Under no circumstances can loan or lease losses be charged directly to "Retained earnings." Recoveries on loans and leases represent collections on amounts that were previously charged off against the allowance. Recoveries shall be credited to the allowance, provided, however, that the total amount credited to the allowance as recoveries on an individual loan (which may include amounts representing principal, interest, and fees) is limited to the amount previously charged off against the allowance on that loan. Any amounts collected in excess of this limit should be recognized as income.

ASC Subtopic 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality (formerly AICPA Statement of Position 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer") prohibits a bank from "carrying over" or creating loan loss allowances in the initial accounting for "purchased credit-impaired loans," i.e., loans that a bank has purchased where there is evidence of deterioration of credit quality since the origination of the loan and it is probable, at the purchase date, that the bank will be unable to collect all contractually required payments receivable. This prohibition applies to the purchase of an individual impaired loan, a pool or group of impaired loans, and impaired loans acquired in a purchase business combination. However, if, upon evaluation subsequent to acquisition, based on current information and events, it is probable that the bank is unable to collect all cash flows expected at acquisition (plus additional cash flows expected to be collected arising from changes in estimate after acquisition) on a purchased credit-impaired loan (not accounted for as a debt security), the loan should be considered impaired for purposes of establishing an allowance pursuant to ASC Subtopic 450-20 or ASC Topic 310, as appropriate. For further information, see the Glossary entry for "purchased credit-impaired loans and debt securities."

When a bank makes a full or partial direct write-down of a loan or lease that is uncollectible, the bank establishes a new cost basis for the asset. Consequently, once a new cost basis has been established

Allowance for Loan and Lease Losses (cont.):

for a loan or lease through a direct write-down, this cost basis may not be "written up" at a later date. Reversing the previous write-down and "re-booking" the charged-off asset after the bank concludes that the prospects for recovering the charge-off have improved, regardless of whether the bank assigns a new account number to the asset or the borrower signs a new note, is not an acceptable accounting practice.

The allowance account must never have a debit balance. If losses charged off exceed the amount of the allowance, a provision sufficient to restore the allowance to an appropriate level must be charged to expense on the income statement immediately. A bank shall not increase the allowance account by transferring an amount from undivided profits or any segregation thereof to the allowance for loan and lease losses.

To the extent that a bank's reserve for bad debts for tax purposes is greater than or less than its "allowance for loan and lease losses" on the balance sheet of the Report of Condition, the difference is referred to as a temporary difference. See the Glossary entry for "income taxes" for guidance on how to report the tax effect of such a temporary difference.

Recourse liability accounts that arise from recourse obligations for any transfers of loans that are reported as sales for purposes of these reports should not be included in the allowance for loan and lease losses. These accounts are considered separate and distinct from the allowance account and from the allowance for credit losses on off-balance sheet credit exposures. Recourse liability accounts should be reported in Schedule RC-G, item 4, "All other liabilities."

For comprehensive guidance on the maintenance of an appropriate allowance for loan and lease losses, banks should refer to the Interagency Policy Statement on the Allowance for Loan and Lease Losses dated December 13, 2006. For guidance on the design and implementation of allowance methodologies and supporting documentation practices, banks should refer to the interagency Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Associations, which was published on July 6, 2001. National banks should also refer to the Office of the Comptroller of the Currency's Handbook for National Bank Examiners discussing the allowance for loan and lease losses. Information on the application of ASC Topic 310, Receivables, to the determination of an allowance for loan and lease losses on those loans covered by that accounting standard is provided in the Glossary entry for "loan impairment."

For information on reporting on foreclosed and repossessed assets, see the Glossary entry for "foreclosed assets."

Applicable Income Taxes: See "income taxes."

Associated Company: See "subsidiaries."

ATS Account: See "deposits."

Bankers Acceptances: A banker's acceptance, for purposes of these reports, is a draft or bill of exchange that has been drawn on and accepted by a banking institution (the "accepting bank") or its agent for payment by that institution at a future date that is specified in the instrument. Funds are advanced to the drawer of the acceptance by the discounting of the accepted draft either by the accepting bank or by others; the accepted draft is negotiable and may be sold and resold subsequent to its original discounting. At the maturity date specified, the holder or owner of the acceptance at that date, who has advanced funds either by initial discount or subsequent purchase, presents the accepted draft to the accepting bank for payment.

The accepting bank has an unconditional obligation to put the holder in funds (to pay the holder the face amount of the draft) on presentation on the specified date. The account party (customer) has an unconditional obligation to put the accepting bank in funds at or before the maturity date specified in the instrument.

Loan Fees (cont.):

All other lending-related costs, whether or not incremental, should be charged to expense as incurred, including costs related to activities performed by the lender for advertising, identifying potential borrowers, soliciting potential borrowers, servicing existing loans, and other ancillary activities related to establishing and monitoring credit policies, supervision, and administration. Employees' compensation and fringe benefits related to these activities, unsuccessful loan origination efforts, and idle time should be charged to expense as incurred. Administrative costs, rent, depreciation, and all other occupancy and equipment costs are considered indirect costs and should be charged to expense as incurred.

Net unamortized loan fees represent an adjustment of the loan yield, and shall be reported in the same manner as unearned income on loans, i.e., deducted from the related loan balances (to the extent possible) or deducted from total loans in "Any unearned income on loans reflected in items 1-9 above" in Schedule RC-C, part I. Net unamortized direct loan origination costs shall be added to the related loan balances in Schedule RC-C, part I. Amounts of loan origination, commitment, and other fees and costs recognized as an adjustment of yield should be reported under the appropriate subitem of item 1, "Interest income," in Schedule RI. Other fees, such as (a) commitment fees that are recognized during the commitment period or included in income when the commitment expires (i.e., fees retrospectively determined and fees for commitments where exercise is remote) and (b) syndication fees that are not deferred, should be reported as "Other noninterest income" on Schedule RI.

Loan Impairment: The accounting standard for impaired loans is ASC Topic 310, Receivables (formerly FASB Statement No. 114, "Accounting by Creditors for Impairment of a Loan," as amended). For further information, refer to ASC Topic 310.

Each institution is responsible for maintaining an allowance for loan and lease losses (allowance) at a level that is appropriate to cover estimated credit losses in its entire portfolio of loans and leases held for investment, i.e., loans and leases that the bank has the intent and ability to hold for the foreseeable future or until maturity or payoff. ASC Topic 310 sets forth measurement methods for estimating the portion of the overall allowance for loan and lease losses attributable to individually impaired loans. For the remainder of the portfolio, an appropriate allowance must be maintained in accordance with ASC Subtopic 450-20, Contingencies – Loss Contingencies (formerly FASB Statement No. 5, “Accounting for Contingencies”). For comprehensive guidance on the maintenance of an appropriate allowance, banks should refer to the Interagency Policy Statement on the Allowance for Loan and Lease Losses dated December 13, 2006, and the Glossary entry for “allowance for loan and lease losses." National banks should also refer to the Office of the Comptroller of the Currency's Handbook for National Bank Examiners discussing the allowance for loan and lease losses.

In general, loans are impaired under ASC Topic 310 when, based on current information and events, it is probable that an institution will be unable to collect all amounts due (i.e., both principal and interest) according to the contractual terms of the original loan agreement. An institution should apply its normal loan review procedures when identifying loans to be individually evaluated for impairment under ASC Topic 310. When an individually evaluated loan is deemed impaired under ASC Topic 310 and is not collateral dependent, an institution must measure impairment using the present value of expected future cash flows discounted at the loan’s effective interest rate (i.e., the contractual interest rate adjusted for any net deferred loan fees or costs, premium, or discount existing at the origination or acquisition of the loan), except that as a practical expedient, an institution may measure impairment based on a loan’s observable market price. As discussed in the following paragraph, the agencies require the impairment of an impaired collateral dependent loan to be measured using the fair value of collateral method. A loan is collateral dependent if repayment of the loan is expected to be provided solely by the underlying collateral and there are no other available and reliable sources of repayment. A creditor should consider estimated costs to sell, on a discounted basis, in the measurement of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy

Loan Impairment (cont.):

the loan. If the measure of an impaired loan is less than the recorded investment in the loan, an impairment should be recognized by creating an allowance for estimated credit losses for the impaired loan or by adjusting an existing allowance with a corresponding charge or credit to "Provision for loan and lease losses."

For purposes of the Reports of Condition and Income, the impairment of an impaired collateral dependent loan must be measured using the fair value of collateral method. In general, any portion of the recorded investment in an impaired collateral dependent loan (including recorded accrued interest, net deferred loan fees or costs, and unamortized premium or discount) in excess of the fair value of the collateral (less estimated costs to sell, if applicable) that can be identified as uncollectible should be promptly charged off against the allowance for loan and lease losses.

An institution should not provide an additional allowance for estimated credit losses on an individually impaired loan over and above what is specified by ASC Topic 310. The allowance established under ASC Topic 310 should take into consideration all available information existing as of the Call Report date that indicates that it is probable that a loan has been impaired. All available information would include existing environmental factors such as industry, geographical, economic, and political factors that affect collectibility.

ASC Topic 310 also addresses the accounting by creditors for all loans that are restructured in troubled debt restructurings involving a modification of terms, except loans that are measured at fair value or the lower of cost or fair value. According to ASC Topic 310, all loans restructured in troubled debt restructurings are impaired loans. For guidance on troubled debt restructurings, see the Glossary entry for "troubled debt restructurings."

As with all other loans, all impaired loans should be reported as past due or nonaccrual loans in Schedule RC-N in accordance with the schedule's instructions. A loan identified as impaired is one for which it is probable that the institution will be unable to collect all principal and interest amounts due according to the contractual terms of the original loan agreement. Therefore, a loan that is not already in nonaccrual status when it is first identified as impaired will normally meet the criteria for placement in nonaccrual status at that time. Exceptions may arise when a loan not previously in nonaccrual status is identified as impaired because its terms have been modified in a troubled debt restructuring, but the borrower's sustained historical repayment performance for a reasonable time prior to the restructuring is consistent with the modified terms of the loan and the loan is reasonably assured of repayment (of principal and interest) and of performance in accordance with its modified terms. This determination must be supported by a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. Exceptions may also arise for those purchased credit-impaired loans for which the criteria for accrual of income under the interest method are met as specified in ASC Subtopic 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality (formerly AICPA Statement of Position 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer"). Any cash payments received on impaired loans in nonaccrual status should be reported in accordance with the criteria for the cash basis recognition of income in the Glossary entry for "nonaccrual status." For further guidance, see the Glossary entries for "nonaccrual status" and "purchased credit-impaired loans and debt securities."

Loan Secured by Real Estate: For purposes of these reports, a loan secured by real estate is a loan that, at origination, is secured wholly or substantially by a lien or liens on real property for which the lien or liens are central to the extension of the credit – that is, the borrower would not have been extended credit in the same amount or on terms as favorable without the lien or liens on real property. To be considered wholly or substantially secured by a lien or liens on real property, the estimated value of the real estate collateral at origination (after deducting any more senior liens held by others) must be greater than 50 percent of the principal amount of the loan at origination.

Securities Activities (cont.):

of applicable taxes, should be reported in item 10 of Schedule RI-A, Changes in Bank Equity Capital, and included on the balance sheet in Schedule RC, item 26.b, "Accumulated other comprehensive income." The amount of other-than-temporary impairment losses on held-to-maturity and available-for-sale debt securities recognized in earnings during the current calendar year-to-date reporting period should be reported in Schedule RI, Memorandum item 14. For a held-to-maturity debt security on which the institution has recognized an other-than-temporary impairment loss related to factors other than credit loss in other comprehensive income, the institution should report the carrying value of the debt security in Schedule RC, item 2.a, and in column A of Schedule RC-B, Securities. Under ASC Topic 320, this carrying value should be the fair value of the held-to-maturity debt security as of the date of the most recently recognized other-than-temporary impairment loss adjusted for subsequent accretion of the impairment loss related to factors other than credit loss.

The proper categorization of securities is important to ensure that trading gains and losses are promptly recognized in earnings and regulatory capital. This will not occur when securities intended to be held for trading purposes are categorized as held-to-maturity or available-for-sale. The following practices are considered trading activities:

(1) Gains Trading – Gains trading is characterized by the purchase of a security and the subsequent sale of the same security at a profit after a short holding period, while securities acquired for this purpose that cannot be sold at a profit are typically retained in the available-for-sale or held-to-maturity portfolio. Gains trading may be intended to defer recognition of losses, as unrealized losses on available-for-sale and held-to-maturity debt securities do not directly affect regulatory capital and generally are not reported in income until the security is sold.

(2) When-Issued Securities Trading – When-issued securities trading is the buying and selling of securities in the period between the announcement of an offering and the issuance and payment date of the securities. A purchase of a "when-issued" security acquires the risks and rewards of owning a security and may sell the when-issued security at a profit before having to take delivery and pay for it. Because such transactions are intended to generate profits from short-term price movements, they should be categorized as trading.

(3) Pair-offs – Pair-offs are security purchase transactions that are closed-out or sold at, or prior to, settlement date. In a pair-off, an institution commits to purchase a security. Then, prior to the predetermined settlement date, the institution will pair-off the purchase with a sale of the same security. Pair-offs are settled net when one party to the transaction remits the difference between the purchase and the sale price to the counterparty. Pair-offs may also involve the same sequence of events using swaps, options on swaps, forward commitments, options on forward commitments, or other off-balance sheet derivative contracts.

(4) Extended Settlements – In the U.S., regular-way settlement for federal government and federal agency securities (except mortgage-backed securities and derivative contracts) is one business day after the trade date. Regular-way settlement for corporate and municipal securities is three business days after the trade date. For mortgage-backed securities, it can be up to 60 days or more after the trade date. The use of extended settlements may be offered by securities dealers in order to facilitate speculation on the part of the purchaser, often in connection with pair-off transactions. Securities acquired through the use of a settlement period in excess of the regular-way settlement periods in order to facilitate speculation should be reported as trading assets.

(5) Repositioning Repurchase Agreements – A repositioning repurchase agreement is a funding technique offered by a dealer in an attempt to enable an institution to avoid recognition of a loss. Specifically, an institution that enters into a "when-issued" trade or a "pair-off" (which may include an extended settlement) that cannot be closed out at a profit on the payment or settlement date will be provided dealer financing in an effort to fund its speculative position until the security can be sold at a gain. The institution purchasing the security typically pays the dealer a small margin that

Securities Activities (cont.):

approximates the actual loss in the security. The dealer then agrees to fund the purchase of the security, typically buying it back from the purchaser under a resale agreement. Any securities acquired through a dealer financing technique such as a repositioning repurchase agreement that is used to fund the speculative purchase of securities should be reported as trading assets.

(6) Short Sales – A short sale is the sale of a security that is not owned. The purpose of a short sale generally is to speculate on a fall in the price of the security. (For further information, see the Glossary entry for "short position.")

One other practice, referred to as "adjusted trading," is not acceptable under any circumstances. Adjusted trading involves the sale of a security to a broker or dealer at a price above the prevailing market value and the contemporaneous purchase and booking of a different security, frequently a lower-rated or lower quality issue or one with a longer maturity, at a price above its market value. Thus, the dealer is reimbursed for losses on the purchase from the institution and ensured a profit. Such transactions inappropriately defer the recognition of losses on the security sold and establish an excessive cost basis for the newly acquired security. Consequently, such transactions are prohibited and may be in violation of 18 U.S.C. Sections 1001–Statements or Entries Generally and 1005–Bank Entries, Reports and Transactions.

See also "trading account."

Securities Borrowing/Lending Transactions: Securities borrowing/lending transactions are typically initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer's failure to deliver securities sold. A transferee ("borrower") of securities generally is required to provide "collateral" to the transferor ("lender") of securities, commonly cash but sometimes other securities or standby letters of credit, with a value slightly higher than that of the securities "borrowed."

Most securities borrowing/lending transactions do not qualify as sales under ASC Topic 860, Transfers and Servicing (formerly FASB Statement No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” as amended), because the agreement entitles and obligates the securities lender to repurchase or redeem the transferred assets before their maturity. (See the Glossary entry for "transfers of financial assets" for further discussion of sale criteria.) When such transactions do not qualify as sales, securities lenders and borrowers should account for the transactions as secured borrowings in which cash (or securities that the holder is permitted by contract or custom to sell or repledge) received as "collateral" by the securities lender is considered the amount borrowed and the securities "loaned" are considered pledged as collateral against the amount borrowed. The "loaned" securities should continue to be reported on the securities lender's balance sheet as available-for-sale securities, held-to-maturity securities, or trading assets, as appropriate. "Loaned" securities that are reported as available-for-sale or held-to-maturity securities in Schedule RC-B, Securities, should also be reported as "Pledged securities" in Memorandum item 1 of that schedule. Similarly, “loaned” securities that are reported as trading assets in Schedule RC-D, Trading Assets and Liabilities, should be reported as “Pledged securities” in Memorandum item 4.a of that schedule.

If the securities borrowing/lending transaction meets the criteria for a sale under ASC Topic 860, the lender of the securities should remove the securities from its balance sheet, record the proceeds from the sale of the securities (including the forward repurchase commitment), and recognize any gain or loss on the transaction. The borrower of the securities should record the securities on its balance sheet at fair value and record the payment for the purchased assets (including the forward resale commitment).

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

<u>Servicing Assets and Liabilities:</u> The accounting and reporting standards for servicing assets and liabilities are set forth in ASC Subtopic 860-50, Transfers and Servicing – Servicing Assets and Liabilities (formerly FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," as amended by FASB Statement No. 156, “Accounting for Servicing of Financial Assets,” and FASB Statement No. 166, “Accounting for Transfers of Financial Assets”), and ASC Topic 948, Financial Services-Mortgage Banking (formerly FASB Statement No. 65, "Accounting for Certain Mortgage Banking Activities," as amended by Statement No. 140). A summary of the relevant sections of these accounting standards follows. For further information, see ASC Subtopic 860-50, ASC Topic 948, 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 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 for accounting purposes only in certain circumstances as discussed below. Servicing assets result from contracts to service financial assets under which the benefits of servicing (estimated future revenues from <u>contractually specified servicing fees</u>, late charges, and other ancillary sources) are expected to more than <u>adequately compensate</u> the servicer for performing the servicing. Servicing liabilities result from contracts to service financial assets under which the benefits of servicing are not expected to adequately compensate the servicer for performing the servicing. <u>Contractually specified servicing fees</u> 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. <u>Adequate compensation</u> 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.

A bank must recognize and initially measure at fair value a servicing asset or a servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in either of the following situations:

(1) The bank’s transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that meets the requirements for sale accounting; or

(2) An acquisition or assumption of a servicing obligation that does not relate to financial assets of the bank or its consolidated affiliates included in the Reports of Condition and Income being presented.

If a bank sells a participating interest in an entire financial asset, it only recognizes a servicing asset or servicing liability related to the participating interest sold.

A bank that transfers its financial assets to an unconsolidated entity in a transfer that qualifies as a sale in which the bank obtains the resulting securities and classifies them as debt securities held-to-maturity in accordance with ASC Topic 320, Investments–Debt and Equity Securities (formerly FASB Statement No. 115, “Accounting for Certain Investments in Debt and Equity Securities”), may either separately recognize its servicing assets or servicing liabilities or report those servicing assets or servicing liabilities together with the assets being serviced.

Servicing Assets and Liabilities (cont.):

A bank should account for its servicing contract that qualifies for separate recognition as a servicing asset or servicing liability initially measured at fair value regardless of whether explicit consideration was exchanged. A bank that transfers or securitizes financial assets in a transaction that does not meet the requirements for sale accounting under ASC Topic 860 and is accounted for as a secured borrowing with the underlying assets remaining on the bank's balance sheet must not recognize a servicing asset or a servicing liability.

After initially measuring a servicing asset or servicing liability at fair value, a bank should subsequently measure each class of servicing assets and servicing liabilities using either the amortization method or the fair value measurement method. The election of the subsequent measurement method should be made separately for each class of servicing assets and servicing liabilities. A bank must apply the same subsequent measurement method to each servicing asset and servicing liability in a class. Each bank should identify its classes of servicing assets and servicing liabilities based on (a) the availability of market inputs used in determining the fair value of servicing assets and servicing liabilities, (b) the bank's method for managing the risks of its servicing assets or servicing liabilities, or (c) both. Different elections can be made for different classes of servicing. For a class of servicing assets and servicing liabilities that is subsequently measured using the amortization method, a bank may change the subsequent measurement method for that class of servicing by making an irrevocable decision to elect the fair value measurement method for that class at the beginning of any fiscal year. Once a bank elects the fair value measurement method for a class of servicing, that election must not be reversed.

Under the amortization method, all servicing assets or servicing liabilities in the class should be amortized in proportion to, and over the period of, estimated net servicing income for assets (servicing revenues in excess of servicing costs) or net servicing loss for liabilities (servicing costs in excess of servicing revenues). The servicing assets or servicing liabilities should be assessed for impairment or increased obligation based on fair value at each quarter-end report date. The servicing assets within a class should be stratified into groups based on one or more of the predominant risk characteristics of the underlying financial assets. If the carrying amount of a stratum of servicing assets exceeds its fair value, the bank should separately recognize impairment for that stratum by reducing the carrying amount to fair value through a valuation allowance for that stratum. The valuation allowance should be adjusted to reflect changes in the measurement of impairment subsequent to the initial measurement of impairment. For the servicing liabilities within a class, if subsequent events have increased the fair value of the liability above the carrying amount of the servicing liabilities, the bank should recognize the increased obligation as a loss in current earnings.

Under the fair value measurement method, all servicing assets or servicing liabilities in a class should be measured at fair value at each quarter-end report date. Changes in the fair value of these servicing assets and servicing liabilities should be reported in earnings in the period in which the changes occur.

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 2.a, "Mortgage servicing assets." Servicing assets resulting from contracts to service all other financial assets should be reported in Schedule RC-M, item 2.b, "Purchased credit card relationships and nonmortgage servicing assets." When reporting the carrying amount of mortgage servicing assets in Schedule RC-M, item 2.a, and

Servicing Assets and Liabilities (cont.):

nonmortgage servicing assets in Schedule RC-M, item 2.b, banks should include all classes of servicing accounted for under the amortization method as well as all classes of servicing accounted for under the fair value measurement method. The fair value of all recognized mortgage servicing assets should be reported in Schedule RC-M, item 2.a.(1), regardless of the subsequent measurement method applied to these assets. The amount of mortgage servicing assets reported in Schedule RC-M, item 2.a, should be used when determining the amount of such assets, net of associated deferred tax liabilities, that exceed the 10 and 15 percent common equity tier 1 capital deduction thresholds in Schedule RC-R, Part I. Servicing liabilities should be reported in Schedule RC-G, item 4, "All other liabilities." If the amount of servicing liabilities is greater than $100,000 and exceeds 25 percent of "All other liabilities," this amount should be itemized and described in Schedule RC-G, item 4.e, 4.f, or 4.g, as appropriate.

Servicing assets and servicing liabilities may not be netted on the balance sheet (Schedule RC), but must be reported gross as assets and liabilities, respectively.

Changes in the fair value of any class of servicing assets and servicing liabilities accounted for under the fair value measurement method should be included in earnings in Schedule RI, item 5.f, "Net servicing fees." In addition, certain information about assets serviced by the reporting bank should be reported in Schedule RC-S, Servicing, Securitization, and Asset Sale Activities.

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, "Trading liabilities." In this situation, the right to receive payment shall be reported in Schedule RC-F, item 6, "All 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 Letter of Credit: See "letter of credit."

Start-Up Activities: Guidance on the accounting and reporting for the costs of start-up activities, including organization costs, is set forth in ASC Subtopic 720-15, Other Expenses – Start-Up Costs (formerly AICPA Statement of Position 98-5, "Reporting on the Costs of Start-Up Activities"). A summary of this accounting guidance follows. For further information, see ASC Subtopic 720-15.

Start-up activities are defined broadly as those one-time activities related to opening a new facility, introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer, or commencing some new operation. Start-up activities include activities related to organizing a new entity, such as a new bank, the costs of which are commonly referred to as organization costs.[1]

[1] Organization costs for a bank are the direct costs incurred to incorporate and charter the bank. Such costs include, but are not limited to, professional (e.g., legal, accounting, and consulting) fees and printing costs directly related to the chartering or incorporation process, filing fees paid to chartering authorities, and the cost of economic impact studies.

Start-Up Activities (cont.):

Costs of start-up activities, including organization costs, should be expensed as incurred. Costs of acquiring or constructing premises and fixed assets and getting them ready for their intended use are not start-up costs, but the costs of using such assets that are allocated to start-up activities (e.g., depreciation of computers) are considered start-up costs.

For a new bank, pre-opening expenses such as salaries and employee benefits, rent, depreciation, supplies, directors' fees, training, travel, postage, and telephone are considered start-up costs.

Pre-opening income earned and expenses incurred from the bank's inception until the date the bank commences operations should be reported in the Consolidated Report of Income using one of the two following methods, consistent with the manner in which the bank reports pre-opening income and expenses for other financial reporting purposes:

(1) Pre-opening income and expenses for the entire period from the bank's inception until the date the bank commences operations should be reported in the appropriate items of Schedule RI, Income Statement, each quarter during the calendar year in which operations commence; or

(2) Pre-opening income and expenses for the period from the bank's inception until the beginning of the calendar year in which the bank commences operations should be included, along with the bank's opening (original) equity capital, in Schedule RI-A, item 5, "Sale, conversion, acquisition, or retirement of capital stock, net." The net amount of these pre-opening income and expenses should be identified and described in Schedule RI-E, item 7. Pre-opening income earned and expenses incurred during the calendar year in which the bank commences operations should be reported in the appropriate items of Schedule RI, Income Statement, each quarter during the calendar year in which operations commence.

The organization costs of forming a holding company and the costs of other holding company start-up activities are sometimes paid by the bank that will be owned by the holding company. Because these are the holding company's costs, whether or not the holding company formation is successful, they should not be reported as expenses of the bank. Accordingly, any unreimbursed costs paid by the bank on behalf of the holding company should be reported as a cash dividend to the holding company in Schedule RI-A, item 9. In addition, if a new bank and holding company are being formed at the same time, the costs of the bank's start-up activities, including its organization costs, should be reported as start-up costs for the bank. If the holding company pays these costs for the bank but is not reimbursed by the bank, the bank should treat the holding company's forgiveness of payment as a capital contribution, which should be reported in Schedule RI-A, item 11, "Other transactions with stockholders (including a parent holding company)," and in Schedule RI-E, item 5.

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.