Instructions for Preparation of Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only and Total Assets Less than $1 Billion

FFIEC 051

As of September 30, 2017

Redlined Copy
Showing Changes Made to
the Initial (March 31, 2017)
Version of the Instructions
for the FFIEC 051 Call Report
(Includes Pages with Changes Only)

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Eligibility to File the FFIEC 051

Institutions with domestic offices only and total assets less than $1 billion, excluding those that are advanced approaches institutions for regulatory capital purposes,[1] are eligible to file the FFIEC 051 Call Report. An institution's total assets are measured as of June 30 each year to determine the institution's eligibility to file the FFIEC 051 beginning in March of the following year.

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

Close of Business

The term "close of business" refers to the time established by the reporting bank as the cut-off time for receipt of work for posting transactions to its general ledger accounts for that day. The time designated as the close of business should be reasonable and applied consistently. The posting of a transaction to the general ledger means that both debit and credit entries are recorded as of the same date. In addition, entries made to general ledger accounts in the period subsequent to the close of business on the report date that are applicable to the period covered by the Call Report (e.g., adjustments of accruals, posting of items held in suspense on the report date to their proper accounts, and other quarter-end adjusting entries) should be reported in the Call Report as if they had actually been posted to the general ledger at or before the cut-off time on the report date.

With respect to deposits received by the reporting bank after the cut-off time for posting them to individual customer accounts for a report date (i.e., so-called "next day deposits" or "late deposits"), but which are nevertheless posted in any manner to the reporting bank's general ledger accounts for that report date (including, but not limited to, through the use of one or more general ledger contra accounts), such deposits must be reported in Schedule RC-O, Other Data for Deposit Insurance and FICO Assessments, item 1, and may also be reported in Schedule RC, Balance Sheet, item 13, "Deposits," and Schedule RC-E, Deposit Liabilities. However, the use of memorandum accounts outside the reporting bank's general ledger system for control over "next day" or "late deposits" received on the report date does not in and of itself make such deposits reportable in Schedule RC-O and Schedules RC and RC-E.

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[1] In general, an advanced approaches institution, as defined in the regulatory capital rules, has consolidated total assets equal to $250 billion or more, has consolidated total on-balance sheet foreign exposure equal to $10 billion or more, is a subsidiary of a depository institution or holding company that uses the advanced approaches to calculate its total risk-weighted assets, or elects to use the advanced approaches to calculate its total risk-weighted assets. The regulatory capital rules are set forth in 12 CFR Part 3 for national banks and federal savings associations; 12 CFR Part 217 for state member banks; and 12 CFR Part 324 for state nonmember banks and state savings associations.

Part II. (cont.)

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

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 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.

For further information, a bank with one or more financial subsidiaries should refer to the discussion of "Adjustments for Financial Subsidiaries" in the General Instructions for Schedule RC-R, Part II, in the instructions for the FFIEC 031 and FFIEC 041 Call Reports.

Treatment of Embedded Derivatives

If a bank has a hybrid contract containing an embedded derivative that must be separated from the host contract and accounted for as a derivative instrument under ASC Topic 815, Derivatives and Hedging (formerly FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended), then the host contract and embedded derivative should be treated separately for risk-based capital purposes. When the fair value of the embedded derivative has been reported as part of the bank's assets on Schedule RC – Balance Sheet, that fair value (whether positive or negative) should be reported (as a positive or negative number) in column B of the corresponding asset category item in Schedule RC-R, Part II (items 1 to 8). The host contract, if an asset, should be risk weighted according to the obligor or, if relevant, the guarantor or the nature of the collateral. All derivative exposures should be risk weighted in the derivative items of Schedule RC-R, Part II, as appropriate (items 20 or 21).

Reporting Exposures Hedged with Cleared Eligible Credit Derivatives

Institutions are able to obtain full or partial protection for (i.e., "hedge") on-balance sheet assets or off-balance sheet items using credit derivatives that are cleared through a qualified central counterparty (QCCP) or a central counterparty (CCP) that is not a QCCP. In some cases, a cleared credit derivative used for this purpose meets the definition of an eligible credit derivative in §.2 of the regulatory capital rules. In these cases, under §.36 of the regulatory capital rules, an institution that is a clearing member or a clearing member client may recognize the credit risk mitigation benefits of the eligible credit derivative. More specifically, the risk weight of the underlying exposure (e.g., 20 percent, 50 percent, or 100 percent) may be replaced with the risk weight of the CCP or QCCP as the protection provider if the credit derivative is an eligible credit derivative, is cleared through a CCP or a QCCP, and meets the applicable requirements under §.35 and §.36 of the regulatory capital rules. The risk weight for an eligible credit derivative cleared through a QCCP is 2 percent or 4 percent, based on conditions set forth in the rules. The risk weight for an eligible credit derivative cleared through a CCP is determined according to §.32 of the regulatory capital rules. In addition, the coverage amount provided by an eligible credit derivative must be adjusted downward under certain conditions as described in §.36 of the regulatory capital rules.

If a clearing member bank or clearing member client bank has obtained full or partial protection for an on-balance sheet asset or off-balance sheet item using a cleared eligible credit derivative cleared through a QCCP, the institution may, but is not required to, recognize the benefits of this eligible credit derivative in determining the risk-weighted asset amount for the hedged exposure in Schedule RC-R, Part II, by reporting the protected exposure amounts and credit equivalent amounts in the 2 percent or 4 percent

Part II. (cont.)

Item No. **Caption and Instructions**

14 (cont.)

- *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.

- For commercial and similar letters of credit that must be risk weighted according to the Country Risk Classification (CRC) methodology, including commercial and similar letters of credit (and self-liquidating, trade-related contingent items that arise from the movement of goods) with an original maturity of one year or less that have been conveyed to foreign banks, assign the credit equivalent amount of the portion of such letters of credit to risk-weight categories based on the CRC methodology described in the instructions for Schedule RC-R, Part, II, item 14, in the instructions for the FFIEC 031 and FFIEC 041 Call Reports.

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 SU, items 4 and 5, 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(~~c~~a) of the Small Business Act (1~~2~~5 U.S.C. 63~~1~~2 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 SU, items 4 and 5, 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 SU, items 4 and 5, that are secured by collateral or has a guarantee that qualifies for the 20 percent risk weight.

Item No. **Caption and Instructions**

1 (cont.) interest rate forwards, forward rate agreements, and interest rate options, including caps, floors, collars, and corridors.

Interest rate derivative contracts also include:

(1) A reporting institution's commitments (i.e., commitments that have a specific interest rate or price, selling date, and dollar amount) to sell loans secured by 1-to-4 family residential properties that meet the definition of a derivative contract under ASC Topic 815.
(2) A reporting institution's commitments to lend that meet the definition of a derivative and must be accounted for in accordance with ASC Topic 815 are considered written options for purposes of Schedule SU, items 1.a through 1.d. All other commitments to lend should be reported in Schedule RC-L, item 1.

Interest rate derivative contracts exclude contracts involving the exchange of one or more foreign currencies (e.g., cross-currency swaps and currency options), which are to be reported as foreign exchange contracts in Schedule SU, item 1.b or 1.d, as appropriate. In addition, interest rate derivative contracts exclude ~~and other~~ contracts not involving the exchange of foreign currency whose predominant risk characteristic is foreign exchange risk, which are also to be reported as foreign exchange contracts in Schedule SU, item 1.b or 1.d, as appropriate.

Examples of interest rate derivative contracts to be reported in Schedule SU, items 1.a and 1.c, include Chicago Board Options Exchange options on the 13-week Treasury bill rate and futures on 90-day U.S. Treasury bills, 12-year GNMA pass-through securities, and 2-, 4-, 6-, and 10-year U.S. Treasury notes.

Other Derivative Contracts. Other derivative contracts include foreign exchange contracts, equity derivative contracts, commodity contracts, credit derivative contracts, and any other derivative contracts not reportable as interest rate derivative contracts.

The following types of derivative contracts are to be included in Schedule SU, items 1.b and 1.d:

(1) **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, whose predominant risk characteristic is foreign exchange risk. 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. All amounts are to be reported in U.S. dollar equivalent values.

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 institution enters into a futures contract which obligates the institution to purchase U.S. dollar exchange against which it sells Japanese yen, then the institution would report (in U.S. dollar equivalent values) the amount of Japanese yen sold. In cross-currency transactions, which involve the purchase and sale of two non-U.S. currencies, only the purchase side is to be reported (in U.S. dollar equivalent values).

Examples of foreign exchange contracts to be reported in Schedule SU, items 1.b and 1.d, include exchange-traded options on major currencies such as the Euro, Japanese Yen, and British Pound Sterling, options on futures contracts of major currencies, and

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4 and 5 (cont.) *interests and subordinated securities* retained by an institution when it securitizes assets expose the institution to more than its pro rata share of loss and thus are considered a form of credit enhancement to the securitization structure.

4 **Does the institution have any assets it has sold and securitized with servicing retained or with recourse or other seller-provided credit enhancements?**

If your institution has any assets currently outstanding that it has sold and securitized with servicing retained or with recourse or other seller-provided credit enhancements, place an "X" in the box marked "Yes" and complete item 4.a, below.

If your institution has no assets currently outstanding that it has sold and securitized with servicing retained or with recourse or other seller-provided credit enhancements, place an "X" in the box marked "No," skip item 4.a, and go to item 5.

4.a **Total outstanding principal balance of assets sold and securitized by the reporting institution with servicing retained or with recourse or other seller-provided credit enhancements.** Report the total principal balance outstanding as of the report date of loans, leases, and other assets which the reporting institution 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 the amount outstanding of any credit card fees and finance charges that the reporting institution 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 institution has (1) pooled into securities that have been guaranteed by the Government National Mortgage Association (Ginnie Mae) and (2) sold with servicing rights retained.

Also include the principal balance outstanding of securitizations of small business obligations transferred with recourse under Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994.

Exclude the principal balance of loans underlying seller's interests owned by the reporting institution. Seller's interest means the reporting institution's ownership interest in loans that have been securitized, except an interest that is a form of recourse or other seller-provided credit enhancement.

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 SU, item 5.a. If servicing has been retained on closed-end 1-4 family residential mortgages sold to Fannie Mae or Freddie Mac, report the outstanding principal balance of the mortgages in Schedule SU, item 6.a.

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4.a (cont.) Exclude securitizations that the reporting institution 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 institution's balance sheet.

5 **Does the institution have any assets it has sold with recourse or other seller-provided credit enhancements but has not securitized?**

If your institution has any assets currently outstanding that it has sold with recourse or other seller-provided credit enhancements but has not securitized, place an "X" in the box marked "Yes" and complete item 5.a, below.

If your institution has no assets currently outstanding that it has sold and securitized with recourse or other seller-provided credit enhancements, place an "X" in the box marked "No," skip item 5.a, and go to item 6.

5.a **Total outstanding principal balance of assets sold by the reporting institution with recourse or other seller-provided credit enhancements, but not securitized by the reporting institution.** Report the unpaid principal balance as of the report date of loans, leases, and other assets, which the reporting institution has sold with recourse or other seller-provided credit enhancements, but which were not securitized by the reporting institution. Include loans, leases, and other assets that the reporting institution 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 reporting institution. Include 1-4 family residential mortgages that the reporting institution 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.

Include the unpaid principal balance of small business obligations the reporting institution has transferred with recourse under Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994, but which were not securitized by the reporting institution.

6 **Does the institution service any closed-end 1-4 family residential mortgage loans for others or does it service more than $10 million of other financial assets for others?**

If your institution either (1) services any closed-end 1-4 family residential mortgage loans for others or (2) services more than $10 million of other financial assets for others, place an "X" in the box marked "Yes" and complete item 6.a, below.

If your institution (1) does not service any closed-end 1-4 family residential mortgage loans for others and (2) does not service more than $10 million of other financial assets for others, place an "X" in the box marked "No," skip item 6.a, and go to item 7.

6.a **Total outstanding principal balance of closed-end 1-4 family residential mortgage loans serviced for others plus the total outstanding principal balance of other financial assets serviced for others if more than $10 million.** Report the sum of (1) the outstanding principal balance of closed-end 1-to-4 family residential mortgage loans the reporting institution services for others, regardless of amount, plus (2) the outstanding principal balance of all other financial assets the reporting institution services for others, provided this balance is more than $10 million. For purposes of reporting the outstanding principal balance of loans serviced for others in accordance with the preceding sentence, include the servicing

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6.a (cont.) of 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 institution has purchased the servicing (i.e., purchased servicing) and (2) the principal balance of loans and other financial assets that the reporting institution 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 institution 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.

Include the outstanding principal balance of all closed-end 1-to-4 family residential mortgage loans (as defined for Schedule RC-C, Part I, item 1.c.(2)) that the reporting institution services for others regardless of whether the reporting institution provides recourse or other service-provided credit enhancements. For example, the reporting institution should include closed-end 1-to-4 family residential mortgages serviced under regular option contracts (i.e., with recourse) with the Federal National Mortgage Association, serviced with recourse for the Federal Home Loan Mortgage Corporation, and serviced with recourse under other servicing contracts.

Other serviced financial assets may include, but are not limited to, home equity lines, credit cards, automobile loans, and loans guaranteed by the Small Business Administration.

Variable Interest Entities

7 **Does the institution have any consolidated variable interest entities?**

If your institution has any consolidated variable interest entities, place an "X" in the box marked "Yes" and complete items 7.a and 7.b, below.

If your institution does not have any consolidated variable interest entities, place an "X" in the box marked "No," skip item items 7.a and 7.b, and go to item 8.

General Instructions

A variable interest entity (VIE), as described in ASC Topic 810, Consolidation (formerly FASB Interpretation No.46 (revised December 2003), "Consolidation of Variable Interest Entities," as amended by FASB Statement No. 167, "Amendments to FASB Interpretation No. 46(R)"), is an entity in which equity investors do not have sufficient equity at risk for that entity to finance its activities without additional subordinated financial support or, as a group, the holders of the equity investment at risk lack one or more of the following three characteristics: (a) the power, through voting rights or similar rights, to direct the activities of an entity that most significantly impact the entity's economic performance, (b) the obligation to absorb the expected losses of the entity, or (c) the right to receive the expected residual returns of the entity.

Variable interests in a VIE are contractual, ownership, or other pecuniary interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests. When an institution or other company has a variable interest or interests in a VIE, ASC Topic 810 provides guidance for determining whether the institution or other company

Derivative Contracts (cont.):

and exceeds 25 percent of "All other liabilities," this amount should be disclosed in Schedule RC-G, item 4.d. Net gains (losses) on derivatives held for purposes other than trading that are not designated as hedging instruments in hedging relationships that qualify for hedge accounting in accordance with ASC Topic 815 should be recognized currently in earnings and reported consistently as either "Other noninterest income" or "Other noninterest expense" in Schedule RI, item 5.l or item 7.d, respectively.

Netting of derivative assets and liabilities is prohibited on the balance sheet except as permitted under ASC Subtopic 210-20, Balance Sheet – Offsetting (formerly FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts"). See the Glossary entry for "offsetting."

~~Banks must report the notional amounts of their derivative contracts (both freestanding derivatives and embedded derivatives that are accounted for separately from their host contract under ASC Topic 815) by risk exposure in Schedule RC-L, first by type of contract in Schedule RC-L, item 12, and then by purpose of contract (i.e., trading, other than trading) in Schedule RC-L, items 13 and 14. Banks must then report the gross fair values of their derivatives, both positive and negative, by risk exposure and purpose of contract in Schedule RC-L, item 15. However, these items exclude credit derivatives, the notional amounts and gross fair values of which must be reported in Schedule RC-L, item 7.~~

Discounts: See "premiums and discounts."

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

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

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

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

Securities Activities (cont.):

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 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~~–False ~~Statements or Entries Generally and 1005~~–False~~Bank Entries, Reports and Transactions.

See also "trading account."

Servicing Assets and Liabilities (cont.):

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 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." In the Call Reports for June and December, 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, an institution must report in Schedule SU, item 6, whether it services any closed-end 1-4 family residential mortgage loans or more than $10 million of other financial assets. If so, the institutions must report information about the serviced assets in Schedule SU, item 6.a.

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.