GLOSSARY

GLOSSARY (cont.)

PREPARATION OF THE REPORTS

Banks are required to prepare and file the Reports of Condition and Income in accordance with these instructions. All reports shall be prepared in a consistent manner.

The bank's financial records shall be maintained in such a manner and scope so as to ensure that the Reports of Condition and Income can be prepared and filed in accordance with these instructions and reflect a fair presentation of the bank's financial condition and results of operations.

Questions and requests for interpretations of matters appearing in any part of these instructions should be addressed to the bank's primary federal bank supervisory agency (i.e., the Federal Reserve Banks, the Comptroller of the Currency, or the Federal Deposit Insurance Corporation). Such inquiries will be referred for resolution to the Reports Task Force of the Federal Financial Institutions Examination Council. Regardless of whether a bank requests an interpretation of a matter appearing in these instructions, when a bank's primary federal bank supervisory agency's interpretation of the instructions differs from the bank's interpretation, the supervisory agency may require the bank to prepare its Reports of Condition and Income in accordance with the agency's interpretation and to amend previously submitted reports.

SIGNATURES

Officer Declaration

A duly authorized officer of the bank shall sign a declaration on the agency-supplied signature page concerning the preparation of the Reports of Condition and Income that the bank has filed with the appropriate supervisory agency.

Director Attestation

National and state member banks -- The correctness of the Report of Condition shall be attested to by at least three directors of the reporting bank, other than the officer signing the officer declaration, as indicated on the agency-supplied signature page.

State nonmember banks -- The correctness of the Report of Condition shall be attested to by at least two directors of the reporting bank, other than the officer signing the officer declaration, as indicated on the agency-supplied signature page.

SUBMISSION OF THE REPORTS

Each bank must file its Reports of Condition and Income in one of the following two ways:

- o A bank may use computer software to prepare its reports and then file the reports directly with the banking agencies' electronic collection agent, Electronic Data Systems Corporation (EDS). The bank can send the data file containing its Reports of Condition and Income to EDS electronically by modem or on a computer diskette.

- o The institution may complete its reports in paper form and arrange with EDS, a Call Report software vendor, or another party to convert its paper reports to electronic form. If a party other than EDS performs this service, that party must electronically transmit the data file containing the bank's Reports of Condition and Income to EDS.

The filing of Reports of Condition and Income in paper form directly with the FDIC (for national and FDIC-supervised banks) or with the appropriate Federal Reserve District Bank (for state member banks) is no longer an acceptable method of submission.

Regardless of the method a bank uses to file its Reports of Condition and Income, the bank remains responsible for the accuracy of the data in its Reports of Condition and Income.

In order to file its completed reports with EDS using a computer and modem or to send EDS a computer diskette, banks must use computer software that has been certified for this purpose by EDS. Certified software is available through certain vendors that have completed a certification process. Alternatively, banks may develop their own reporting software and go through the certification process.

Reports submitted in automated form using software that has not been certified will not be accepted by EDS, the banking agencies' collection agent, and resubmission using certified software will be necessary. In addition, reports sent to EDS on computer diskettes that EDS cannot read will not be accepted and resubmission will be necessary. In either case, if such resubmission is received by EDS after the submission date for the report (as defined below), the submitting bank may be subject to the penalties prescribed for late submission.

Each bank is responsible for ensuring that the report format used each quarter is the appropriate format for the bank to use (i.e., FFIEC 031, 032, 033, or 034) for that report date and reflects fully and accurately the item reporting requirements for that report date, including any changes that may be made from time to time. This responsibility cannot be transferred or delegated to servicers or others outside the reporting bank.

A bank filing its Reports of Condition and Income with EDS electronically or under the paper-based alternative must maintain in its files a signed and attested record of its completed report each quarter. This record should be either a computer printout showing at least the caption of each item in the Reports of Condition and Income and the reported amount, a computer-generated facsimile of the report form, or a copy of the printed report form. Either the cover page of the agency-supplied sample set of report forms for the quarter, a photocopy of this cover page, or a copy of the cover page printed from the bank's report preparation software should be used to fulfill the signature and attestation requirement for that report date. This signed cover page should be attached to the printout, computer-generated facsimile, or copy of the form that the bank places in its files.

No item on the Reports of Condition and Income is to be left blank unless otherwise indicated in the instructions. Except in those instances, an entry must be made for each item, i.e., an amount, a zero, the word "none," an "X," or an "N/A."

State banks should refer to their appropriate state bank supervisory authority for information concerning state requirements for submitting copies of the Reports of Condition and Income filed with federal bank supervisory authorities.

MISCELLANEOUS GENERAL INSTRUCTIONS

Rounding

For banks with total assets of less than $10 billion, all dollar amounts must be reported in thousands, with the figures rounded to the nearest thousand. Items less than $500 will be reported as zero.

For banks with total assets of $10 billion or more, all dollar amounts may be reported in thousands, but each bank, at its option, may round the figures reported to the nearest million, with zeros reported in the thousands column. For banks exercising this option, amounts less than $500,000 will be reported as zero.

Rounding may result in details not adding to their stated totals. The only permissible differences between totals and the sums of their components are those attributable to the mechanics of rounding.

On the Report of Condition, Schedule RC, item 12, "Total assets," and Schedule RC, item 29, "Total liabilities and equity capital," which must be equal, must be derived from unrounded numbers and then rounded in order to ensure that these two items are equal as reported.

Negative Entries

Except for the items listed below, negative entries are not appropriate on the Report of Condition and shall not be reported. Hence, assets with credit balances must be reported in liability items and liabilities with debit balances must be reported in asset items, as appropriate, and in accordance with these instructions. The Report of Condition items for which negative entries may be made, if appropriate, are:

(1) Schedule RC, item 8, "Investments in unconsolidated subsidiaries and associated companies."

(2) Schedule RC, item 26.a, "Undivided profits and capital reserves."

(3) Schedule RC, item 26.b, "Net unrealized holding gains (losses) on available-for-sale securities."

(4) Schedule RC, item 26.c, "Accumulated net gains (losses) on cash flow hedges."

(5) Schedule RC, item 27, "Cumulative foreign currency translation adjustments" (for banks with foreign offices).

(6) Schedule RC-C, item 10, "Lease financing receivables (net of unearned income)" (item 9 in the FFIEC 034).

(7) Schedule RC-M, items 8.b.(1), 8.b.(2), and 8.b.(3), on "Investments in unconsolidated subsidiaries and associated companies."

(8) Schedule RC-M, item 11, "Net unamortized realized deferred gains (losses) on off-balance sheet derivative contracts included in assets and liabilities reported in Schedule RC."

(9) Schedule RC-R, items 3.a.(1) and 3.b, "Tier 1 capital," and "Total risk-based capital," respectively.

(10) Schedule RC-R, item 8, "On-balance sheet asset values excluded from and deducted in the calculation of the risk-based capital ratio."

When negative entries do occur in one or more of these items, they shall be recorded in parentheses rather than with a minus (-) sign.

On the Report of Income, negative entries may appear as appropriate. Income items with a debit balance and expense items with a credit balance must be reported in parentheses.

Verification

All addition and subtraction should be double-checked before reports are submitted. Totals and subtotals in supporting materials should be cross-checked to corresponding items elsewhere in the reports.

Before a report is submitted, all amounts should be compared with the corresponding amounts in the previous report. If there are any unusual changes from the previous report, a brief explanation of the changes should be attached to the submitted reports.

Banks should retain workpapers and other records used in the preparation of these reports.

Transactions Occurring Near the End of a Reporting Period

Transactions between banks occurring near the end of a reporting period may not be reported by the parties to the transaction in such a manner as to cause the asset (or liability) either to disappear entirely from the Reports of Condition submitted for that report date or to appear on both of the submitted reports, regardless of the time zones in which the banks are located, the time zone in which the transaction took place, or the actual zone clock times at the effective moment of the transaction.

In the case of a transaction occurring in different reporting periods for the parties because of time zone differences, the parties may decide between themselves on the reporting period in which they will all, consistently, report the transaction as having occurred, so that in any given reporting period, the asset (or liability) transferred will appear somewhere and without duplication in the reports submitted by the parties to the transaction.

If, in such cases, the parties do not agree on the reporting period in which the transaction is to be treated as having occurred on the reports of all parties, i.e., if they do not agree on which party will reflect the asset (or liability) on its reports for these purposes, the transaction will be deemed to have occurred prior to midnight in the time zone of the buyer (or transferee) and must be reported accordingly by all parties to the transaction.

If, in fact, the parties, in their submitted reports, treat the transaction as having occurred in different reporting periods, the parties will be required to amend their submitted reports on the basis of the standard set forth in the preceding paragraph.

SEPARATE BRANCH REPORTS

Each U.S. bank shall submit for each of its branches located in a foreign country, Puerto Rico, or a U.S. territory or possession (including trust territories) a "Foreign Branch Report of Condition" (FFIEC 030) once a year as of the end of December. However, a branch must report quarterly if it has either $2 billion in total assets or $5 billion in commitments to purchase foreign currencies and U.S. dollar exchange.

Item No. **Caption and Instructions**

5 (cont.) losses (i.e., assets and liabilities) from the "marking to market" of the reporting bank's interest rate, foreign exchange rate, and other off-balance sheet commodity and equity contracts with the same counterparty that meet the criteria for a valid right of setoff contained in FASB Interpretation No. 39 (e.g., those contracts subject to a qualifying master netting agreement) may be reported on a net basis using this item and Schedule RC, item 15.b, "Trading liabilities," as appropriate. (See the Glossary entry for "offsetting.")

For those banks filing the FFIEC 031 or 032 that must complete Schedule RC-D, this item must equal Schedule RC-D, item 12, "Total trading assets."

6 **Premises and fixed assets.** Report the book value, less accumulated depreciation or amortization, of all premises, equipment, furniture and fixtures purchased directly or acquired by means of a capital lease. Any method of depreciation or amortization conforming to accounting principles that are generally acceptable for financial reporting purposes may be used. However, depreciation for premises and fixed assets may be based on a method used for federal income tax purposes if the results would not be materially different from depreciation based on the asset's estimated useful life.

Do not deduct mortgages or other liens on such property (report in Schedule RC, item 16, "Other borrowed money").

Include as premises and fixed assets:

(1) Premises that are actually owned and occupied (or to be occupied, if under construction) by the bank, its branches, or its consolidated subsidiaries.

(2) Leasehold improvements, vaults, and fixed machinery and equipment.

(3) Remodeling costs to existing premises.

(4) Real estate acquired and intended to be used for future expansion.

(5) Parking lots that are used by customers or employees of the bank, its branches, and its consolidated subsidiaries.

(6) Furniture, fixtures, and movable equipment of the bank, its branches, and its consolidated subsidiaries.

(7) Automobiles, airplanes, and other vehicles owned by the bank and used in the conduct of its business.

(8) The amount of capital lease property (with the bank as lessee): premises, furniture, fixtures, and equipment. See the discussion of accounting with bank as lessee in the Glossary entry for "lease accounting."

(9) Stocks and bonds issued by nonmajority-owned corporations whose principal activity is the ownership of land, buildings, equipment, furniture, or fixtures occupied or used (or to be occupied or used) by the bank, its branches, or its consolidated subsidiaries.

Item No. **Caption and Instructions**

6 (cont.) Exclude from premises and fixed assets:

(1) Original paintings, antiques, and similar valuable objects (report in Schedule RC-F, item 4, "Other" assets).

(2) Favorable leasehold rights (report in Schedule RC, item 10, "Intangible assets").

7 **Other real estate owned.** Report the total amount of other real estate owned from Schedule RC-M, item 8.a.(3). For further information on other real estate owned, see the instruction to Schedule RC-M, item 8.a, and the Glossary entry for "foreclosed assets."

8 **Investments in unconsolidated subsidiaries and associated companies.** Report the total amount of the bank's investments in unconsolidated subsidiaries and associated companies from Schedule RC-M, item 8.b.(3). For further information on unconsolidated subsidiaries and associated companies, see the instruction to Schedule RC-M, item 8.b.

9 **Customers' liability to this bank on acceptances outstanding.** Report the *full* amount (with the exceptions noted below) of customers' liability to the reporting bank on drafts and bills of exchange that have been accepted by the reporting bank, or by others for its account, and are outstanding.

The amount of customers' liability to the reporting bank on its acceptances that have not yet matured should be reduced *only* when: (1) the customer anticipates its liability to the reporting bank on an outstanding acceptance by making a payment to the bank in advance of the acceptance's maturity that immediately reduces the customer's indebtedness to the bank on such an acceptance; or (2) the reporting bank acquires and holds its own acceptance. See the Glossary entry for "bankers acceptances" for further information.

10 **Intangible assets.** Report the total amount of intangible assets from Schedule RC-M, item 6.d. For further information on intangible assets, see the instruction to Schedule RC-M, item 6.

11 **Other assets.** Report the amount from Schedule RC-F, item 5, "Total."

12 **Total assets.** Report the sum of items 1 through 11. This item must equal Schedule RC, item 29, "Total liabilities and equity capital."

Item No. **Caption and Instructions**

26.a (cont.) possible losses which the bank may sustain because of lawsuits, the deductible amount under the bank's blanket bond, defaults on obligations for which the bank is contingently liable, or other claims against the bank. A reserve for contingencies represents a segregation of undivided profits. It should not include any element of known losses or of any probable losses the amount of which can be estimated with reasonable accuracy (see the Glossary entry for "loss contingencies" for additional information).

Exclude from undivided profits and capital reserves:

(1) Any portion of the proceeds received from the sale of common stock in excess of its par or stated value (report in Schedule RC, item 25) except where required by state law or regulation.

(2) Any portion of the proceeds received from the sale of preferred stock in excess of its par or stated value (report in Schedule RC, item 22 or 23, as appropriate).

(3) "Reserves" that reduce the related asset balances such as valuation allowances (e.g., allowance for loan and lease losses), reserves for depreciation, and reserves for bond premiums.

26.b **Net unrealized holding gains (losses) on available-for-sale securities.** Report the difference between the amortized cost and the fair value of the reporting bank's available-for-sale securities, net of tax effects, as of the report date. [1] For most banks, all "securities," as that term is defined in FASB Statement No. 115, that are designated as "available-for-sale" will be reported as "Available-for-sale securities" in Schedule RC, item 2.b, and in Schedule RC-B, columns C and D. However, a bank may have certain assets that fall within the definition of "securities" in FASB Statement No. 115 (e.g., nonrated industrial development obligations) that the bank has designated as "available-for-sale" which are reported for purposes of the Report of Condition in a balance sheet category other than "Securities" (e.g., "Loans and lease financing receivables"). These "available-for-sale" assets must be carried on the Report of Condition balance sheet at fair value rather than amortized cost and the difference between these two amounts, net of tax effects, must be included in this item.

Also include in this item the unamortized amount of the unrealized holding gain or loss at the date of transfer of any debt security transferred into the held-to-maturity category from the available-for-sale category. When a debt security is transferred from available-for-sale

[1] For example, if the fair value of the reporting bank's available-for-sale securities exceeds the amortized cost of its available-for-sale securities by $100,000 (and the bank has had no other transactions affecting the "net unrealized holding gains (losses)" account), the amount to be reported in Schedule RC, item 26.b, must be reduced by the estimated amount of taxes using the bank's applicable tax rate (federal, state and local). (See the Glossary entry for "income taxes" for a discussion of "applicable tax rate.") If the bank's applicable tax rate (federal, state and local) is 40% and the tax basis of its available-for-sale securities approximates their amortized cost, the bank would report "net unrealized holding gains" of $60,000 [$100,000 - (40% x $100,000)] in Schedule RC, item 26.b. The bank would also have a deferred tax liability of $40,000 which would enter into the determination of the amount of net deferred tax assets or liabilities to report in Schedule RC-F, item 2, or Schedule RC-G, item 2.

Item No. **Caption and Instructions**

26.b (cont.) to held-to-maturity, the unrealized holding gain or loss at the date of transfer continues to be reported in this equity capital account, but must be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount.

26.c **Accumulated net gains (losses) on cash flow hedges.** [2] Report the effective portion [3] of the accumulated change in fair value (gain or loss) on derivatives designated and qualifying as cash flow hedges in accordance with FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities."

Under Statement No. 133, a bank that elects to apply hedge accounting must exclude from net income the effective portion of the change in fair value of a derivative designated as a cash flow hedge and record it on the balance sheet in a separate component of equity capital (referred to as "accumulated other comprehensive income" in the accounting standard). The ineffective portion of the cash flow hedge must be reported in earnings. The equity capital component (i.e., the accumulated other comprehensive income) associated with a hedged transaction should be adjusted each reporting period to a balance that reflects the lesser (in absolute amounts) of:

(1) The cumulative gain or loss on the derivative from inception of the hedge, less (a) amounts excluded consistent with the bank's defined risk management strategy and (b) the derivative's gains or losses previously reclassified from accumulated other comprehensive income into earnings to offset the hedged transaction, or

(2) The portion of the cumulative gain or loss on the derivative necessary to offset the cumulative change in expected future cash flows on the hedged transaction from inception of the hedge less the derivative's gains or losses previously reclassified from accumulated other comprehensive income into earnings.

Accordingly, the amount reported in this item should reflect the sum of the adjusted balance (as described above) of the cumulative gain or loss for each derivative designated and qualifying as a cash flow hedge. These amounts will be reclassified into earnings in the same period or periods during which the hedged transaction affects earnings (for example, when a hedged

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[2] Generally, the objective of a cash flow hedge is to link a derivative to an existing recognized asset or liability or a forecasted transaction with exposure to variability in expected future cash flows, e.g., the future interest payments (receipts) on a variable-rate liability (asset) or a forecasted purchase (sale). The changes in cash flows of the derivative are expected to offset changes in cash flows of the hedged item or transaction. To achieve the matching of cash flows, FASB Statement No. 133 requires that changes in the fair value of properly designated and qualifying derivatives initially be reported in a separate component of equity (accumulated other comprehensive income) and reclassified into earnings in the same future period that the hedged transaction affects earnings.

[3] The effective portion of a cash flow hedge can be described as the change in fair value of the derivative that offsets the change in expected future cash flows being hedged. Refer to FASB Statement No. 133, Appendix A, Section 2, for further information.

variable-rate interest receipt on a loan is accrued or when a forecasted sale occurs).

Item No.	**Caption and Instructions**
27	**Cumulative foreign currency translation adjustments.** Item 27 does not apply to banks with domestic offices only. On the FFIEC 031, report in this item the sum of the bank's foreign currency translation adjustments accumulated in accordance with FASB Statement No. 52. A net debit balance should be reported in parentheses. See the Glossary entry for "foreign currency transactions and translation" for further information.
28	**Total equity capital.** Report the sum of items 23 through 27. On the FFIEC 034, for the report period ending December 31, this item must equal Report of Income Schedule RI-A, item 13, "Equity capital end of current period." On the FFIEC 032 and 033, this item must equal Report of Income Schedule RI-A, item 13, "Equity capital end of current period." On the FFIEC 031, this item must equal Report of Income Schedule RI-A, item 14, "Equity capital end of current period."
29	**Total liabilities and equity capital.** Report the sum of items 21 and 28. This item must equal Schedule RC, item 12, "Total assets."

Memoranda

Item No. **Caption and Instructions**

8 Not applicable.

9 **Structured notes.** Report in this item all structured notes included in the held-to-maturity and available-for-sale accounts and reported in Schedule RC-B, items 2, 3, and 5. In general, structured notes are debt securities whose cash flow characteristics (coupon rate, redemption amount, or stated maturity) depend upon one or more indices and/or that have embedded forwards or options or are otherwise commonly known as "structured notes." Include as structured notes any asset-backed securities (other than mortgage-backed securities) which possess the aforementioned characteristics. ***Exclude*** from structured notes all "inflation-indexed" securities issued by the U.S. Treasury.

Structured notes include, but are not limited to, the following common structures:

(1) Floating rate debt securities whose payment of interest is based upon a single index of a Constant Maturity Treasury (CMT) rate or a Cost of Funds Index (COFI).

(2) **Step-up Bonds.** Step-up securities initially pay the investor an above-market yield for a short noncall period and then, if not called, "step up" to a higher coupon rate (which will be below current market rates). The investor initially receives a higher yield because of having implicitly sold one or more call options. A step-up bond may continue to contain call options even after the bond has stepped up to the higher coupon rate. A **multistep** bond has a series of fixed and successively higher coupons over its life. At each call date, if the bond is not called, the coupon rate increases.

(3) **Index Amortizing Notes (IANs).** IANs repay principal according to a predetermined amortization schedule that is linked to the level of a specific index (usually the London Interbank Offered Rate - LIBOR - or a specified prepayment rate). As market interest rates increase (or prepayment rates decrease), the maturity of an IAN extends, similar to that of a collateralized mortgage obligation.

(4) **Dual Index Notes.** These bonds have coupon rates that are determined by the difference between two market indices, typically the CMT rate and LIBOR. These bonds often have a fixed coupon rate for a brief period, followed by a longer period of variable rates, e.g., 8 percent fixed for two years, then the 10-year CMT rate plus 300 basis points minus three-month LIBOR.

(5) **De-leveraged Bonds.** These bonds pay investors according to a formula that is based upon a fraction of the increase or decrease in a specified index, such as the CMT rate or the prime rate. For example, the coupon might be the 10-year CMT rate multiplied by 0.5, plus 150 basis points. The de-leveraging multiplier (0.5) causes the coupon to lag overall movements in market yields. A **leveraged** bond would involve a multiplier greater than 1.

(6) **Range Bonds.** Range bonds (or accrual bonds) pay the investor an above-market coupon rate as long as the reference rate is between levels established at issue. For each day that the reference rate is outside this range, the bonds earn no interest. For example, if LIBOR is the reference rate, a bond might pay LIBOR plus 75 basis points for each day that LIBOR is between 3.5 and 5.0 percent. When LIBOR is less than 3.5 percent or more than 5 percent, the bond would accrue no interest.

Memoranda

Item No. **Caption and Instructions**

9 (cont.) (7) **Inverse Floaters.** These bonds have coupons that increase as rates decline and decrease as rates rise. The coupon is based upon a formula, such as 12 percent minus three-month LIBOR.

Exclude from structured notes floating rate debt securities denominated in U.S. dollars whose payment of interest is based upon a single index of a Treasury bill rate, the prime rate, or LIBOR and which do not contain adjusting caps, adjusting floors, leverage, or variable principal redemption. Furthermore, debt securities that do not possess the aforementioned characteristics of a structured note need not be reported as structured notes solely because they are callable as of a specified date at a specified price. In addition, debt securities that in the past possessed the characteristics of a structured note, but which have "fallen through" their structures (e.g., all of the issuer's call options have expired and there are no more adjustments to the interest rate on the security), need not be reported as structured notes.

Generally, municipal and corporate securities that have periodic call options should **not** be reported as structured notes. Although many of these securities have features similar to those found in some structured notes (e.g., step-ups, which generally remain callable after a step-up date), they are **not commonly known** as structured notes. Examples of such callable securities that should ***not*** be reported as structured notes include:

(1) Callable municipal and corporate bonds which have single (or multiple) explicit call dates and then can be called on any interest payment date after the last explicit call date (i.e., they are continuously callable).

(2) Callable federal agency securities that have continuous call features after an explicit call date, except step-up bonds (which are structured notes).

The mere existence of simple caps and floors does not necessarily make a security a structured note. Securities with **adjusting** caps or floors (i.e., caps or floors that change over time), however, are structured notes. Therefore, the following types of securities should ***not*** be reported as structured notes:

(1) Variable rate securities, including Small Business Administration "Guaranteed Loan Pool Certificates," **unless** they have features of securities which are commonly known as structured notes (i.e., they are inverse, range, or de-leveraged floaters, index amortizing notes, dual index or variable principal redemption or step-up bonds), or have adjusting caps or floors.

(2) Mortgage-backed securities.

9.a **<u>Amortized cost (of structured notes).</u>** Report the amortized cost of all structured notes included in the held-to-maturity and available-for-sale accounts. The amortized cost of these securities will have been reported in columns A and C of the body of Schedule RC-B.

9.b **<u>Fair value (of structured notes).</u>** Report the fair (market) value of structured notes reported in Memorandum item 9.a above. The fair value of these securities will have been reported in columns B and D of the body of Schedule RC-B. Do not combine or otherwise net the fair value of any structured note with the fair or book value of any related asset, liability, or off-balance sheet derivative instrument.

Item No. Caption and Instructions

3.a (cont.) (3) All noninterest-bearing balances that the reporting bank's trust department maintains with other commercial banks in the U.S.

3.b **Currency and coin.** (Item 3.b is not applicable to banks filing the FFIEC 031, 032, and 033 report forms.) Report the amount of currency and coin included in Schedule RC, item 1.a, "Noninterest-bearing balances and currency and coin." Currency and coin include both U.S. and foreign currency and coin owned and held in all offices of the reporting bank, currency and coin in transit to a Federal Reserve Bank or to any other depository institution for which the reporting bank has not yet received credit, and currency and coin in transit from a Federal Reserve Bank or from any other depository institution for which the reporting bank's account has already been charged. Foreign currency and coin should be converted into U.S. dollar equivalents as of the report date.

4 **Outstanding principal balance of 1-4 family residential mortgage loans serviced for others.** Report in the appropriate subitem the outstanding principal balance of 1-to-4 family residential mortgage loans serviced for others. Include those 1-to-4 family residential mortgage loans for which the reporting bank has purchased the servicing (i.e., purchased servicing) and those 1-to-4 family residential mortgages which the reporting bank has originated and sold (or swapped with FHLMC or FNMA) but for which it has retained the servicing duties and responsibilities (i.e., retained servicing).

4.a **Mortgages serviced under a GNMA contract.** Report the outstanding principal balance of 1-to-4 family residential mortgage loans serviced for others under servicing contracts entered into with the Government National Mortgage Association (GNMA). GNMA contracts generally cover residential mortgage loans guaranteed by the Department of Veterans Affairs/Veterans Administration (VA) and insured by the Federal Housing Administration (FHA).

4.b **Mortgages serviced under a FHLMC contract.** Report in the appropriate subitem the outstanding principal balance of 1-to-4 family residential mortgage loans serviced for others under servicing contracts entered into with the Federal Home Loan Mortgage Corporation (FHLMC). FHLMC contracts cover VA, FHA, and conventional mortgages, i.e., mortgages that have not been guaranteed or insured by a U.S. Government agency. A seller sells (or swaps) mortgages to FHLMC with or without recourse, as elected by the seller, and endorses each mortgage note sold to (or swapped with) FHLMC accordingly. A seller electing to sell to (or swap with) FHLMC with recourse bears all risks and costs of a borrower default, including the costs of foreclosure. If the servicing of mortgages sold to (or swapped with) FHLMC with recourse is transferred, the transferee bears these risks and costs. If a seller elects to sell (or swap) mortgages without recourse, FHLMC assumes the risk of loss from borrower defaults to the extent of FHLMC's percentage of participation in the mortgages.

4.b.(1) **Serviced with recourse to servicer.** Report the outstanding principal balance of 1-to-4 family residential mortgage loans serviced for others under servicing contracts entered into with FHLMC in which the mortgages being serviced have been sold to (or swapped with) FHLMC with recourse and the mortgage notes have been endorsed accordingly.

4.b.(2) **Serviced without recourse to servicer.** Report the outstanding principal balance of 1-to-4 family residential mortgage loans serviced for others under servicing contracts entered into with FHLMC in which the mortgages being serviced have been sold to (or swapped with) FHLMC without recourse and the mortgage notes have been endorsed accordingly.

Item No. Caption and Instructions

4.c **Mortgages serviced under a FNMA contract.** Report in the appropriate subitem the outstanding principal balance of 1-to-4 family residential mortgage loans serviced for others under servicing contracts entered into with the Federal National Mortgage Association (FNMA). FNMA contracts cover VA, FHA, and conventional mortgages that have been sold to (or swapped with) FNMA. Residential mortgages are serviced for FNMA under either the regular or special servicing option. Under a regular option contract, the servicer assumes the risk of loss from a mortgagor default. Under a special option contract, FNMA assumes the risk of loss from a mortgagor default.

4.c.(1) **Serviced under a regular option contract.** Report the outstanding principal balance of 1-to-4 family residential mortgage loans serviced for others under regular servicing option contracts entered into with FNMA.

4.c.(2) **Serviced under a special option contract.** Report the outstanding principal balance of 1-to-4 family residential mortgage loans serviced for others under special servicing option contracts entered into with FNMA.

4.d **Mortgages serviced under other servicing contracts.** Report the outstanding principal balance of 1-to-4 family residential mortgage loans serviced for others under other types of servicing contracts. Include mortgages serviced under all contracts other than GNMA, FHLMC, and FNMA contracts.

5 **Customers' liability to this bank on acceptances outstanding.** (Items 5.a and 5.b are to be completed only by banks with $1 billion or more in total assets that file the FFIEC 031 and 032 report forms.) The sum of items 5.a and 5.b must equal Schedule RC, item 9.

5.a **U.S. addressees (domicile).** Report the portion of Schedule RC, item 9, that represents liabilities of customers who are U.S. addressees, i.e., are domiciled in the United States (see the Glossary entry for "domicile").

5.b **Non-U.S. addressees (domicile).** Report the portion of Schedule RC, item 9, that represents liabilities of customers who are not U.S. addressees, i.e., are domiciled outside the United States (see the Glossary entry for "domicile").

6 **Intangible assets.** Report in the appropriate subitem the unamortized amount of intangible assets. Intangible assets primarily result from business combinations accounted for under the purchase method in accordance with Accounting Principles Board Opinion No. 16, as amended, from acquisitions of portions or segments of another institution's business such as branch offices, mortgage servicing portfolios, and credit card portfolios, and from the sale or securitization of financial assets with servicing retained. Consistent with Securities and Exchange Commission guidance, intangible assets should be amortized over their estimated useful lives, generally not to exceed 25 years.

6.a **Mortgage servicing assets.** Report the carrying value of mortgage servicing assets, i.e., the unamortized cost of acquiring 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") that have been securitized or are owned by another party, net of any related valuation allowances. Exclude servicing assets resulting from contracts to service financial assets other than loans secured by real estate (report nonmortgage servicing assets in Schedule RC-M, item 6.b.(1)). For further information, see the Glossary entry for "servicing assets and liabilities."

Item No. **Caption and Instructions**

6.a.(1) **Estimated fair value of mortgage servicing assets.** Report the estimated fair value of the capitalized mortgage servicing assets reported in Schedule RC-M, item 6.a, above.

According to FASB Statement No. 125, the fair value of mortgage servicing assets is the amount at which the assets could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of the fair value of an asset and should be used to measure fair value if available. If quoted market prices are not available, the estimate of fair value should be based on the best information available in the circumstances, considering prices for similar assets and the results of valuation techniques such as the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved. Valuation techniques for measuring servicing assets should be consistent with the objective of measuring fair value and should incorporate assumptions that market participants would use. Estimates of expected future cash flows, if used to estimate fair value, should be the best estimate based on reasonable and supportable assumptions and projections.

For purposes of this item, the reporting bank should determine the fair value of mortgage servicing assets in the same manner that it determines the fair value of these assets for other financial reporting purposes, consistent with the guidance in FASB Statement No. 125.

6.b **Other identifiable intangible assets:**

6.b.(1) **Purchased credit card relationships and nonmortgage servicing assets.** Report the carrying value of purchased credit card relationships plus the carrying value of nonmortgage servicing assets.

Purchased credit card relationships represent the right to conduct ongoing credit card business dealings with the cardholders. In general, purchased credit card relationships are an amount paid in excess of the value of the purchased credit card receivables. Such relationships arise when the reporting bank purchases existing credit card receivables and also has the right to provide credit card services to those customers. Purchased credit card relationships may also be acquired when the reporting bank purchases an entire depository institution.

Purchased credit card relationships shall be carried at amortized cost, not in excess of the discounted amount of estimated future net cash flows. Management of the institution shall review the carrying value at least quarterly, adequately document this review, and adjust the carrying value as necessary. If unanticipated acceleration or deceleration of cardholder payments, account attrition, changes in fees or finance charges, or other events occur that reduce the amount of expected future net cash flows, a writedown of the book value of the purchased credit card relationships shall be made to the extent that the discounted amount of estimated future net cash flows is less than the asset's carrying amount.

The carrying value of *nonmortgage servicing assets* is the unamortized cost of acquiring contracts to service financial assets, other than loans secured by real estate (as defined for Schedule RC-C, part I, item 1), that have been securitized or are owned by another party, net of any related valuation allowances. For further information, see the Glossary entry for "servicing assets and liabilities."

6.b.(2) **All other identifiable intangibles.** Report the unamortized amount (book value) of all other specifically identifiable intangible assets such as core deposit intangibles and favorable leasehold rights.

Item No. Caption and Instructions

6.c **Goodwill.** Report the amount (book value) of unamortized goodwill. Goodwill represents the excess of the cost of a company over the sum of the fair values of the tangible and identifiable intangible assets acquired less the fair value of liabilities assumed in a business combination accounted for as a purchase.

Goodwill and similar intangible assets ordinarily cannot be disposed of apart from an institution as a whole. Accordingly, a bank may not remove goodwill from its balance sheet by "selling" or "dividending" this asset to its parent holding company or another affiliate. An exception to the rule precluding the disposal of goodwill is made when a large segment or separable group of assets of an acquired company or an entire acquired company is sold or otherwise liquidated. In that case, some or all of the unamortized goodwill recognized in the acquisition should be included in the cost of the assets sold.

The amount of goodwill reported in this item should not be reduced by any negative goodwill. Any negative goodwill arising from a business combination accounted for as a purchase must be reported in Schedule RC-G, item 4, "Other" liabilities, and in Schedule RC, item 20, "Other liabilities."

6.d **Total.** Report the sum of items 6.a, 6.b.(1), 6.b.(2), and 6.c. This amount must equal Schedule RC, item 10, "Intangible assets."

6.e **Amount of intangible assets that have been grandfathered or are otherwise qualifying for regulatory capital purposes.** Report in this item the amount of intangible assets that, in accordance with the regulatory capital standards issued by the reporting bank's primary federal bank regulatory agency, have been grandfathered. Grandfathered intangibles are intangible assets that were allowed to be used to meet capital requirements under the bank's previous regulatory capital rules but which no longer qualify for this treatment under the current capital rules of the bank's primary federal regulatory agency. Do *not* include in this item the portion of any identifiable intangible asset that, under current regulatory capital rules, would count toward (i.e., not be deducted from) the bank's regulatory capital.

For state member banks, report the remaining book value as of the report date of all intangible assets (excluding goodwill, purchased mortgage servicing rights, and purchased credit card relationships) that were recorded on the balance sheet of the reporting bank on or before February 19, 1992. Examples of intangible assets that may be reported in this item are core deposit intangibles, favorable leasehold rights, and organization costs.

Also report in this item the amount of any deferred tax liability that is specifically related to an intangible asset (other than purchased mortgage servicing rights and purchased credit card relationships) acquired in a nontaxable purchase business combination that the reporting bank chooses to net against the intangible asset for regulatory capital purposes. However, a deferred tax liability that is reported in this item and netted in this manner may not also be netted against deferred tax assets when the reporting bank determines the amount of deferred tax assets that are dependent upon future taxable income and calculates the maximum allowable amount of such deferred tax assets for regulatory capital purposes.

7 **Mandatory convertible debt.** Report the total amount of outstanding mandatory convertible debt. Mandatory convertible debt is a form of subordinated debt, i.e., equity contract notes, which obligates the holder to take the common or perpetual preferred stock of the issuer in lieu of cash for repayment of principal.

General Instructions (cont.)

party. The strike price would be the equivalent of the par value of the loan. If the credit quality of the loan deteriorates, thereby reducing the value of the loan to the second bank, the reporting bank would be required by the second bank to take the loan onto its books.

Treatment of Low Level Recourse Transactions -- The banking agencies' risk-based capital standards provide that the amount of risk-based capital that must be maintained for assets transferred with recourse should not exceed the maximum amount of recourse for which a bank is contractually liable under the recourse agreement. This rule, known as the low level recourse rule, applies to transactions accounted for as sales under generally accepted accounting principles (GAAP) in which a bank contractually limits its risk of loss or recourse exposure to less than the full effective minimum risk-based capital requirement for the assets transferred -- generally, four percent for qualifying first lien 1-to-4 family residential mortgages and eight percent for most other assets. Low level recourse transactions may arise when a bank sells or securitizes assets and:

- Uses contractual cash flows (e.g., interest-only strips receivable and so-called "spread accounts"), retained subordinated interests, retained securities (e.g., collateral invested amounts or cash collateral accounts), or other assets as credit enhancements. When a credit enhancement is carried as an asset on the bank's Call Report balance sheet in accordance with GAAP and the low level recourse rule applies, the on-balance sheet asset amount of the credit enhancement should be reported in Schedule RC-R, item 8. The "maximum contractual dollar amount of recourse exposure" for the transaction is this on-balance sheet asset amount on a net of tax basis, when appropriate.

OR

- Provides limited recourse to purchasers of the assets sold, but does not use on-balance sheet assets as credit enhancements. In this situation, the "maximum contractual dollar amount of recourse exposure" for a transaction is the maximum contractual amount of the bank's recourse exposure as of the report date, less the balance of any associated recourse liability account established in accordance with GAAP and reported in Schedule RC, item 20, "Other liabilities."

Banks that have entered into low level recourse transactions should report these transactions in Schedule RC-R using either the "direct reduction method" or the "gross-up method" in accordance with the following guidance. When using the "gross-up method," a bank includes an amount in its risk-weighted assets (the denominator of its risk-based capital ratios) for its "maximum contractual dollar amount of recourse exposure" that is calculated under the assumption that the bank's total risk-based capital ratio equals the 8 percent minimum requirement. In contrast, when using the "direct reduction method," a bank includes an institution-specific amount in its risk-weighted assets for its "maximum contractual dollar amount of recourse exposure" that is calculated using the actual amount of the bank's total risk-based capital. This institution-specific calculation produces the effect of directly reducing Tier 1 and total risk-based capital by the "maximum contractual dollar amount of recourse exposure" without lowering the bank's Tier 1 leverage capital ratio. For a bank whose risk-based capital ratios exceed the required minimums, it is normally preferable to use the "direct reduction method."

- If the bank chooses to use the "direct reduction method," the "maximum contractual dollar amount of recourse exposure," as defined above, should be reported in Schedule RC-R, item 3.e. In addition, the bank should report as a credit equivalent amount in Schedule RC-R, item 7.b, column B, an "institution-specific add-on factor" for its low level recourse exposure. The amount of this factor also should be included in the "net risk-weighted assets" that the bank reports in Schedule RC-R, item 3.d.(1). The "institution-specific add-on factor," which is independent of the risk weight category of the assets to which the recourse applies, is calculated as follows:

General Instructions (cont.)

$$F = \frac{C \times A}{C - R} - A$$

where F = institution-specific add-on factor;
C = total risk-based capital (as reported in Schedule RC-R, item 3.b);
A = net risk-weighted assets excluding low level recourse exposures; and
R = maximum contractual dollar amount of recourse exposure in low level recourse transactions (as reported in Schedule RC-R, item 3.e)

For purposes of calculating the amount of the bank's total risk-based capital to be used in the preceding formula (C in the formula) and to be reported in Schedule RC-R, item 3.b, the bank should determine the Tier 2 capital limit on the allowance for loan and lease losses by multiplying its "maximum contractual dollar amount of recourse exposure" (R in the preceding formula, as defined in these instructions) by 12.5 and adding this product to its gross risk-weighted assets excluding low level recourse exposures. This adjusted gross risk-weighted-assets figure multiplied by 1.25 percent is the bank's Tier 2 capital limit on the allowance for loan and lease losses. Once this limit on the allowance has been calculated, the limit is fixed at this amount. This limit should not be changed after the bank calculates the actual amount of its net risk-weighted assets excluding low level recourse exposures (A in the preceding formula) or its institution-specific add-on factor for low level recourse under the "direct reduction method" (F in the preceding formula). This means that a bank will measure its Tier 2 capital and its total risk-based capital prior to its application of the "direct reduction method" and will not recalculate these two amounts once the add-on factor is known.

- If the bank chooses to use the "gross-up method," the "maximum contractual dollar amount of recourse exposure" for a transaction, as defined above, should be multiplied by a factor of 12.5, 25, or 62.5 according to whether the assets sold would be assigned to the 100 percent, 50 percent, or 20 percent risk weight category, respectively. The resulting dollar amount should be reported as an off-balance sheet credit equivalent amount in column B of Schedule RC-R in the item (item 7.b, 6.b, or 5.b) appropriate to the risk weight category of the assets sold.

For example, a bank has sold $2 million in first lien residential mortgages subject to two percent recourse. The bank has removed the $2 million in mortgages from its Call Report balance sheet and, in accordance with GAAP, has also established a recourse liability account with a balance of $10,000. The maximum amount for which the bank is liable is $40,000. The mortgages qualify for a 50 percent risk weight and the bank's recourse exposure is less than the $80,000 minimum risk-based capital requirement for these assets sold with recourse. Thus, the low level recourse rule applies. The "maximum contractual dollar amount of recourse exposure" for this transaction is $30,000, the $40,000 maximum contractual amount of the bank's recourse exposure as of the report date, less the $10,000 balance of the recourse liability account for this transaction. The bank has gross risk-weighted assets excluding low level recourse exposures of $100 million, Tier 1 capital of $8 million, an allowance for loan and lease losses of $1.1 million, and other qualifying Tier 2 capital components of $1.4 million.

- If the bank chooses to use the "direct reduction method," the bank would report $30,000 -- its "maximum contractual dollar amount of recourse exposure" -- in Schedule RC-R, item 3.e, and would use this amount to calculate its institution-specific add-on factor using the formula provided above. To determine the Tier 2 capital limit for the bank's allowance for loan and lease losses, the bank would first add $375,000 ($30,000 -- its "maximum contractual recourse exposure" -- multiplied by 12.5) to its $100 million of gross risk-weighted assets excluding low level recourse exposures. Its Tier 2 capital limit for the allowance would be $1,254,688 ($100,375,000 -- its

General Instructions (cont.)

adjusted gross risk-weighted assets -- multiplied by 1.25 percent -- the limit for the allowance). Since the bank's $1.1 million allowance is less than its Tier 2 capital limit for the allowance, the bank would report an "excess allowance for loan and lease losses" of $0 in Schedule RC-R, item 3.c. The bank's total risk-based capital is $10.5 million and its net risk-weighted assets excluding low level recourse exposures are $100 million. Based on the facts in the example, the bank calculates that its institution-specific add-on factor is $286,533. The bank would report the amount of this add-on factor as a credit equivalent amount in Schedule RC-R, item 7.b, column B, and also include this amount in the "net risk-weighted assets" that it reports in Schedule RC-R, item 3.d.(1).

- If the bank chooses to use the "gross-up method," the bank would report $750,000 as a credit equivalent amount in Schedule RC-R, item 6.b, column B ($30,000 -- its "maximum contractual dollar amount of recourse exposure" -- multiplied by 25 -- the factor for assets that qualify for a 50 percent risk weight). Because the $2 million in mortgages sold have been removed from the balance sheet, the difference between the $750,000 credit equivalent amount and the $2 million is not reported in Schedule RC-R. In addition, because the $750,000 credit equivalent amount is assigned to the 50 percent risk category, the bank would include $375,000 ($750,000 multiplied by 50 percent) in its gross risk-weighted assets for purposes of determining the Tier 2 capital limit for the allowance for loan and lease losses and in the "net risk-weighted assets" that it reports in Schedule RC-R, item 3.d.(1).

Treatment of Small Business Obligations Transferred with Recourse 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) of the Small Business Act (12 U.S.C. 631) 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.

When reporting eligible transfers with recourse in Schedule RC-R, only the amount of retained recourse should be reported as a credit equivalent amount in column B. This amount, which is reported in Schedule RC-L, item 9.c.(2), will normally be accorded a 100 percent risk weight and be included in Schedule RC-R, item 7.b.

Treatment of covered positions by banks that are subject to the market risk capital guidelines -- The banking agencies' risk-based capital standards 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 guidelines 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, the primary federal supervisory authority may exempt or include a bank if necessary or appropriate for safe and sound banking practices.

General Instructions (cont.)

A bank that is subject to the market risk capital guidelines 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. 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 gross risk-weighted assets. However, foreign exchange positions that are outside of the trading account and all over-the-counter (OTC) derivatives continue to have a counterparty credit risk capital charge. Those positions are included in both gross risk-weighted assets for credit risk and the bank's covered positions for market risk.

The value-at-risk (VAR) of the bank’s covered positions should be used to determine the bank's measure for market risk. VAR is an estimate of the amount by which a bank's positions in a risk category could decline due to expected losses in the bank's portfolio due to market movements during a given period, measured with a specified confidence level. A bank's measure for market risk equals the sum of its VAR-based capital charge, the specific risk add-on (if any), and the capital charge for de minimus exposures (if any). A bank's market risk equivalent assets equal its measure for market risk multiplied by 12.5 (the reciprocal of the minimum 8.0 percent capital ratio). Banks subject to the market risk capital guidelines must maintain an overall minimum 8.0 percent ratio of total qualifying capital (the sum of Tier 1 capital (both allocated and excess), Tier 2 capital (both allocated and excess), and Tier 3 capital (allocated for market risk), net of all deductions) to risk-weighted assets and market risk equivalent assets. Banks should refer to the capital guidelines of their primary federal supervisory authority for specific instructions on the calculation of the measure for market risk.

Item Instructions

Item No. Caption and Instructions

1 Test for determining the extent to which Schedule RC-R must be completed.

Item 1 is to be completed only by banks with total assets of less than $1 billion. Indicate in the appropriate box at the right whether the bank has total capital greater than or equal to eight percent of adjusted total assets.

If "total risk-based capital," as reported in item 3.b below, divided by "adjusted total assets" (on an unrounded basis) is greater than or equal to 8.00 percent and the bank has less than $1 billion in total assets, the reporting bank should place an "X" in the box marked "YES." If "total capital" divided by "adjusted total assets" (on an unrounded basis) is less than 8.00 percent, the reporting bank should place an "X" in the box marked "NO." If the box marked "YES" is checked, then the bank must complete only items 2 and 3 of this schedule. If the box marked "NO" is checked, then the bank must complete items 2 through 9 and Memorandum items 1 and 2. In addition, checking the box marked "NO" does not necessarily mean that the bank's actual risk-based capital ratio is less than eight percent or that the bank is not in compliance with the risk-based capital guidelines.

"Adjusted total assets" is defined as total assets (after adjusting available-for-sale securities from fair value to amortized cost) LESS cash, U.S. Treasury securities, U.S. Government agency obligations, and 80 percent of U.S. Government-sponsored agency obligations not held for trading PLUS the allowance for loan and lease losses and selected off-balance sheet items. "Adjusted total assets" should be measured by using amounts reported elsewhere in the Report of Condition according to the following formula:

Total assets	Schedule RC, item 12
Adjustment to Available-for-Sale Securities	- Schedule RC-B, item 7, column D, + Schedule RC-B, item 7, column C
LESS:	
Cash (currency and coin)	- Schedule RC-M, item 3.b, on the FFIEC 034; - Schedule RC-A, item 1.b, on the FFIEC 031, 032, and 033
U.S. Treasuries (not held for trading)	- Schedule RC-B, item 1, sum of columns A and C
U.S. Government agencies (not held for trading)	- Schedule RC-B, item 2.a, sum of columns A and C, plus item 4.a.(1), sum of columns A and C
80% of U.S. Government-sponsored agencies (not held for trading)	- 0.8 x (Schedule RC-B, item 2.b, sum of columns A and C, plus item 4.a.(2), sum of columns A and C, plus item 4.b.(1), sum of columns A and C)
PLUS:	
Allowance for Loan and Lease Losses	+ Schedule RC, item 4.b

Item No.	**Caption and Instructions**	
1 (cont.)	Unused Commitments	+ Schedule RC-L, sum of items 1.a through 1.e
	Financial Standby Letters of Credit, Net	+ Schedule RC-L, item 2 minus item 2.a
	Performance Standby Letters of Credit, Net	+ Schedule RC-L, item 3 minus item 3.a
	Commercial Letters of Credit	+ Schedule RC-L, item 4
	Participations Acquired in Acceptances	+ Schedule RC-L, item 6
	Securities Lent	+ Schedule RC-L, item 8
	Financial Assets Transferred with Recourse	+ Schedule RC-L, sum of items 9.a.(1), 9.b.(1), and 9.c.(2)
	Credit Derivatives	+ Schedule RC-L, sum of items 10.a and 10.b
	Forward Contracts	+ Schedule RC-L, item 14.b, sum of columns A through D
	Exchange-Traded Purchased Options	+ Schedule RC-L, item 14.c.(2), sum of columns A through D
	Over-the-Counter Purchased Options	+ Schedule RC-L, item 14.d.(2), sum of columns A through D
	Swaps	+ Schedule RC-L, item 14.e, sum of columns A through D
	Other Off-Balance Sheet Liabilities	+ Schedule RC-L, item 12
	EQUALS:	= Adjusted Total Assets

2 **<u>Portion of qualifying limited-life capital instruments (original weighted average maturity of at least five years) that is includible in Tier 2 capital.</u>** The portion of a bank's qualifying limited-life capital instruments that is includible in Tier 2 capital is the amount that remains after discounting those instruments, if any, with five years or less until maturity and then applying any applicable percentage of Tier 1 capital limit. For limited-life capital instruments with serial maturities or with sinking fund provisions, the amount associated with each maturity date is to be treated as a separate issue and discounted on an individual basis. If the holder of the reporting bank's subordinated debt or intermediate-term or long-term preferred stock has the right to require the bank to redeem, repay, or repurchase the instrument prior to the original stated maturity, then maturity would be defined as the earliest possible date on which the holder can put the instrument back to the issuing bank.

2.a **<u>Subordinated debt and intermediate-term preferred stock.</u>** Report the portion of the reporting bank's qualifying term subordinated debt and intermediate-term preferred stock (including any related surplus) that is includible in Tier 2 capital. These capital instruments must have an original weighted average maturity of at least five years. Include as

Item No. **Caption and Instructions**

2.a (cont.) intermediate-term preferred stock those issues of preferred stock with an original maturity of less than 20 years.

Include as subordinated debt the amount of any mandatory convertible debt that has common or perpetual preferred stock dedicated (in accordance with guidelines issued or established by the bank's primary federal bank supervisory authority) to redeem, in whole or in part, such outstanding issues. Otherwise, mandatory convertible debt should be excluded from this item.

Qualifying term subordinated debt and intermediate-term preferred stock is the amount that remains after discounting any instruments with five years or less until maturity. The portion of this qualifying amount that is includible in Tier 2 capital is limited to 50 percent of Tier 1 capital. This portion is calculated as follows:

(1)	Amount of subordinated debt and intermediate-term preferred stock with a remaining maturity of more than five years	_____ x 100% = _____
(2)	Amount of subordinated debt and intermediate-term preferred stock with a remaining maturity of more than four years, but less than five years	_____ x 80% = _____
(3)	Amount of subordinated debt and intermediate-term preferred stock with a remaining maturity of more than three years, but less than four years	_____ x 60% = _____
(4)	Amount of subordinated debt and intermediate-term preferred stock with a remaining maturity of more than two years, but less than three years	_____ x 40% = _____
(5)	Amount of subordinated debt and intermediate-term preferred stock with a remaining maturity of more than one year, but less than two years	_____ x 20% = _____
(6)	Amount of subordinated debt and intermediate-term preferred stock with a remaining maturity of one year or less	_____ x 0% = _____
(7)	Qualifying subordinated debt and intermediate-term preferred stock (sum of discounted amounts of lines (1) through (6))	_____
(8)	Tier 1 capital (from Schedule RC-R, item 3.a)	_____
(9)	Multiplied by 50 percent	x 50%
(10)	Limit for qualifying subordinated debt and intermediate-term preferred stock (line (8) multiplied by 50 percent)	_____
(11)	Portion of qualifying subordinated debt and intermediate-term preferred stock includible in Tier 2 capital (lesser of lines (7) and (10))	_____

Report the amount from line (11) in Schedule RC-R, item 2.a.

2.b **Other limited-life capital instruments.** Report the portion of the reporting bank's qualifying other limited-life capital instruments, such as long-term preferred stock with an original maturity of 20 years or more, that is includible in Tier 2 capital.

Qualifying other limited-life capital instruments is the amount that remains after discounting any instruments with five years or less until maturity. The entire amount of this qualifying

Item No. **Caption and Instructions**

2.b (cont.) amount is the portion that is includible in Tier 2 capital. This portion is calculated as follows:

(1)	Amount of other limited-life capital instruments with a remaining maturity of more than five years	_____ x 100% = _____
(2)	Amount of other limited-life capital instruments with a remaining maturity of more than four years, but less than five years	_____ x 80% = _____
(3)	Amount of other limited-life capital instruments with a remaining maturity of more than three years, but less than four years	_____ x 60% = _____
(4)	Amount of other limited-life capital instruments with a remaining maturity of more than two year, but less than three years	_____ x 40% = _____
(5)	Amount of other limited-life capital instruments with a remaining maturity of more than one year, but less than two years	_____ x 20% = _____
(6)	Amount of other limited-life capital instruments with a remaining maturity of one year or less	_____ x 0% = _____
(7)	Portion of qualifying other limited-life capital instruments (sum of discounted amounts of lines (1) through (6))	_____

Report the amount from line (7) in Schedule RC-R, item 2.b.

3 **Amounts used in calculating regulatory capital ratios.** Report in the appropriate subitem the indicated amounts used in calculating the bank's risk-based and leverage capital ratios.[4] Some of these amounts are also used in calculating other regulatory limitations, such as limits on loans to insiders. The amounts to be reported in these subitems should be those determined by the bank for its own internal regulatory capital analyses consistent with applicable capital standards and these instructions and they are subject to examiner review.

3.a.(1) **Tier 1 capital.** Report the amount of the bank's Tier 1 capital. The amount reported in this item is the numerator of the bank's Tier 1 risk-based capital ratio and its Tier 1 leverage ratio.

Tier 1 (core) capital consists of:
(1) common stockholders' equity capital,
(2) noncumulative perpetual preferred stock and any related surplus, and
(3) minority interests in equity capital accounts of consolidated subsidiaries,
less goodwill, other disallowed intangible assets, and disallowed deferred tax assets, and any other amounts that are deducted in determining Tier 1 capital in accordance with the capital standards issued by the reporting bank's primary federal supervisory authority.

[4] For purposes of Schedule RC-R, items 3.a.(1), 3.d.(1), and 3.f, insured state banks with real estate subsidiaries whose continued operations have been approved by the FDIC pursuant to Section 362.4 of the FDIC's Rules and Regulations should deduct from the parent bank's Tier 1 capital and assets, as appropriate: (a) any equity investment in the subsidiary, (b) any debt issued by the subsidiary that is held by the insured state bank or guarantees of any debt issued by the subsidiary by the insured state bank, and (c) any extensions of credit from the insured state bank to the subsidiary. Insured state banks with FDIC-approved phase-out plans for real estate subsidiaries need not make these deductions.

Item No. **Caption and Instructions**

3.a.(1) (cont.) NOTE: For regulatory capital purposes, common stockholders' equity capital includes any net unrealized holding losses on available-for-sale equity securities with readily determinable fair values (net of any applicable tax effect), but excludes other net unrealized holding gains (losses) on available-for-sale securities. Common stockholders' equity capital also excludes accumulated net gains (losses) on cash flow hedges.

For most banks, Tier 1 capital will equal common stockholders' equity capital (Schedule RC, the sum of items 24, 25, 26.a, and 27, less any net unrealized holding losses on available-for-sale equity securities with readily determinable fair values, net of any applicable tax effect) less goodwill and other disallowed intangible assets and less disallowed deferred tax assets. (Net unrealized holding losses on available-for-sale equity securities with readily determinable fair values can be determined from Schedule RC-B, item 6.a. In general, if item 6.a, column C, is greater than item 6.a, column D, the excess should be deducted from Tier 1 capital, net of any applicable tax effect. Intangible assets are reported in Schedule RC, item 10, and in Schedule RC-M, item 6. Disallowed deferred tax assets are reported in Schedule RC-F, Memorandum item 1.)

If the bank has any low level recourse transactions and chooses to use the "direct reduction method" for reporting these transactions in Schedule RC-R (as discussed in the General Instructions to Schedule RC-R), do *not* deduct any of the bank's "maximum contractual dollar amount of recourse exposure in low level recourse transactions," as reported in Schedule RC-R, item 3.e, from the amount of Tier 1 capital that the bank reports in this item.

3.a.(2) **Tier 2 capital.** Report the amount of the bank's Tier 2 capital. The amount reported in this item must be less than or equal to the amount reported in Schedule RC-R, item 3.a.(1), "Tier 1 capital."

Tier 2 (supplementary) capital is limited to 100 percent of Tier 1 capital and consists of:

(1) cumulative perpetual preferred stock and any related surplus,
(2) long-term preferred stock (original maturity of 20 years or more) and any related surplus (discounted for capital purposes as it approaches maturity),
(3) auction rate and similar preferred stock (both cumulative and noncumulative),
(4) hybrid capital instruments (including mandatory convertible debt securities),
(5) term subordinated debt and intermediate-term preferred stock (original weighted average maturity of five years or more) to the extent of 50 percent of Tier 1 capital (and discounted for capital purposes as they approach maturity),
(6) the allowance for credit losses, i.e., the allowance for loan and lease losses plus any portions of the allowance for credit losses related to off-balance sheet exposures (limited to the lesser of the balance of the allowance or 1.25 percent of gross risk-weighted assets), and
(7) up to 45 percent of pretax net unrealized holding gains on available-for-sale equity securities with readily determinable fair values.

For most banks, Tier 2 capital will equal the allowable portion of the allowance for loan and lease losses (Schedule RC, item 4.b) and is further limited to 100 percent of Tier 1 capital. Banks with other Tier 2 capital components (e.g., subordinated debt and preferred stock) should refer to the definition of Tier 2 capital set forth above and to the risk-based capital guidelines for the proper treatment of such components.

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3.a.(3) **Tier 3 capital.** (Item 3.a.(3) is to be completed only by banks that file the FFIEC 031 or 032 report forms.) Report the amount of the bank's Tier 3 capital allocated for market risk. This item is only applicable to banks that are subject to the market risk capital guidelines. The amount reported in this item may only be used to satisfy the bank's market risk capital requirement and may not be used to support credit risk. The sum of the amount reported in this item and the amount reported in Schedule RC-R, item 3.a.(2), "Tier 2 capital," must be less than or equal to the amount reported in Schedule RC-R, item 3.a.(1), "Tier 1 capital." In addition, Tier 3 capital allocated for market risk plus Tier 2 capital allocated for market risk are limited to 71.4 percent of a bank's measure for market risk.

3.b **Total risk-based capital.** Report the amount of the bank's total risk-based capital. The amount reported in this item is the numerator of the bank's total risk-based capital ratio.

Total risk-based capital is the sum of Tier 1 capital, Tier 2 capital, and Tier 3 capital allocated for market risk, net of all deductions. *Deductions* are made for investments in banking and finance subsidiaries that are not consolidated for regulatory capital purposes, intentional reciprocal cross-holdings of banking organizations' capital instruments, and other deductions as determined by the reporting bank's primary federal supervisory authority.

For most banks, total risk-based capital will equal the sum of Schedule RC-R, item 3.a.(1), "Tier 1 capital," and item 3.a.(2), "Tier 2 capital."

If the bank has any low level recourse transactions and chooses to use the "direct reduction method" for reporting these transactions in Schedule RC-R (as discussed in the General Instructions to Schedule RC-R), do *not* deduct the bank's "maximum contractual dollar amount of recourse exposure in low level recourse transactions," as reported in Schedule RC-R, item 3.e, from the amount of total risk-based capital that the bank reports in this item.

3.c **Excess allowance for loan and lease losses.** Report the amount, if any, by which the bank's allowance for credit losses exceeds 1.25 percent of the bank's *gross* risk-weighted assets. The allowance for credit losses is reported in Schedule RI-B, part II, item 6. On the FFIEC 034 in quarters when Schedule RI-B, part II, is not completed, the allowance for credit losses generally is the allowance for loan and lease losses as reported in Schedule RC, item 4.b. However, the allowance for credit losses also includes any portions of the allowance for credit losses related to off-balance sheet credit exposures reported elsewhere on the balance sheet (Schedule RC).

Gross risk-weighted assets is the amount of the bank's risk-weighted assets *before* deducting the amount of any excess allowance for loan and lease losses. (Note: The amount reported in Schedule RC-R, item 3.d.(1), is *net* risk-weighted assets. Do *not* multiply the amount reported in item 3.d.(1) by 1.25 percent to determine the amount of the bank's excess allowance for loan and lease losses.)

If the bank has any low level recourse transactions and chooses to use the "direct reduction method" for reporting these transactions in Schedule RC-R, refer to the discussion of this subject in the General Instructions to Schedule RC-R for guidance on determining the limit on the allowance for loan and lease losses for Tier 2 capital purposes.

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3.c (cont.)	For banks that are subject to the market risk capital guidelines, report the amount, if any, by which the allowance for credit losses exceeds 1.25 percent of the sum of market risk equivalent assets (as reported in Schedule RC-R, item 3.d.(2)) plus gross risk-weighted assets.
3.d.(1)	**Net risk-weighted assets.** Report the amount of the bank's risk-weighted assets *net* of all deductions. The amount reported in this item is the denominator of the bank's total risk-based capital ratio and, thus, should include any amount reported in Schedule RC-R, item 3.d.(2), "Market risk equivalent assets." When determining the amount of risk-weighted assets, on-balance sheet assets are assigned an appropriate risk weight (zero percent, 20 percent, 50 percent, or 100 percent) and off-balance sheet items are first converted to a credit equivalent amount and then assigned to one of the four risk weight categories. All covered positions that are subject to the market risk capital guidelines, except for foreign exchange positions that are outside of the trading account and all over-the-counter (OTC) derivatives, are excluded from the amounts used to determine risk-weighted assets. Foreign exchange positions outside of the trading account and all OTC derivatives have a counterparty credit risk capital charge and are included in net risk-weighted assets. The on-balance sheet assets and the credit equivalent amounts of off-balance sheet items are then multiplied by the appropriate risk weight percentages and the sum of these risk-weighted amounts, less certain deductions, is the bank's *gross* risk-weighted assets. These deductions are for goodwill, other disallowed intangible assets, disallowed deferred tax assets, investments in banking and finance subsidiaries that are not consolidated for regulatory capital purposes, intentional reciprocal cross-holdings of banking organizations' capital instruments, and other deductions as determined by the reporting bank's primary federal supervisory authority. Gross risk-weighted assets minus any excess allowance for loan and lease losses (reported in Schedule RC-R, item 3.c) and minus any allocated transfer risk reserve is the bank's *net* risk-weighted assets, which is the amount to be reported in this item. If the bank has any low level recourse exposures, it should include in the net risk-weighted assets reported in this item the appropriate amount for these exposures as determined under the "direct reduction method" or the "gross-up method." These methods are discussed in the section of the General Instructions to Schedule RC-R on "Treatment of Low Level Recourse Transactions."
3.d.(2)	**Market risk equivalent assets.** (Item 3.d.(2) is to be completed only by banks that file the FFIEC 031 or 032 report forms.) Report the amount of the bank's market risk equivalent assets. This item is only applicable to banks that are subject to the market risk capital guidelines. Market risk equivalent assets equals the bank's measure for market risk multiplied by 12.5. Banks should refer to the capital guidelines of their primary federal supervisory authority for specific instructions on the calculation of the measure for market risk.
3.e	**Maximum contractual dollar amount of recourse exposure in low level recourse transactions.** If the bank has any low level recourse transactions and chooses to use the "direct reduction method" for reporting these transactions in Schedule RC-R, report the "maximum contractual dollar amount of recourse exposure" for these transactions in accordance with the guidance in the section of the General Instructions to Schedule RC-R on "Treatment of Low Level Recourse Transactions."

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3.e (cont.) If the bank has no low level recourse transactions or if the bank chooses to use the "gross-up method" for reporting its low level recourse transactions in Schedule RC-R, report a zero in this item.

3.f **"Average total assets."** Report the amount of the bank's "average total assets," i.e., the denominator of the bank's Tier 1 leverage capital ratio.

"Average total assets" consists of the quarterly average for "total assets" as reported in the Call Report, less goodwill, other disallowed intangible assets, disallowed deferred tax assets, and any other assets that are deducted in determining Tier 1 capital in accordance with the capital standards issued by the reporting bank's primary federal supervisory authority. For FDIC-supervised banks, the quarterly average for "total assets" must be adjusted for any securities subsidiary subject to Section 337.4 of the FDIC's Rules and Regulations.

For most banks, "average total assets" will equal Schedule RC-K, item 7 on the FFIEC 034, item 9 on the FFIEC 031, 032, and 033, less goodwill and other disallowed intangible assets and less disallowed deferred tax assets. Intangible assets are reported in Schedule RC, item 10, and in Schedule RC-M, item 6. Disallowed deferred tax assets are reported in Schedule RC-F, Memorandum item 1.

4 **Assets and credit equivalent amounts of off-balance sheet items assigned to the Zero percent risk category.** Report in the appropriate subitem:

(1) Currency and coin (domestic and foreign) held in the bank or in transit (from Schedule RC-A on the FFIEC 031, 032, and 033; from Schedule RC-M, item 3.b, on the FFIEC 034);

(2) Securities issued by and other direct claims (such as loans or leases) on the U.S. Government and other OECD central governments (including U.S. Treasury securities from Schedule RC-B, item 1);

(3) Portions of claims on other counterparties that are *unconditionally* guaranteed by the U.S. Government and its agencies and other OECD central governments (including GNMA and SBA securities and loans guaranteed by the Export-Import Bank);

(4) Local currency claims on, and the portions of local currency claims that are *unconditionally* guaranteed by, non-OECD central governments (including central banks) to the extent that the bank has liabilities booked in that currency; and

(5) Gold bullion held in the bank's vaults or in another's vaults on an allocated basis, to the extent offset by gold bullion liabilities.

For national and state member banks, this item includes those claims, or portions of claims, that (a) are collateralized by cash on deposit in the reporting bank or by securities issued by, or directly and unconditionally guaranteed by, the U.S. Government or its agencies or the central government of an OECD country and (b) qualify for a zero percent risk weight in accordance with the risk-based capital standards issued by the reporting bank's primary federal supervisory authority. The extent to which qualifying securities are recognized as collateral is determined by their current market value. If a claim is partially secured, that is, the market value of the pledged securities is less than the face amount of an asset or off-balance sheet item, only the portion that is covered by the market value of the collateral

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4 (cont.) is to be reported in this item. The face amount of a claim secured by two types of qualifying collateral is to be reported in the items appropriate to the collateral types, apportioned according to the market value of each of the two types of collateral.

Claims on OECD central governments includes balances due from the Federal Reserve Banks (including Federal Reserve Bank stock) and central banks in other OECD countries. If the reporting bank is the correspondent bank in a pass-through reserve balance relationship, report the amount of its own reserves as well as those reserve balances actually passed through to a Federal Reserve Bank on behalf of its respondent depository institutions.

If the reporting bank is the respondent bank in a pass-through reserve balance relationship, report in this item the amount of the bank's reserve balances due from its correspondent bank that its correspondent has actually passed through to a Federal Reserve Bank on the reporting bank's behalf, i.e., for purposes of this item, treat these balances as balances due from a Federal Reserve Bank. This treatment differs from that required in Schedule RC-A, item 2 (on the FFIEC 031, 032, and 033), "Balances due from depository institutions in the U.S.," which would treat balances held by a bank's correspondent as balances due from a depository institution as opposed to balances due from the Federal Reserve.

For banks that are subject to the market risk capital guidelines, exclude all covered positions except for foreign exchange positions that are outside of the trading account and over-the-counter (OTC) derivatives. The book value or credit equivalent amount, as appropriate, of foreign exchange positions that are outside of the trading account and all OTC derivatives assigned to the Zero percent risk category should continue to be included in this item. Covered positions include all positions in a bank's trading account, and all foreign exchange and commodity positions whether or not in the trading account.

4.a **Assets recorded on the balance sheet.** Report the book value (i.e., fair value for assets held for trading) of all assets recorded on the reporting bank's balance sheet which are assigned a Zero percent risk weight under the risk-based capital guidelines. However, for available-for-sale securities assigned to the Zero percent risk category, report the amortized cost of such securities rather than the fair value at which they are reported on the balance sheet.

4.b **Credit equivalent amount of off-balance sheet items.** Report the credit equivalent amount, as determined under the risk-based capital guidelines, for those off-balance sheet items that are to be risk weighted at Zero percent in accordance with the guidelines. Include the credit equivalent amount of those off-balance sheet direct claims on, or claims unconditionally guaranteed by the U.S. Government and other OECD central governments.

5 **Assets and credit equivalent amounts of off-balance sheet items assigned to the 20 percent risk category.** Report in the appropriate subitem:

(1) Cash items in the process of collection (from Schedule RC-A on the FFIEC 031, 032, and 033; a portion of Schedule RC, item 1.a on the FFIEC 034);

(2) Claims on (including balances due from), and the portion of claims guaranteed by, U.S. depository institutions and other OECD banks (except as noted below);

(3) Short-term (one year or less) claims on, and the portions of short-term claims guaranteed by, non-OECD banks;

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5 (cont.) (4) Portions of claims collateralized by securities issued, or guaranteed, by the U.S. Government and other OECD central governments that, under the risk-based capital standards issued by the reporting bank's primary federal supervisory authority, do not qualify for the zero percent risk weight category;

(5) Portions of securities, loans, and other claims *conditionally* guaranteed by the U.S. Government and its agencies and other OECD central governments (e.g., VA and FHA mortgage loans and student loans on which the U.S. Department of Education acts as a reinsurer);

(6) Portions of local currency claims that are *conditionally* guaranteed by the central governments of non-OECD countries, to the extent that the bank has liabilities booked in that country;

NOTE: A guarantee is conditional if its validity is dependent upon some affirmative action by the bank or a third party (e.g., servicing requirements).

(7) General obligation claims on, and the portion of claims that are guaranteed by the full faith and credit of local governments and political subdivisions in the U.S. and other OECD local governments;

(8) Portions of claims collateralized by cash on deposit in the reporting bank -- including standby letters of credit collateralized by cash -- that, under the risk-based capital standards issued by the reporting bank's primary federal supervisory authority, do not qualify for the zero percent risk weight category;

NOTE: Claims collateralized by deposits in other depository institutions (e.g., certificates of deposit issued by other banks) do *not* qualify for a 20 percent risk weight. Such collateralized claims are to be reported in Schedule RC-R, item 6 or item 7, as appropriate.

(9) Claims (including securities from Schedule RC-B) on or guaranteed by U.S. Government-sponsored agencies;

(10) Portions of claims collateralized by securities issued or guaranteed by U.S. Government-sponsored agencies (e.g., loans collateralized by FHLMC pass-through securities);

(11) Certain privately-issued mortgage-backed securities representing indirect ownership of U.S. Government agency or U.S. Government-sponsored agency mortgage-backed securities (e.g., GNMA, FNMA, and FHLMC pass-through securities); and

(12) Claims on, guaranteed by, or collateralized by securities of, official multilateral lending institutions or regional development banks, e.g., the World Bank including the International Finance Corporation.

<u>Include</u> as claims guaranteed by U.S. depository institutions and foreign banks all risk participations in bankers acceptances, standby letters of credit, and commitments that are conveyed to such institutions. Do *not* include in this item the portion of loans insured under the FHA Title I insurance program, claims on bank holding companies, or holdings of bank-issued securities that qualify as capital of the issuing bank for risk-based capital

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5 (cont.) purposes (report in item 7). In addition, claims on foreign official institutions that are not multilateral lending institutions or regional development banks (e.g., agencies of the United Nations other than the World Bank and the International Finance Corporation) are *not* to be reported in this item (report in item 7).

The extent to which qualifying securities are recognized as collateral is determined by their current market value. If a claim is partially secured, that is, the market value of the pledged securities is less than the face amount of an asset or off-balance sheet item, only the portion that is covered by the market value of the collateral is to be reported in this item. The face amount of a claim secured by two types of qualifying collateral is to be reported in the items appropriate to the collateral types, apportioned according to the market value of each of the two types of collateral.

If a claim is partially guaranteed or covered by two types of guarantees, then the aforementioned treatment of claims that are collateralized is applicable.

For banks that are subject to the market risk capital guidelines, exclude all covered positions except for foreign exchange positions that are outside of the trading account and over-the-counter (OTC) derivatives. The book value or credit equivalent amount, as appropriate, of foreign exchange positions that are outside of the trading account and all OTC derivatives assigned to the 20 percent risk category should continue to be included in this item. Covered positions include all positions in a bank's trading account, and all foreign exchange and commodity positions whether or not in the trading account.

5.a **Assets recorded on the balance sheet.** Report the book value (fair value for assets held for trading) of all assets recorded on the reporting bank's balance sheet which are assigned a 20 percent risk weight under the risk-based capital guidelines. However, for available-for-sale debt securities assigned to the 20 percent risk category, report the amortized cost of such securities rather than the fair value at which they are reported on the balance sheet. For available-for-sale equity securities, if total cost exceeds total fair value, report in this item the fair value of available-for-sale equity securities assigned to the 20 percent risk category rather than their cost; if total fair value exceeds total cost, report in this item the cost of available-for-sale equity securities assigned to the 20 percent risk category rather than the fair value at which they are reported on the balance sheet.

5.b **Credit equivalent amount of off-balance sheet items.** Report the credit equivalent amount, as determined under the risk-based capital guidelines, for those off-balance sheet items that are risk weighted at 20 percent. Include the credit equivalent amount of off-balance sheet claims collateralized by cash on deposit (e.g., standby letters of credit collateralized by cash) that, under the risk-based capital standards issued by the reporting bank's primary federal supervisory authority, do not qualify for the zero percent risk weight category.

6 **Assets and credit equivalent amounts of off-balance sheet items assigned to the 50 percent risk category.** Report the book value (fair value for assets held for trading) of all assets recorded on the reporting bank's balance sheet and the credit equivalent amount of all off-balance sheet items which are assigned a 50 percent risk weight under the risk-based capital guidelines. However, for available-for-sale debt securities assigned to the 50 percent risk category, report the amortized cost of such securities rather than the fair value at which they are reported on the balance sheet. For available-for-sale equity securities, if total cost exceeds total fair value, report in this item the fair value of available-for-sale equity securities assigned to the 50 percent risk category rather than their cost; if total fair

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6 (cont.) value exceeds total cost, report in this item the cost of available-for-sale equity securities assigned to the 50 percent risk category rather than the fair value at which they are reported on the balance sheet. In addition, the 50 percent risk weight is the maximum risk weight to be applied to the credit equivalent amounts of those interest rate, foreign exchange, equity derivative, and commodity and other derivative contracts covered under the risk-based capital guidelines.

For banks that are subject to the market risk capital guidelines, exclude all covered positions except for foreign exchange positions that are outside of the trading account and over-the-counter (OTC) derivatives. The book value or credit equivalent amount, as appropriate, of foreign exchange positions that are outside of the trading account and all OTC derivatives assigned to the 50 percent risk category should continue to be included in this item. Covered positions include all positions in a bank's trading account, and all foreign exchange and commodity positions whether or not in the trading account.

6.a **Assets recorded on the balance sheet.** Report in this item loans that are fully secured by first liens on 1-to-4 family residential properties (including certain presold residential construction loans) that were made in accordance with prudent underwriting standards (including an appropriate loan-to-value ratio), that are performing in accordance with their original terms, and that are not 90 days or more past due or in nonaccrual status.

If a bank holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the loans will be viewed as a single extension of credit secured by a first lien on the underlying property for purposes of determining the loan-to-value ratio and assigning a risk weight. The combined loan amount will be assigned to either the 50 percent or 100 percent risk category, depending on whether the credit satisfies the criteria for a 50 percent risk weighting. To qualify for the 50 percent risk category, the combined loan must be made in accordance with prudent underwriting standards (including an appropriate loan-to-value ratio) and none of the combined loans may be 90 days or more past due or in nonaccrual status. If the combined loan does not meet all of these criteria, the combined loans must be assigned in their entirety to the 100 percent risk category and reported in Schedule RC-R, item 7.a below.

Also report in this item loans fully secured by first liens on multifamily residential properties that have been prudently underwritten and meet the requirements specified in the risk-based capital standards for loan-to-value ratios, level of annual net operating income to required debt service, maximum amortization period, minimum original maturity, and demonstrated timely repayment performance.

Also include certain privately-issued mortgage-backed securities representing direct and indirect ownership of the aforementioned mortgage loans if the criteria for privately-issued mortgage-backed securities outlined in the risk-based capital guidelines (and listed below) are met. For example, a homebuilder issues a pass-through security that is backed by a pool of first mortgages on 1-to-4 family residential mortgages that are prudently underwritten and are not restructured, past due, or in nonaccrual status. The criteria outlined in the risk-based capital guidelines allowing these securities to be risk-weighted on the basis of the pool of mortgage collateral rather than on the issuer require that:

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6.a (cont.)

(1) the underlying assets are held by an independent trustee and the trustee has a first priority, perfected security interest in the underlying assets on behalf of the holders of the security;

(2) either (a) the holder of the security has an undivided *pro rata* ownership interest in the underlying mortgage assets or (b) the trust or single purpose entity that issues the security has no liabilities unrelated to the issued securities;

(3) the security is structured such that the cash flow from the underlying assets in all cases fully meets the cash flow requirements of the security without undue reliance on any reinvestment income; and

(4) there is no material reinvestment risk associated with any funds awaiting distribution to the holders of the security.

In addition, include revenue bonds or similar claims that are obligations of U.S. state or local governments, or other OECD local governments, for which the government is committed to repay the debt only out of revenues from the facilities financed.

Exclude from this item loans collateralized by mortgage notes that the reporting bank has indirectly financed, e.g., mortgage warehousing lines.

6.b **Credit equivalent amount of off-balance sheet items.** Report the credit equivalent amount, as determined under the risk-based capital guidelines, for those off-balance sheet items that are to be risk weighted at 50 percent in accordance with the guidelines. Include in this item the credit equivalent amounts of interest rate and foreign exchange rate contracts that are not accorded a lower risk weight as a result of the counterparty, collateral, or a guarantee.

7 **Assets and credit equivalent amounts of off-balance sheet items assigned to the 100 percent risk category.** Report the book value (fair value for assets held for trading) of all assets recorded on the reporting bank's balance sheet and the credit equivalent amount of all off-balance sheet items which are assigned a 100 percent risk weight under the risk-based capital guidelines. For available-for-sale debt securities assigned to the 100 percent risk category, report the amortized cost of such securities rather than the fair value at which they are reported on the balance sheet. For available-for-sale equity securities, if total cost exceeds total fair value, report in this item the fair value of available-for-sale equity securities assigned to the 100 percent risk category rather than their cost; if total fair value exceeds total cost, report in this item the cost of available-for-sale equity securities assigned to the 100 percent risk category (rather than the fair value at which they are reported on the balance sheet) plus the portion of the pretax net unrealized holding gains (up to 45 percent) the bank has included in Tier 2 capital.

For banks that are subject to the market risk capital guidelines, exclude all covered positions except for foreign exchange positions that are outside of the trading account and over-the-counter (OTC) derivatives. The book value or credit equivalent amount, as appropriate, of foreign exchange positions that are outside of the trading account and all OTC derivatives assigned to the 100 percent risk category should continue to be included in this item. Covered positions include all positions in a bank's trading account, and all foreign exchange and commodity positions whether or not in the trading account.

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7.a **Assets recorded on the balance sheet.** Report all assets that are not reportable in items 4 through 6 above or in item 8 below. Include:

(1) Stripped mortgage-backed securities (e.g., interest-only and principal-only strips);
(2) Residual and subordinated interests in asset-backed securities;
(3) Mortgage servicing assets, purchased credit card relationships, and nonmortgage servicing assets (excluding any portion that is disallowed for regulatory capital purposes);
(4) Premises and fixed assets;
(5) Industrial development bonds;
(6) Loans, debt securities, and other claims where the counterparty is a private obligor;
(7) Margin accounts on futures contracts;
(8) Other real estate owned;
(9) Net deferred tax assets (excluding any portion that is disallowed for regulatory capital purposes); and
(10) All other assets not already reported above (excluding those reportable in Schedule RC-R, item 8 below).

For purposes of this schedule, the amount to be reported in this item should be *reduced* by the amount of any valuation allowances the reporting bank maintains against assets other than loans and available-for-sale securities (e.g., valuation allowances for other real estate owned).

7.b **Credit equivalent amounts of off-balance sheet items.** Report the credit equivalent amount, as determined under the risk-based capital guidelines, for those off-balance sheet items that are risk weighted at 100 percent in accordance with the guidelines. Include those off-balance sheet items where the counterparty is a private obligor and which are not accorded a lower risk weight as a result of collateral or a guarantee.

8 **On-balance sheet asset values excluded from and deducted in the calculation of the risk-based capital ratio.** Report in this item the difference between the fair value and the amortized cost of the reporting bank's available-for-sale debt securities (and report the amortized cost of these debt securities in Schedule RC-R, items 4 through 7 above). Furthermore, to the extent that the amount of net deferred tax assets carried on the balance sheet (Schedule RC) and reported in Schedule RC-F, item 2, includes the deferred tax effects of any unrealized holding gains and losses on available-for-sale debt securities, these deferred tax effects *may* be excluded from the net deferred tax asset amount reported as a 100 percent risk weight asset in Schedule RC-R, item 7.a. If these deferred tax assets are excluded, they should be reported in this item and this reporting treatment must be followed consistently over time. For available-for-sale equity securities, if total cost exceeds total fair value, report the fair value of these equity securities in items 5 through 7 above and include no amount in this item. However, if total fair value exceeds total cost, the bank may include up to 45 percent of the pretax net unrealized holding gains as a component of Tier 2 capital. In this situation, report the cost of these equity securities in items 5 through 7 above, report the portion of the pretax net unrealized holding gains (up to 45 percent) included in Tier 2 capital in item 7.a above, and include the remainder of the pretax net unrealized holding gains (55 percent or more) in this item.

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8 (cont.)	Include in this item any portion of the bank's mortgage servicing assets, purchased credit card relationships, nonmortgage servicing assets, and net deferred tax assets that is disallowed for regulatory capital purposes as well as all other intangible assets and other assets that are required to be deducted from regulatory capital in accordance with the capital standards issued by the bank's primary federal regulatory agency.

If the bank has low level recourse transactions that use contractual cash flows (e.g., interest-only strips receivable and so-called "spread accounts"), retained subordinated interests, retained securities (e.g., collateral invested amounts or cash collateral accounts) or other assets as credit enhancements, the on-balance sheet asset amount of the credit enhancements should be included in this item. The "maximum contractual dollar amount of recourse exposure" for low level recourse transactions should be converted into off-balance sheet credit equivalent amounts and reported in accordance with the section of the General Instructions to Schedule RC-R on "Treatment of Low Level Recourse Transactions."

Also report in this item the on-balance sheet asset values (or portions thereof) of off-balance sheet interest rate, foreign exchange, equity derivative, and commodity and other contracts that are treated for risk-based capital purposes as off-balance sheet items even though they may have on-balance sheet amounts included on Schedule RC. In addition, include in this item the on-balance sheet asset values related to (1) foreign exchange contracts with an original maturity of fourteen calendar days or less, (2) instruments traded on organized exchanges that require daily payment and receipt of variation margin (e.g., futures contracts), and (3) other interest rate, foreign exchange, equity derivative, and commodity and other contracts not covered under the risk-based capital guidelines such as over-the-counter written options. These on-balance sheet asset values may have been reported on Schedule RC on a net basis in accordance with the FASB Interpretation No. 39, as described in the Glossary entry for "Offsetting." (Purchased options that are traded on an organized exchange are to be included in the calculation of the risk-based capital ratio because such option contracts are not subject to a daily variation margin.) For banks that are subject to the market risk capital guidelines, to the extent that their on-balance sheet amounts have not already been included in this item in accordance with the preceding instructions, also report in this item the on-balance sheet asset values of all positions in the trading account and commodity positions.

For those off-balance sheet interest rate, foreign exchange, equity derivative, and commodity and other contracts subject to risk-based capital, banks should report the on-balance sheet asset values (or portions thereof) in this item to avoid a capital charge against the on-balance sheet amounts in addition to the capital charge against the credit equivalent amounts calculated under the risk-based capital guidelines. The amount to be reported in this item for each off-balance sheet interest rate, foreign exchange, equity derivative, and commodity and other contract should equal the lower of the contract's positive on-balance sheet asset amount included in Schedule RC or its positive market value included in computing the credit equivalent amount of the transaction. (For purposes of this comparison, if the amount of any accrued receivable is included in the calculation of the credit equivalent amount of an off-balance sheet derivative contract, this amount should be treated as part of the contract's positive on-balance sheet asset amount.) If either amount is zero or negative, then report for that contract in this item the amount, if any, which has been included in the on-balance sheet asset amount reported for such contract on Schedule RC. For example, a forward contract that is marked to market for reporting purposes will have its on-balance sheet market value, if positive, reported in this item and,

Item No.	Caption and Instructions
8 (cont.)	as a result, this on-balance sheet asset amount will be excluded from the risk-based capital ratio computation. The positive market value, however, will be included in the credit equivalent amount of this off-balance sheet item for risk-based capital purposes. If the on-balance sheet asset value of a purchased option exceeds the market value of the purchased option, then the excess is not to be included in this item; rather, the excess is to be included in the appropriate risk weight category in Schedule RC-R, items 4 through 6 above. However, if the market value equals or exceeds the on-balance sheet asset value, the full on-balance sheet amount would be included in this item. Exclude from this item any accrued receivables associated with off-balance sheet derivative contracts that are not included in the calculation of the credit equivalent amounts of these contracts and margin accounts related to derivative contracts. Margin accounts must be assigned to the 100 percent risk category while accrued receivables not reported in this item are to be included in the appropriate risk-weight category.
9	**Total assets recorded on the balance sheet.** Report in column A the sum of items 4.a, 5.a, 6.a, 7.a, and 8, column A. This amount must equal Schedule RC, item 12 plus items 4.b and 4.c.

LINE ITEM INSTRUCTIONS FOR THE CONSOLIDATED REPORT OF INCOME

The line item instructions should be read in conjunction with the Glossary and other sections of these instructions. See the discussion of the Organization of the Instruction Books in the General Instructions.

SCHEDULE RI -- INCOME STATEMENT

General Instructions

Report in accordance with these instructions all income and expense of the bank for the calendar year-to-date. Include adjustments of accruals and other accounting estimates made shortly after the end of a reporting period which relate to the income and expense of the reporting period.

A bank that began operating during the year-to-date reporting period should report in the appropriate items of Schedule RI *all* income earned and expenses incurred since commencing operations. The bank should report pre-opening income earned and expenses incurred from inception until the date operations commenced using one of the two methods described in the Glossary entry for "start-up activities."

If the bank entered into a business combination which became effective during the year-to-date reporting period and which has been accounted for as a pooling of interests, report the income and expense of the combined business for the entire year-to-date. If the bank entered into a business combination which became effective during the reporting period and which has been accounted for as a purchase, report the income and expense of the acquired bank or business only after its acquisition. If the bank was acquired in a transaction which became effective during the reporting period and push down accounting was used to account for the acquisition, Schedule RI should only include amounts from the date of the bank's acquisition through the end of the year-to-date reporting period. For further information on poolings of interests, purchase acquisitions, and push down accounting, see the Glossary entry for "business combinations."

Schedule RI is one of four schedules (and one memorandum item) in the FFIEC 033 and 034 Reports of Condition and Income in which banks are permitted to report loan detail in terms of general loan categories that are based upon each bank's own internal loan categorization system. While the definitions for the general loan categories are left to the choice of each reporting bank, each bank *must* use consistent definitions for these categories in each of the four schedules and the memorandum item. For further information, refer to the discussion of "Reporting of Loan Detail by Banks with Assets of Less Than $300 Million and No Foreign Offices" in the General Instructions section of this book.

Item Instructions

Item No. **Caption and Instructions**

1 **Interest income:**

1.a **Interest and fee income on loans.** Report in the appropriate subitem all interest, fees, and similar charges levied against or associated with all assets reportable as loans in Schedule RC-C, part I, items 1 through 8 on the FFIEC 034; items 1 through 9 on the FFIEC 031, 032, and 033.

Deduct interest rebated to customers on loans paid before maturity from gross interest earned on loans; do *not* report as an expense.

Include as interest and fee income on loans:

(1) Interest on all assets reportable as loans extended directly, purchased from others, sold under agreements to repurchase, or pledged as collateral for any purpose.

(2) All yield-related fees on loans held in the bank's portfolio. Report only the bank's proportional share of yield-related fees collected in connection with a loan syndication or participation that are not passed through to another lender.

(3) Loan commitment fees recognized as described under the Glossary entry for "loan fees."

(4) Investigation and service charges, fees representing a reimbursement of loan processing costs, renewal and past-due charges, prepayment penalties, and fees charged for the execution of mortgages or agreements securing the bank's loans.

(5) Accretion of discount on acceptances, loans secured by real estate (including points charged), and other loans. Deduct amortization of premium on loans secured by real estate or other loans from gross interest on loans.

(6) Charges levied against overdrawn accounts based on the length of time the account has been overdrawn, the magnitude of the overdrawn balance, or which are otherwise equivalent to interest. See exclusion (5) below.

Exclude from interest and fee income on loans:

(1) Fees that are not yield-related, such as management fees and servicing fees on real estate mortgages or other loans which are not assets of the bank (report as "Other fee income" in item 5.b.(1) on the FFIEC 034; item 5.f.(1) on the FFIEC 031, 032, and 033).

(2) Charges to merchants for the bank's handling of credit card or charge sales when the bank does not carry the related loan accounts on its books (report as "Other fee income" in item 5.b.(1) on the FFIEC 034; item 5.f.(1) on the FFIEC 031, 032, and 033). Banks may report this income net of the expenses (except salaries) related to the handling of these credit card or charge sales.

SCHEDULE RI-A -- CHANGES IN EQUITY CAPITAL

General Instructions

On the FFIEC 034, this schedule is to be completed for the report period ending December 31. On the FFIEC 031, 032, and 033, this schedule is to be completed quarterly.

Total equity capital includes perpetual preferred stock, common stock, surplus, undivided profits and capital reserves, net unrealized holding gains (losses) on available-for-sale securities, and accumulated net gains (losses) on cash flow hedges, (and, on the FFIEC 031, cumulative foreign currency translation adjustments). All amounts in Schedule RI-A, other than those reported in items 1, 3, and 13 (items 1, 3, and 14 on the FFIEC 031), should represent net aggregate changes for the calendar year-to-date. Enclose all net decreases and losses (net reductions in equity capital) in parentheses.

Item No. **Caption and Instructions**

1 **Total equity capital originally reported in the December 31, 19xx, Reports of Condition and Income.** Report the bank's total equity capital balance as of the previous calendar year-end as originally reported in the Reports of Condition and Income before the filing of any amended report(s).

For banks opened since January 1 of the current calendar year, report a zero or the word "none" in this item. Report the bank's opening (original) total equity capital in Schedule RI-A, item 5, "Sale, conversion, acquisition, or retirement of capital stock, net."

Do *not* enter the bank's total equity capital ending balance from the Report of Income for the preceding quarter when preparing the June 30, September 30, or December 31 report.

2 **Equity capital adjustments from amended Reports of Income, net.** Include the net cumulative effect of all corrections and adjustments made in any amended report(s) on the total equity capital ending balance originally reported in the Reports of Condition and Income for the previous calendar year-end. State the dollar amount of and describe each adjustment included in this item in Schedule RI-E, item 4.

Report a zero or the word "none" in this item if no amended report has been filed for the previous year-end report date.

3 **Amended balance end of previous calendar year.** Report the sum of items 1 and 2. If no amended report was filed for the previous calendar year-end reporting period, Schedule RI-A, item 3, must equal Schedule RI-A, item 1.

4 **Net income (loss).** Report the net income (loss) for the calendar year-to-date as reported in Schedule RI, item 12, "Net income (loss)."

5 **Sale, conversion, acquisition, or retirement of capital stock, net.** Report the changes in the bank's total equity capital resulting from:

(1) Sale of the bank's perpetual preferred stock or common stock. Limited-life preferred stock is *not* included in equity capital; any proceeds from the sale of limited-life preferred stock during the calendar year-to-date is *not* to be reported in this schedule.

Item No. **Caption and Instructions**

5 (cont.) (2) Exercise of stock options, including:

(a) Any income tax benefits to the bank resulting from the sale of the bank's own stock acquired under a qualified stock option within three years of its purchase by the employee who had been granted the option.

(b) Any tax benefits to the bank resulting from the exercise (or granting) of nonqualified stock options (on the bank's stock) based on the difference between the option price and the fair market value of the stock at the date of exercise (or grant).

(3) Conversion of convertible debt, limited-life preferred stock, or perpetual preferred stock into perpetual preferred or common stock.

(4) Redemption of perpetual preferred stock or common stock.

(5) Retirement of perpetual preferred stock or common stock.

(6) Acquisition (without retirement) and resale or other disposal of the bank's own perpetual preferred stock or common stock, i.e., treasury stock transactions (see the Glossary entry for "treasury stock").

(7) Capital-related transactions involving the bank's Employee Stock Ownership Plan.

Include in this item:

(1) The net decrease in equity capital which occurs when cash is distributed in lieu of fractional shares in a stock dividend.

(2) The net increase in equity capital when a stockholder who receives a fractional share from a stock dividend purchases the additional fraction necessary to make a whole share.

For banks opened since January 1 of the year-to-date reporting period, report opening (original) equity capital in this item. Pre-opening income earned and expenses incurred from the bank's inception until the date the bank commenced operations should be reported in the 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 commenced operations should be reported in the appropriate items of Schedule RI, Income Statement, each quarter during the calendar year in which operations commenced; 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 commenced operations should be included, along with the bank's opening (original) equity capital, in this item. The net amount of these pre-opening income and expenses should be identified and described in Schedule RI-E, item 9. Pre-opening income earned and expenses incurred during the

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5 (cont.) calendar year in which the bank commenced operations should be reported in the appropriate items of Schedule RI, Income Statement, each quarter during the calendar year in which operations commenced.

6 **Changes incident to business combinations, net.** If the bank has entered into a business combination which became effective during the year-to-date reporting period and which has been accounted for as a pooling of interests, report the historical equity capital balances of the bank or other business acquired as of the end of the previous calendar year. For further information of poolings of interests, refer to the Glossary entry for "business combinations."

If the bank purchased another bank or business during the year-to-date reporting period, report the fair value of any perpetual preferred or common shares issued (less the direct cost of issuing the shares). Exclude the fair value of limited-life preferred stock issued in connection with purchase acquisitions. Refer to the Glossary entry for "business combinations" for further information on purchase acquisitions.

If the bank has been acquired in a transaction accounted for using push down accounting, report in this item the initial increase or decrease in equity capital that results from the application of push down accounting, i.e., the difference between the bank's total equity capital as of the end of the previous calendar year and its restated equity capital after the push down adjusting entries have been recorded as of the acquisition date. For further information on push down accounting, refer to the Glossary entry for "business combinations."

7 **LESS: Cash dividends declared on preferred stock.** Report all cash dividends *declared* on limited-life preferred and perpetual preferred stock during the calendar year-to-date, including dividends not payable until after the report date.

Do *not* include dividends *declared* during the previous calendar year but paid in the current period.

Refer to the Glossary entry for "dividends" for further information on cash dividends.

8 **LESS: Cash dividends declared on common stock.** Report all cash dividends *declared* on common stock during the calendar year-to-date, including dividends not payable until after the report date.

Do *not* include dividends *declared* during the previous calendar year but paid in the current period.

For further information on cash dividends, see the Glossary entry for "dividends."

9 **Cumulative effect of changes in accounting principles from prior years.** Report the cumulative effect, net of applicable income taxes, of those changes in accounting principles adopted during the calendar year-to-date reporting period that were applied retroactively and for which prior years' financial statements were restated.

The cumulative effect of a change in accounting principle is the difference between (1) the balance in the undivided profits account at the beginning of the year in which the change is

Item No. **Caption and Instructions**

9 (cont.) made and (2) the balance in the undivided profits account that would have been reported at the beginning of the year had the newly adopted accounting principle been applied in all prior periods.

The cumulative effect, if any, of all other changes in accounting principles adopted during the calendar year-to-date reporting period must be reported in Schedule RI, item 11, "Extraordinary items and other adjustments, net of income taxes."

State the dollar amount of and describe each cumulative effect included in this item in Schedule RI-E, item 5.

Refer to the Glossary entry for "accounting changes" for additional information on how to report the effects of changes in accounting principles.

10 **Corrections of material accounting errors from prior years.** Report the sum of all corrections, net of applicable income taxes, resulting from material accounting errors which were made in prior years' Reports of Condition and Income and *not* corrected by the filing of an amended report for the period in which the error was made. Include *only* those corrections which result from:

(1) Mathematical mistakes.

(2) Mistakes in applying accounting principles.

(3) Improper use of information which existed when the prior Reports of Condition and Income were prepared.

(4) A change from an accounting principle that is neither accepted nor sanctioned by bank supervisors to one that is acceptable to supervisors.

State the dollar amount of and describe each correction included in this item in Schedule RI-E, item 6.

The effect of accounting errors differs from the effect of changes in accounting estimates. Changes in accounting estimates are an inherent part of the accrual accounting process. Report the effect of any changes in accounting estimates in the appropriate line items of Schedule RI, Income Statement. For further information on corrections of errors and changes in estimates, refer to the Glossary entry for "accounting changes."

11.a **Change in net unrealized holding gains (losses) on available-for-sale securities.** Report the change during the calendar year to date in Schedule RC, item 26.b, "Net unrealized holding gains (losses) on available-for-sale securities." If the amount to be reported represents a reduction in the bank's equity capital, enclose it in parentheses.

11.b **Change in accumulated net gains (losses) on cash flow hedges.** Report the change during the calendar year to date in Schedule RC, item 26.c, "Accumulated net gains (losses) on cash flow hedges." If the amount represents a reduction in the bank's equity capital, enclose it in parentheses.

FFIEC 032, 033, and 034 Item No.	FFIEC 031 Item No.	Caption and Instructions
-	12	**Foreign currency translation adjustments.** Report the increase or decrease during the calendar year-to-date in the cumulative foreign currency translation adjustments and qualifying foreign currency transaction gains and losses, net of applicable income taxes, if any. Refer to the Glossary entry for "foreign currency transactions and translation" for further information on accounting for foreign currency translation.
12	13	**Other transactions with parent holding company.** Report the net aggregate amount of transactions with the bank's parent holding company which affect equity capital directly, other than those reported in Schedule RI-A, items 5, 7, and 8 above, such as: (1) Capital contributions other than those for stock (report issuances of perpetual preferred and common stock in Schedule RI-A, item 5 above; issuances of limited-life preferred stock are not reported in this schedule). (2) Dividends to the holding company in the form of property rather than cash (report cash dividends in Schedule RI-A, items 7 or 8, as appropriate). Record such property dividends at the fair value of the transferred asset. Include any gain or loss recognized on the disposition of the asset in the determination of net income for the calendar year-to-date in Schedule RI, Income Statement. Refer to the Glossary entry for "dividends" for additional information on property dividends. State the dollar amount of and describe each transaction included in this item in Schedule RI-E, item 7.
13	14	**Total equity capital end of current period.** On the FFIEC 032, 033, and 034, report the sum of items 3 through 12. On the FFIEC 031, report the sum of items 3 through 13. This item must equal Schedule RC, item 28, "Total equity capital."

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 guidance presented by the American Institute of Certified Public Accountants in a Notice to Practitioners issued in February 1986 (or, if appropriate, in notices issued in November 1983 and November 1984).

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).

Agreement Corporation: *See* "Edge and Agreement corporation."

Allowance for Loan and Lease Losses: Each bank must maintain an allowance for loan and lease losses (allowance) that is adequate to absorb estimated credit losses associated with its loan and lease portfolio, including all binding commitments to lend. To the extent not provided for in a separate liability account, the allowance should also be sufficient to absorb estimated credit losses associated with off-balance sheet credit instruments such as standby letters of credit. (These instruments are included in the terms "loan(s)," "loans and leases" and "portfolio," as used in this Glossary entry.)

The term "estimated credit losses" means an estimate of the current amount of the loan and lease portfolio (net of unearned income) that is not likely to be collected; that is, net charge-offs that are likely to be realized for a loan or pool of loans given facts and circumstances as of the evaluation date. These estimated credit losses should meet the criteria for accrual of a loss contingency (i.e., 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 appropriate entries to maintain the balance of the allowance for loan and lease losses on the balance sheet at a level adequate to absorb estimated credit losses. Management must maintain reasonable records in support of their evaluations and entries.

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 and any recoveries on loans or leases previously charged off shall be credited to the allowance. Under no circumstances can loan or lease losses be charged directly to "Undivided profits and capital reserves."

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 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.

Allowance for Loan and Lease Losses (cont.):

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 adequate 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 should be reported as liabilities on Schedule RC, item 20, "Other liabilities."

For comprehensive guidance on the maintenance of an adequate allowance for loan and lease losses, banks should refer to the Interagency Policy Statement on the Allowance for Loan and Lease Losses dated December 21, 1993. National banks should also refer to the Office of the Comptroller of the Currency's Banking Circular 201 (BC-201) and the section of the Comptroller's Handbook for National Bank Examiners discussing the allowance for loan and lease losses. Information on the application of FASB Statement No. 114, "Accounting by Creditors for Impairment of a Loan," to the determination of an allowance for credit 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.

Bankers Acceptances (cont.):

The following description covers the treatment in the Report of Condition of (1) acceptances that have been executed by the reporting bank, that is, those drafts that have been drawn on and accepted by it; (2) "participations" in acceptances, that is, "participations" in the accepting bank's obligation to put the holder of the acceptance in funds at maturity, or participations in the accepting bank's risk of loss in the event of default by the account party; and (3) acceptances owned by the reporting bank, that is, those acceptances -- whether executed by the reporting bank or by others -- that the bank has discounted or purchased.

(1) Acceptances executed by the reporting bank -- With the exceptions described below, the accepting bank *must* report on its balance sheet the *full* amount of the acceptance in both (1) the liability item, "Bank's liability on acceptances executed and outstanding" (Schedule RC, item 18), reflecting the accepting bank's obligation to put the holder of the acceptance in funds at maturity, and (2) the asset item, "Customers' liability to this bank on acceptances outstanding" (Schedule RC, item 9), reflecting the account party's liability to put the accepting bank in funds at or before maturity.

Brokered Deposits (cont.):

In addition, deposit instruments of the reporting bank that are sold to brokers, dealers, or underwriters (including both bank affiliates of the reporting bank and nonbank subsidiaries of the reporting bank's parent holding company such as so-called Section 20 affiliates) who then reoffer and/or resell these deposit instruments to one or more investors, regardless of the minimum denomination which the investor must purchase, are considered brokered deposits.

Broker's Security Draft: A broker's security draft is a draft with securities or title to securities attached that is drawn to obtain payment for the securities. This draft is sent to a bank for collection with instructions to release the securities only on payment of the draft.

Business Combinations: Business combinations between unrelated parties are of two types: "poolings of interests" and "purchase acquisitions." A business combination involving the exchange of voting common stock between stock institutions and meeting *all* 12 of the conditions specified in APB Opinion No. 16, "Business Combinations," is a pooling of interests. All other unrelated party business combinations are purchase acquisitions.

Pooling of interests -- In a pooling of interests, the assets, liabilities, and capital of the bank and the business being acquired are added together on a line-by-line basis without any adjustments for fair market value. The historical cost-based amount (cost adjusted for amortization of premiums and discounts or depreciation) of each asset, liability, and capital account of the acquiring bank is added to the corresponding account of the business being acquired to arrive at the balance sheet for the combined bank. However, the capital stock outstanding of the combined bank must be equal to the number of shares issued and outstanding (including the shares issued in connection with the acquisition) multiplied by par or stated value.

If the sum of the capital stock accounts of the entities being combined does not equal this amount (and it rarely, if ever, will), adjustment is required. If the sum of the capital stock accounts is less than the number of shares outstanding of the combined bank multiplied by par or stated value, "Surplus," Schedule RC, item 25, must be debited for the amount of the difference and "Common stock," Schedule RC, item 24, is credited. If the surplus account is insufficient to absorb such an adjustment the remainder must be debited to "Undivided profits and capital reserves," Schedule RC, item 26.a. If the sum of the capital stock accounts is more than the amount of the outstanding stock of the combined bank, "Surplus" must be credited and "Common stock" debited.

Any adjustments necessary to conform the accounting methods of the acquired entity to those of the reporting bank must be made, net of related tax effects, to "Undivided profits."

For the year in which a pooling of interests occurs, income and expenses must be reported as though the companies had combined at the beginning of the year. The portion of the adjustment necessary to conform the accounting methods applicable to the current period must also be allocated to income and expenses for the period.

Purchase acquisition -- In a purchase acquisition the assets and liabilities of the acquired business must be recorded on the books of the combined bank at their *fair value*. The fair value of an asset is generally its market or appraised value and liabilities are generally valued on a present value basis. Therefore, to the extent possible, the cost of the acquisition is allocated to each identifiable asset or liability being acquired or assumed. Identifiable assets may be tangible (such as securities or fixed assets) or intangible (such as service contracts or the estimated value of certain deposit relationships). If the amount allocated to an identifiable tangible or intangible asset or liability differs from the tax basis of the asset or liability, this difference is considered a temporary difference (see the Glossary entry for "income taxes"). As a result, the acquired asset or liability must be recorded at fair value and a deferred tax asset or liability is recorded for the difference between the assigned value of the acquired asset or liability and its tax basis.

Business Combinations (cont.):

Any excess of the cost of the acquisition over the net fair value of the identifiable assets and liabilities acquired or assumed is purchased goodwill. Identifiable and unidentifiable intangible assets (i.e., goodwill) are reportable in Schedule RC, item 10, "Intangible assets," and in Schedule RC-M, item 6. An intangible asset such as goodwill should not be written off in the year of its acquisition. Instead, consistent with Securities and Exchange Commission guidance, all intangible assets should be amortized over their estimated useful lives, generally not to exceed 25 years. The amortization expense of purchased goodwill and any other intangible assets shall be reported in Schedule RI, item 7.c, "Other noninterest expense," and in Schedule RI-E, item 2.a.

If the net fair value of the identifiable assets and liabilities acquired or assumed exceeds the cost of the acquisition, the values otherwise assignable to the acquired fixed assets, intangible assets, and other assets of a "noncurrent" nature shall be reduced proportionately for the amount of such excess. Negative goodwill shall not be recorded unless these categories of assets acquired are reduced to a zero value. Negative goodwill should be reported in Schedule RC, item 20, "Other liabilities," and in Schedule RC-G and should be amortized systematically to income over the period estimated to be benefited. Negative goodwill should not be used to reduce the amount of goodwill reportable in Schedule RC, item 10, and in Schedule RC-M.

In a purchase acquisition, the historical equity capital balances of the acquired business are *not* to be carried forward to the balance sheet of the combined bank. If the reporting bank has issued any stock in connection with the acquisition, the fair value of the shares issued shall be used in determining the cost of the acquisition unless the net fair value of the assets acquired and liabilities assumed presents a more accurate measure of the value of the transaction. The aggregate par or stated value of perpetual preferred or common shares issued shall be credited to the acquiring bank's appropriate stock account and any excess of fair value over par or stated value of shares issued (reduced by any direct costs of issuing the shares) shall be credited to surplus. The total fair value of limited-life preferred stock issued shall be credited to Schedule RC, item 19, "Subordinated notes and debentures." The operating results of the acquired bank or business are to be included in the income and expenses of the reporting bank *only* from the date of acquisition.

<u>Push down accounting</u> -- Push down accounting is the establishment of a new accounting basis for a bank in its separate financial statements as a result of a substantive change in control. Under push down accounting, when a bank is acquired, yet retains its separate corporate existence, the assets and liabilities of the acquired bank are restated to their fair values as of the acquisition date. These values, including any goodwill, are reflected in the separate financial statements of the acquired bank as well as in any consolidated financial statements of the bank's parent.

Push down accounting is *required* for purposes of the Reports of Condition and Income if a direct or indirect change in control of at least 95 percent of the voting stock of the bank has occurred, and the bank does not have an outstanding issue of publicly traded debt or preferred stock. Push down accounting also is *required* if the bank's separate financial statements are presented on a push down basis in reports filed with the Securities and Exchange Commission. Push down accounting may also be used when a direct or indirect change in control of at least 80 percent, but less than 95 percent, of the voting stock of the bank has occurred.

In all cases, the bank's primary federal supervisory authority reserves the right to determine whether or not a bank must use push down accounting for purposes of the Reports of Condition and Income.

Income Taxes (cont.):

(2) Deferred income tax expense or benefit measured as the change in the net deferred tax assets or liabilities for the period reported. Deferred tax liabilities and assets represent the amount by which taxes payable (or receivable) are expected to increase or decrease in the future as a result of "temporary differences" and net operating loss or tax credit carryforwards that exist at the reporting date.

The deferred portion of the total applicable income taxes for the calendar year should be reported in the December Report of Income in Schedule RI, Memorandum item 12.

The actual tax liability (or receivable) calculated on the bank's tax returns may differ from the estimate reported as currently payable or receivable on the year-end Report of Income. An amendment to the bank's year-end and subsequent Reports of Condition and Income may be appropriate if the difference is significant. Minor differences should be handled as accrual adjustments to applicable income taxes in Reports of Income during the year the differences are detected. The reporting of applicable income taxes in the Report of Income for report dates other than year-end is discussed below under "interim period applicable income taxes."

Temporary differences result when events are recognized in one period on the bank's books but are recognized in another period on the bank's tax return. These differences result in amounts of income or expense being reported in the Report of Income in one period but in another period in the tax returns. There are two types of temporary differences. Deductible temporary differences reduce taxable income in future periods. Taxable temporary differences result in additional taxable income in future periods.

For example, a bank's provision for loan and lease losses is expensed for financial reporting purposes in one period. However, for some banks, this amount may not be deducted for tax purposes until the loans are actually charged off in a subsequent period. This deductible temporary difference "originates" when the provision for loan and lease losses is recorded in the financial statements and "turns around" or "reverses" when the loans are subsequently charged off, creating tax deductions. Other deductible temporary differences include writedowns of other real estate owned, the recognition of loan origination fees, and other postemployment benefits expense.

Depreciation can result in a taxable temporary difference if a bank uses the straight-line method to determine the amount of depreciation expense to be reported in the Report of Income but uses an accelerated method for tax purposes. In the early years, tax depreciation under the accelerated method will typically be larger than book depreciation under the straight-line method. During this period, a taxable temporary difference originates. Tax depreciation will be less than book depreciation in the later years when the temporary difference reverses. Therefore, in any given year, the depreciation reported in the Report of Income will differ from that reported in the bank's tax returns. However, total depreciation taken over the useful life of the asset will be the same under either method. Other taxable temporary differences include the undistributed earnings of unconsolidated subsidiaries and associated companies and amounts funded to pension plans which exceed the recorded expense.

Some events do not have tax consequences and therefore do not give rise to temporary differences. Certain revenues are exempt from taxation and certain expenses are not deductible. These events were previously known as "permanent differences." Examples of such events (for federal income tax purposes) are interest received on certain obligations of states and political subdivisions in the U.S., premiums paid on officers' life insurance policies where the bank is the beneficiary, and 85 percent of cash dividends received on the corporate stock of domestic U.S. corporations.

Income Taxes (cont.):

Deferred tax assets shall be calculated at the report date by applying the "applicable tax rate" (defined below) to the bank's total deductible temporary differences and operating loss carryforwards. A deferred tax asset shall also be recorded for the amount of tax credit carryforwards available to the bank. Based on the estimated realizability of the deferred tax asset, a valuation allowance should be established to reduce the recorded deferred tax asset to the amount that is considered "more likely than not" (i.e., greater than 50 percent chance) to be realized.

Deferred tax liabilities should be calculated by applying the "applicable tax rate" to total taxable temporary differences at the report date.

Operating loss carrybacks and carryforwards and tax credit carryforwards -- When a bank's deductions exceed its income for federal income tax purposes, it has sustained an operating loss. An operating loss that occurs in a year following periods when the bank had taxable income may be carried back to recover income taxes previously paid. The tax effects of any loss carrybacks that are realizable through a refund of taxes previously paid is recognized in the year the loss occurs. In this situation, the applicable income taxes on the Report of Income will reflect a credit rather than an expense. Banks may carry back operating losses for two years. (For tax years beginning before 1998, banks could carry back operating losses for three years.)

Generally, an operating loss that occurs when loss carrybacks are not available (e.g., occurs in a year following periods of losses) becomes an operating loss carryforward. Banks may carry operating losses forward 20 years. (For tax years beginning before 1998, banks could carry operating losses forward 15 years.)

Tax credit carryforwards are tax credits which cannot be used for tax purposes in the current year, but which can be carried forward to reduce taxes payable in a future period.

Deferred tax assets are recognized for operating loss and tax credit carryforwards just as they are for deductible temporary differences. As a result, a bank can recognize the benefit of a net operating loss for tax purposes or a tax credit carryforward to the extent the bank determines that a valuation allowance is not considered necessary (i.e., if the realization of the benefit is more likely than not).

Applicable tax rate -- The income tax rate to be used in determining deferred tax assets and liabilities is the rate under current tax law that is expected to apply to taxable income in the periods in which the deferred tax assets or liabilities are expected to be realized or paid. If the bank's income level is such that graduated tax rates are a significant factor, then the bank shall use the average graduated tax rate applicable to the amount of estimated taxable income in the period in which the deferred tax asset or liability is expected to be realized or settled. When the tax law changes, banks shall determine the effect of the change, adjust the deferred tax asset or liability and include the effect of the change in Schedule RI, item 9, "Applicable income taxes (on item 8)."

Valuation allowance -- A valuation allowance must be recorded, if needed, to reduce the amount of deferred tax assets to an amount that is more likely than not to be realized. Changes in the valuation allowance generally shall be reported in Schedule RI, item 9, "Applicable income taxes (on item 8)." The following discussion of the valuation allowance relates to the allowance, if any, included in the amount of net deferred tax assets or liabilities to be reported on the balance sheet (Schedule RC) and in Schedule RC-F, item 2, or Schedule RC-G, item 2. This discussion does not address the determination of the amount of deferred tax assets, if any, that is disallowed for regulatory capital purposes and reported in Schedule RC-F, Memorandum item 1.

Income Taxes (cont.):

The difference between item 9, "Applicable income taxes (on item 8)," and the total amount of the applicable taxes shall then be reflected in item 11 as applicable income taxes on extraordinary items and other adjustments.

Tax calculations by tax jurisdiction -- Separate calculations of income taxes, both current and deferred amounts, are required for each tax jurisdiction. However, of the tax laws of the state and local jurisdictions do not significantly differ from federal income tax laws, then the calculation of deferred income tax expense can be made in the aggregate. The bank would calculate both current and deferred tax expense considering the combination of federal, state and local income tax rates. The rate used should consider whether amounts paid in one jurisdiction are deductible in another jurisdiction. For example, since state and local taxes are deductible for federal purposes, the aggregate combined rate would generally be (1) the federal tax rate plus (2) the state and local tax rates minus (3) the federal tax effect of the deductibility of the state and local taxes at the federal tax rate.

Income taxes of a bank subsidiary of a holding company -- A bank should generally report income tax amounts in its Reports of Condition and Income as if it were a separate entity. A bank's separate entity taxes include taxes of subsidiaries *of the bank* that are included with the bank in a consolidated tax return. In other words, when a bank has subsidiaries of its own, the bank and its consolidated subsidiaries are treated as one separate taxpayer for purposes of computing the bank's applicable income taxes. This treatment is also applied in determining net deferred tax asset limitations for regulatory capital purposes.

During profitable periods, a bank subsidiary of a holding company which files a consolidated tax return should record current tax expense for the amount which would be due on a separate entity basis. Certain adjustments resulting from the consolidated status may, however, be made to the separate entity calculation as long as these adjustments are made on a consistent and equitable basis. For example, the consolidated group's single surtax exemption may be allocated among the holding company affiliates if such an allocation is equitable and applied consistently. Such allocations should be reflected in the bank's applicable income taxes, rather than as "Other transactions with parent holding company" in Schedule RI-A, Changes in Equity Capital.

In addition, bank subsidiaries should first compute their taxes on a separate entity basis without considering the alternative minimum tax (AMT). The AMT should be determined on a consolidated basis, and if it exceeds the regular tax on a consolidated basis, the holding company should allocate that excess to its affiliates on an equitable and consistent basis. The allocation method must be based upon the portion of tax preferences, adjustments, and other items causing the AMT to be applicable at the consolidated level that are generated by the parent holding company and each bank and nonbank subsidiary. In no case should amounts be allocated to bank subsidiaries that have not generated any tax preference or positive tax adjustment items. Furthermore, the AMT allocated to banks within the consolidated group should not exceed the consolidated AMT in any year.

In future years when a consolidated AMT credit carryforward is utilized, the credit must be reallocated to the subsidiary banks. The allocation should be done on an equitable and consistent basis based upon the amount of AMT giving rise to the credit that had been previously allocated. In addition, the amount of AMT credit reallocated to affiliates within the consolidated group should not exceed the consolidated AMT credit in any year. All AMT allocations should be reflected in the bank's applicable income taxes, rather than as "Other transactions with parent holding company" in Schedule RI-A, Changes in Equity Capital.

Income Taxes (cont.):

Similarly, bank subsidiaries incurring a loss should record an income tax benefit and receive an equitable refund from their parent, if appropriate. The refund should be based on the amount they would have received on a separate entity basis, adjusted for statutory tax considerations, and shall be made on a timely basis.

An exception to this rule is made when the bank, on a separate entity basis, would not be entitled to a current refund because it has exhausted benefits available through carryback on a separate entity basis, yet the holding company can utilize the bank's tax loss to reduce the *consolidated* liability for the current year. In this situation, realization of the tax benefit is assured. Accordingly, the bank may recognize a current tax benefit in the year in which the operating loss occurs, *provided* the holding company reimburses the bank on a timely basis for the amount of benefit recognized. Any such tax benefits recognized in the loss year should be reflected in the bank's applicable income taxes and not as an extraordinary item. If timely reimbursement is not made, the bank cannot recognize the tax benefit in the current year. Rather, the tax loss becomes a net operating loss carryforward for the bank.

A parent holding company shall not adopt an *arbitrary* tax allocation policy within its consolidated group if it results in a significantly different amount of subsidiary bank applicable income taxes than would have been provided on a separate entity basis. If a holding company forgives payment by the subsidiary of all or a significant portion of the current portion of the applicable income taxes computed in the manner discussed above, such forgiveness should be treated as a capital contribution and reported in Schedule RI-A in "Other transactions with parent holding company" and in Schedule RI-E, item 7.

Further, if the subsidiary bank pays an amount greater than its separate entity current tax liability (calculated as previously discussed), the excess should be reported as a cash dividend to the holding company in Schedule RI-A, item 8. Payment by the bank of its deferred tax liability, in addition to its current tax liability, is considered an excessive payment of taxes. As a result, the deferred portion should likewise be reported as a cash dividend. Failure to pay the subsidiary bank an equitable refund attributable to the bank's net operating loss should also be considered a cash dividend paid by the bank to the parent holding company.

<u>Purchase business combinations</u> -- In purchase business combinations (as described in the Glossary entry for "business combinations"), banks shall recognize as a temporary difference the difference between the tax basis of acquired assets or liabilities and the amount of the purchase price allocated to the acquired assets and liabilities (with certain exceptions specified in FASB Statement No. 109). As a result, the acquired asset or liability shall be recorded gross and a deferred tax asset or liability shall be recorded for any resulting temporary difference.

In a purchase business combination, a deferred tax asset shall generally be recognized at the date of acquisition for deductible temporary differences and net operating loss and tax credit carryforwards of either company in the transaction, net of an appropriate valuation allowance. The determination of the valuation allowance should consider any provisions in the tax law which may restrict the use of an acquired company's carryforwards.

Subsequent recognition (i.e., by elimination of the valuation allowance) of the benefit of deductible temporary differences and net operating loss or tax credit carryforwards not recognized at the acquisition date will depend on the source of the benefit. If the valuation allowance relates to deductible temporary differences and carryforwards of the acquiring company established before the acquisition, then subsequent recognition is reported as a reduction of income tax expense. If the benefit is related to the acquired company's deductible temporary differences and carryforwards,

Income Taxes (cont.):

then the benefit is subsequently recognized by first reducing any goodwill related to the acquisition, then by reducing all other noncurrent intangible assets related to the acquisition, and finally, by reducing income tax expense.

Alternative Minimum Tax -- Any taxes a bank must pay in accordance with the alternative minimum tax (AMT) shall be included in the bank's current tax expense. Amounts of AMT paid can be carried forward in certain instances to reduce the bank's regular tax liability in future years. The bank may record a deferred tax asset for the amount of the AMT credit carryforward, which shall then be evaluated in the same manner as other deferred tax assets to determine whether a valuation allowance is needed.

Other tax effects -- A bank may have transactions or items that are reportable in Schedule RI-A of the Report of Income such as the "Cumulative effect of changes in accounting principles from prior years," and "Corrections of material accounting errors from prior years," (and "Foreign currency translation adjustments" on FFIEC 031 only). These transactions or other items will enter into the determination of taxable income in some year (not necessarily the current year), but are not included in the pretax income reflected in Schedule RI of the Report of Income. They shall be reported in Schedule RI-A net of related income tax effects. These effects may increase or decrease the bank's total tax liability calculated on its tax returns for the current year or may be deferred to one or more future periods.

For further information, see FASB Statement No. 109, "Accounting for Income Taxes."

The following table has been included to aid respondent banks in calculating their "applicable income taxes" for purposes of the Reports of Condition and Income. The table includes the tax rates in effect for the years presented.

FEDERAL INCOME TAX RATES APPLICABLE TO BANKS

Year	First $25,000	Second $25,000	Third $25,000	Fourth $25,000	Over $100,000	Capital Gains	Alternative Minimum Tax
1988-1992	15%	15%	25%	34%	[5]	Regular tax rates	20%
1993-1999	15%	15%	25%	34%	[6]	Regular tax rates	20%

[5] A 39% tax rate applies to taxable income from $100,001 to $335,000 and a 34% tax rate applies to taxable income over $335,000.

[6] A 39% tax rate applies to taxable income from $100,001 to $335,000; a 34% tax rate applies to taxable income from $335,001 to $10,000,000; a tax rate of 35% applies to taxable income from $10,000,001 to $15,000,000; a tax rate of 38% applies to taxable income from $15,000,001 to $18,333,333; and a 35% tax rate applies to taxable income over $18,333,333.

Intangible Assets: *See* "business combinations" and the instruction to Report of Condition Schedule RC-M, item 6.

Interest-Bearing Account: *See* "deposits."

Interest Capitalization: *See* "capitalization of interest costs."

Interest Rate Swaps: *See* "derivative contracts."

Internal-Use Computer Software: Guidance on the accounting and reporting for the costs of internal-use computer software is set forth in AICPA Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." A summary of this accounting guidance follows. For further information, see AICPA Statement of Position 98-1.

Internal-use computer software is software that meets both of the following characteristics:

(1) The software is acquired, internally developed, or modified solely to meet the bank's internal needs; and

(2) During the software's development or modification, no substantive plan exists or is being developed to market the software externally.

Statement of Position 98-1 identifies three stages of development for internal-use software: the preliminary project stage, the application development stage, and the post-implementation/operation stage. The processes that occur during the preliminary project stage of software development are the conceptual formulation of alternatives, the evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives. The application development stage involves the design of the chosen path (including software configuration and software interfaces), coding, installation of software to hardware, and testing (including the parallel processing phase). Generally, training and application maintenance occur during the post-implementation/ operation stage. Upgrades of and enhancements to existing internal-use software, i.e., modifications to software that result in additional functionality, also go through the three aforementioned stages of development.

Computer software costs that are incurred in the preliminary project stage should be expensed as incurred.

Internal and external costs incurred to develop internal-use software during the application development stage should be capitalized. Capitalization of these costs should begin once (a) the preliminary project stage is completed *and* (b) management, with the relevant authority, implicitly or explicitly authorizes and commits to funding a computer software project and it is probable that the project will be completed and the software will be used to perform the function intended. Capitalization should cease no later than when a computer software project is substantially complete and ready for its intended use, i.e., after all substantial testing is completed. Capitalized internal-use software costs generally should be amortized on a straight-line basis over the estimated useful life of the software.

Only the following application development stage costs should be capitalized:

(1) External direct costs of materials and services consumed in developing or obtaining internal-use software;

Internal-Use Computer Software (cont.):

(2) Payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use computer software project (to the extent of the time spent directly on the project); and

(3) Interest costs incurred when developing internal-use software.

Costs to develop or obtain software that allows for access or conversion of old data by new systems also should be capitalized. Otherwise, data conversion costs should be expensed as incurred. General and administrative costs and overhead costs should not be capitalized as internal-use software costs.

During the post-implementation/operation stage, internal and external training costs and maintenance costs should be expensed as incurred.

Impairment of capitalized internal-use computer software costs should be recognized and measured in accordance with FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of."

The costs of internally developed computer software to be sold, leased, or otherwise marketed as a separate product or process should be reported in accordance with FASB Statement No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed." If, after the development of internal-use software is completed, a bank decides to market the software, proceeds received from the license of the software, net of direct incremental marketing costs, should be applied against the carrying amount of the software.

International Banking Facility (IBF): General definition -- An International Banking Facility (IBF) is a set of asset and liability accounts, segregated on the books and records of the establishing entity, which reflect international transactions. An IBF is established in accordance with the terms of Federal Reserve Regulation D and after appropriate notification to the Federal Reserve. The establishing entity may be a U.S. depository institution, a U.S. office of an Edge or Agreement corporation, or a U.S. branch or agency of a foreign bank pursuant to Federal Reserve Regulations D and Q. An IBF is permitted to hold only certain assets and liabilities. In general, IBF accounts are limited, as specified in the paragraphs below, to non-U.S. residents of foreign countries, residents of Puerto Rico and U.S. territories and possessions, other IBFs, and U.S. and non-U.S. offices of the establishing entity.

Permissible IBF assets include extensions of credit to the following:

(1) non-U.S. residents (including foreign branches of other U.S. banks);
(2) other IBFs; and
(3) U.S. and non-U.S. offices of the establishing entity.

Credit may be extended to non-U.S. *nonbank* residents only if the funds are used in their operations outside the United States. IBFs may extend credit in the form of a loan, deposit, placement, advance, security, or other similar asset.

Nonaccrual Status (cont.):

time prior to the restructuring may be taken into account.) Such a restructuring must improve the collectability of the loan or other debt instrument in accordance with a reasonable repayment schedule and does not relieve the bank from the responsibility to promptly charge off all identified losses.

A formal restructuring may involve a multiple note structure in which, for example, a troubled loan is restructured into two notes. The first or "A" note represents the portion of the original loan principal amount which is expected to be fully collected along with contractual interest. The second or "B" note represents the portion of the original loan that has been charged off and, because it is not reflected as an asset and is unlikely to be collected, could be viewed as a contingent receivable. The "A" note may be returned to accrual status provided the conditions in the preceding paragraph are met and: (1) there is economic substance to the restructuring and it qualifies as a troubled debt restructuring under generally accepted accounting principles, (2) the portion of the original loan represented by the "B" note has been charged off before or at the time of the restructuring, and (3) the "A" note is reasonably assured of repayment and of performance in accordance with the modified terms.

Until the restructured asset is restored to accrual status, if ever, cash payments received must be treated in accordance with the criteria stated above in the preceding section of this entry. In addition, after a formal restructuring, if a restructured asset that has been returned to accrual status later meets the criteria for placement in nonaccrual status as a result of past due status based on its modified terms or for any other reasons, the asset must be placed in nonaccrual status.

For further information on formally restructured assets, see the Glossary entry for "troubled debt restructurings."

Treatment of multiple extensions of credit to one borrower -- As a general principle, nonaccrual status for an asset should be determined based on an assessment of the individual asset's collectability and payment ability and performance. Thus, when one loan to a borrower is placed in nonaccrual status, a bank does not automatically have to place all other extensions of credit to that borrower in nonaccrual status. When a bank has multiple loans or other extensions of credit outstanding to a single borrower, and one loan meets the criteria for nonaccrual status, the bank should evaluate its other extensions of credit to that borrower to determine whether one or more of these other assets should also be placed in nonaccrual status.

Noninterest-Bearing Account: *See* "deposits."

Nontransaction Account: *See* "deposits."

NOW Account: *See* "deposits."

Offsetting: Offsetting is the reporting of assets and liabilities on a net basis in the balance sheet. Banks are permitted to offset assets and liabilities recognized in the Report of Condition when a "right of setoff" exists. Under FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts," a right of setoff exists when *all* of the following conditions are met:

(1) Each of two parties owes the other determinable amounts. Thus, only bilateral netting is permitted.

(2) The reporting party has the right to set off the amount owed with the amount owed by the other party.

Offsetting (cont.):

(3) The reporting party intends to set off. This condition does not have to be met for fair value amounts recognized for conditional or exchange contracts that have been executed with the same counterparty under a master netting arrangement.

(4) The right of setoff is enforceable at law. Legal constraints should be considered to determine whether the right of setoff is enforceable. Accordingly, the right of setoff should be upheld in bankruptcy (or receivership). Offsetting is appropriate only if the available evidence, both positive and negative, indicates that there is reasonable assurance that the right of setoff would be upheld in bankruptcy (or receivership).

According to Interpretation No. 39, for forward, interest rate swap, currency swap, option, and other conditional and exchange contracts, a master netting arrangement exists if the reporting bank has multiple contracts, whether for the same type of conditional or exchange contract or for different types of contracts, with a single counterparty that are subject to a contractual agreement that provides for the net settlement of all contracts through a single payment in a single currency in the event of default or termination of any one contract.

Offsetting the assets and liabilities recognized for conditional or exchange contracts outstanding with a single counterparty results in the net position between the two counterparties being reported as an asset or a liability in the Report of Condition. The reporting entity's choice to offset or not to offset assets and liabilities recognized for conditional or exchange contracts must be applied consistently.

Offsetting of assets and liabilities is also permitted by other accounting pronouncements identified in Interpretation No. 39. These pronouncements apply to such items as leveraged leases, pension plan and other postretirement benefit plan assets and liabilities, and deferred tax assets and liabilities. In addition, FASB Interpretation No. 41, "Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements," describes the circumstances in which amounts recognized as payables under repurchase agreements may be offset against amounts recognized as receivables under reverse repurchase agreements and reported as a net amount in the balance sheet. The reporting entity's choice to offset or not to offset payables and receivables under Interpretation No. 41 must be applied consistently.

See also "reciprocal balances."

One-Day Transaction: *See* "federal funds transactions."

Option: *See* "derivative contracts."

Organization Costs: *See* "start-up activities."

Other Depository Institutions in the U.S.: *See* "depository institutions in the U.S."

Other Real Estate Owned: *See* "foreclosed assets" and the instruction to Schedule RC-M, item 8.a.

Overdraft: An overdraft can be either planned or unplanned. An unplanned overdraft occurs when a depository institution honors a check or draft drawn against a deposit account when insufficient funds are on deposit and there is no advance contractual agreement to honor the check or draft. When a contractual agreement has been made in advance to allow such credit extensions, overdrafts are referred to as planned or prearranged. Any overdraft, whether planned or unplanned, is an extension of credit and is to be treated and reported as a "loan" rather than being treated as a negative deposit balance.

Planned overdrafts in depositors' accounts are to be classified in Schedule RC-C, part I, by type of loan according to the nature of the overdrawn depositor. For example, a planned overdraft by a commercial customer is to be classified as a "commercial and industrial loan."

Unplanned overdrafts in depositors' accounts are to be classified in Schedule RC-C, part I, as "All other loans," *unless* the depositor is a depository institution or a state or political subdivision in the U.S. Such unplanned overdrafts would be reported in Schedule RC-C, part I, as "Loans to depository institutions" and "Obligations (other than securities and leases) of states and political subdivisions in the U.S.," respectively. In addition, for banks filing the FFIEC 031, 032, or 033, an unplanned overdraft in the deposit account of a foreign government or official institution would *not* be reported in "All other loans," but would be reported in "Loans to foreign governments and official institutions."

For purposes of treatment of overdrafts in depositors' accounts, a group of related transaction accounts of a single type (i.e., demand deposit accounts or NOW accounts, but *not* a combination thereof) maintained in the same right and capacity by a customer (a single legal entity) that is established under a *bona fide* cash management arrangement by this customer function as, and are regarded as, one account rather than as multiple separate accounts. In such a situation, overdrafts in one or more of the transaction accounts within the group are not to be classified as loans unless there is a net overdraft position in the group of related transaction accounts taken as a whole. (NOTE: Affiliates and subsidiaries are considered separate legal entities.) For further information, *see* "cash management arrangements."

The reporting bank's overdrafts on deposit accounts it holds with other banks (i.e., its "due from" accounts) are to be reported as borrowings in Schedule RC, item 16, except overdrafts arising in connection with checks or drafts drawn by the reporting bank and drawn on, or payable at or through, another depository institution either on a zero-balance account or on an account that is *not* routinely maintained with sufficient balances to cover checks or drafts drawn in the normal course of business during the period until the amount of the checks or drafts is remitted to the other depository institution (in which case, report the funds received or held in connection with such checks or drafts as deposits in Schedule RC-E until the funds are remitted).

Participations: *See* "transfers of financial assets."

Participations in Acceptances: *See* "bankers acceptances."

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

Pass-through Reserve Balances: Under the Monetary Control Act of 1980, and as reflected in Federal Reserve Regulation D, depository institutions that are *members* of the Federal Reserve System *must* maintain their required reserves (in excess of vault cash) directly with a Federal Reserve Bank. However, *nonmember* depository institutions may maintain their required reserves (in excess of vault cash) in one of two ways: either (1) directly with a Federal Reserve Bank or (2) indirectly in an account with another institution (referred to here as a "correspondent"), which, in turn, is required to pass the reserves through to a Federal Reserve Bank. This second type of account is called a "pass-through account," and a depository institution passing its reserves to the Federal Reserve through a correspondent is referred to here as a "respondent." This pass-through reserve relationship is legally and for supervisory purposes considered to constitute an asset/debt relationship between the respondent and the correspondent, and an asset/debt relationship between the correspondent and the Federal Reserve. The required reporting of the "pass-through reserve balances" reflects this structure of asset/debt relationships.

In the balance sheet of the respondent bank, the pass-through reserve balances are to be treated as a claim on the correspondent (not as a claim on the Federal Reserve) and, as such, are to be reflected in the balance sheet of the Report of Condition, Schedule RC, item 1.a, "Noninterest-bearing balances and currency and coin," or item 1.b, "Interest-bearing balances," as appropriate. (The footings for the respondent are not affected by this required classification of the claim.) For respondent banks with more than $100 million in assets, the pass-through reserve balances would also be reflected in Schedule RC-A, item 2, "Balances due from depository institutions in the U.S."

In the balance sheet of the correspondent bank, the pass-through reserve balances are to be treated as *balances due to respondents* and, to the extent that the balances have actually been passed through to the Federal Reserve, as *balances due from the Federal Reserve*. The balances due to respondents are to be reflected in the balance sheet of the Report of Condition, Schedule RC, item 13.a, "Deposits in domestic offices," and on in Schedule RC-E, Deposit Liabilities, (part I), items 4 or 5, as appropriate. [7] The balances due from the Federal Reserve are to be reflected on the balance sheet in Schedule RC, item 1.a, "Noninterest-bearing balances and currency and coin," and, for correspondent banks with more than $100 million in assets, in Schedule RC-A, item 4. (Under this required treatment, the footings for the correspondent are higher, by the amount of reserves actually passed through to the Federal Reserve, than they would be under treatment as an agent relationship.)

Perpetual Preferred Stock: *See* "preferred stock."

Placements and Takings: Placements and takings are deposits between a foreign office of the reporting bank and a foreign office of another bank and are to be treated as due from or due to depository institutions. Such transactions are always to be reported gross and are not to be netted as reciprocal balances.

Pooling of Interests: *See* "business combinations."

Preauthorized Transfer Account: *See* "deposits."

[7] When an Edge or Agreement Corporation acts as a correspondent, its balances due to respondents are to be reflected in Schedule RC, item 13.b, "Deposits in foreign offices," and, on FFIEC 031 only, in Schedule RC-E, part II, item 1, 2, or 3, as appropriate.

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

(f) sales and securitizations of assets which use contractual cash flows (e.g., interest-only strips receivable and so-called "spread accounts"), retained subordinated interests, or retained securities (e.g., collateral invested amounts and cash collateral accounts) as credit enhancements. If the low-level recourse rule applies to these credit enhancements, the maximum contractual dollar amount of the bank's recourse exposure is generally limited to the amount carried as an asset on the balance sheet in accordance with generally accepted accounting principles.

(4) A transfer where the seller retains risk as a result of a difference in terms between the instrument of transfer and the asset transferred, regardless of the other characteristics of the sale or participation, should be treated by the seller as an asset sale with recourse for purposes of Schedule RC-R. For example, *any* transfer in which there is a difference in maturity between the underlying asset and the instrument of transfer should be treated as an asset sale with recourse.

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

(5) The general rule applies to all transfers of assets (other than those specifically covered in the exception), including sales of a single asset or of a pool of assets and sales of participations in a single asset or in a pool of assets (whether of similar or dissimilar instruments). In participations that are not "syndications" (as described in the Glossary item for that term), the seller of the participations should handle the transfer of shares to participants in accordance with the general rule on sales of assets for risk-based capital purposes, even though the assets being participated were acquired or accumulated for the express purpose of issuing participations and even though the participation was prearranged with the purchasers of the participations. However, the rule does not apply to the *initial* operation and distribution of participations in the form of syndications, since in a syndication there is no transfer of assets involved of the type to which the general rule on sales of assets for risk-based capital purposes is addressed. Any *subsequent* transfers of shares, or parts of shares, in a syndicated loan would be subject to the general rule.

(6) The general rule (and interpretations and exception) is also applicable to asset transfers that are made to special or limited purpose entities that are not technically affiliated with the seller. Regardless of the legal structure of the transaction, if risk of loss is retained by the seller, either contractually or otherwise, either directly or indirectly, the seller should treat the transaction as an asset sale with recourse for purposes of risk-based capital and Schedule RC-R even if the sale to the special purpose entity is stated as being without recourse.

Savings Deposits: *See* "deposits."

<u>Securities Activities:</u> Institutions should categorize each security as trading, available-for-sale, or held-to-maturity consistent with FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities," as amended. Management should periodically reassess its security categorization decisions to ensure that they remain appropriate.

Securities that are intended to be held principally for the purpose of selling them in the near term should be classified as trading assets. Trading activity includes active and frequent buying and selling of securities for the purpose of generating profits on short-term fluctuations in price. Securities held for trading purposes must be reported at fair value, with unrealized gains and losses recognized in current earnings and regulatory capital.

Held-to-maturity securities are debt securities that an institution has the positive intent and ability to hold to maturity. Held-to-maturity securities are generally reported at amortized cost. Securities not categorized as trading or held-to-maturity must be reported as available-for-sale. An institution must report its available-for-sale securities at fair value on the balance sheet, but unrealized gains and losses are excluded from earnings and reported in a separate component of equity capital.

If a decline in fair value of a held-to-maturity or available-for-sale security is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value as a new cost basis and the amount of the write-down shall be included in earnings. For example, if it is probable that an institution will be unable to collect all amounts due according to the contractual terms of a debt security not impaired at acquisition, an other-than-temporary impairment has occurred.

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.

Securities Activities (cont.):

(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 and 1005--False Entries.

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 FASB Statement No. 125 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"

Securities Borrowing/Lending Transactions (cont.):
are considered pledged against the amount borrowed. Securities "loaned" in securities lending transactions that are accounted for as secured borrowings should be reported in the Report of Condition like other pledged assets, as set forth in FASB Statement No. 125.

If the securities borrowing/lending transaction meets the criteria for a sale under FASB Statement No. 125, 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."

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

Servicing of mortgage loans, credit card receivables, or other financial assets includes, but is not limited to, collecting principal, interest, and escrow payments from borrowers; paying taxes and insurance from escrowed funds; monitoring delinquencies; executing foreclosure if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, trustees, and others providing services; and accounting for and remitting principal and interest payments to the holders of beneficial interests in the financial assets. Servicers typically receive certain benefits from the servicing contract and incur the costs of servicing the assets.

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

When a bank sells or securitizes financial assets and retains the servicing asset, the bank shall allocate the cost of the financial assets to the servicing assets and the financial assets (without the servicing) based on their relative fair values. If it is not practicable to estimate the fair values of the servicing assets and the financial assets (without the servicing), the entire cost shall be allocated to the financial assets (without the servicing) and no cost shall be allocated to the servicing assets. If a bank incurs a servicing liability in a sale or securitization, the servicing liability should initially be measured at fair value. If a bank securitizes assets, retains all of the resulting securities, and

Servicing Assets and Liabilities (cont.):

classifies the securities as held-to-maturity debt securities, no separate servicing asset or liability shall be recorded. If a bank purchases servicing assets or assumes servicing liabilities in a transaction other than a sale or securitization of the financial assets being serviced, the asset or liability shall be recorded at fair value. For purchased servicing assets, the fair value is presumptively the price paid to acquire the servicing.

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

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

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

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

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

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

Significant Subsidiary: *See* "subsidiaries."

Standby Contract: *See* "derivative contracts."

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

Start-Up Activities: Guidance on the accounting and reporting for the costs of start-up activities, including organization costs, is set forth in 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 AICPA Statement of Position 98-5.

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. [8]

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 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 9. 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.

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."

[8] 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.

Subordinated Notes and Debentures (cont.):

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

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

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

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

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

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

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

(2) The parent bank's proportional share (based on equity ownership) of the subsidiary's gross operating income or revenue amounts to five percent or more of the gross operating income or revenue of the consolidated parent bank.

(3) The subsidiary's income or loss before income taxes amounts to five percent or more of the parent bank's income or loss before income taxes.

(4) The subsidiary is, in turn, the parent of one or more subsidiaries which, when consolidated with the subsidiary, constitute a significant subsidiary as defined in one or more of the above tests.

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

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

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

Subsidiaries (cont.):

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

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

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

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

Telephone Transfer Account: *See* "deposits."

Term Federal Funds: *See* "federal funds transactions."

Time Deposits: *See* "deposits."