

FFIEC 031 AND FFIEC 041

CALL REPORT

INSTRUCTION BOOK UPDATE

SEPTEMBER 2020

IMPORTANT NOTE

This September 2020 Call Report Instruction Book Update excludes updates pertaining to (1) interim final rules (IFRs) and final rules published by one or all of the banking agencies that revise certain aspects of the agencies' regulatory capital rule, amend the Federal Reserve Board's (Board) Regulation D on reserve requirements, except certain insider loans from the Board's Regulation O, and modify the Federal Deposit Insurance Corporation's (FDIC) deposit insurance assessment rules and (2) Section 4013 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which provides optional temporary relief from accounting for eligible loan modifications as troubled debt restructurings. The agencies have received approvals from the U.S. Office of Management and Budget to implement changes to the Call Report arising from these rulemakings and Section 4013 of the CARES Act.

Instructions for these Call Report changes are provided in the separate standalone [September 2020 COVID-19 Related Supplemental Instructions \(Call Report\)](#), which were attached to the agencies' [Financial Institution Letter](#) for the Consolidated Reports of Condition and Income for Third Quarter 2020 and are available on the FFIEC [Reporting Forms](#) webpages for the Call Report and the FDIC [Bank Financial Reports](#) webpage. The September 2020 COVID-19 Related Supplemental Instructions (Call Report) include instructions for the new Call Report items that took effect June 30, 2020, in Schedule RC-C, Part I, Loans and Leases, for eligible loan modifications under Section 4013 and in Schedule RC-M, Memoranda, for U.S. Small Business Administration Paycheck Protection Program (PPP) loans, borrowings under the Federal Reserve's PPP Liquidity Facility, and holdings of assets purchased under the Federal Reserve's Money Market Mutual Fund Liquidity Facility.

The FFIEC 031-FFIEC 041 Call Report instruction book will be updated to incorporate relevant information from the September 2020 COVID-19 Related Supplemental Instructions (Call Report) after the agencies have completed the standard Paperwork Reduction Act (PRA) process for these Call Report revisions. These revisions are discussed in the banking agencies' initial PRA notice published in the Federal Register on July 22, 2020. The notice is available on the FFIEC [Reporting Forms](#) webpages for the Call Report.

FILING INSTRUCTIONS

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

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**Instructions for Preparation of
Consolidated Reports of Condition and Income**

FFIEC 031 and FFIEC 041

Updated September 2020

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GENERAL INSTRUCTIONS

Schedules RC and RC-A through RC-V constitute the [FFIEC 031](#) and [FFIEC 041](#) versions of the Consolidated Report of Condition and its supporting schedules. Schedules RI and RI-A through RI-E constitute the [FFIEC 031](#) and [FFIEC 041](#) versions of the Consolidated Report of Income and its supporting schedules. The Consolidated Reports of Condition and Income are commonly referred to as the Call Report. For purposes of these General Instructions, the [Financial Accounting Standards Board \(FASB\) Accounting Standards Codification](#) is referred to as "ASC."

Unless the context indicates otherwise, the term "bank" in the Call Report instructions refers to both banks and savings associations.

WHO MUST REPORT ON WHAT FORMS

Every national bank, state member bank, insured state nonmember bank, and savings association is required to file a consolidated Call Report normally as of the close of business on the last calendar day of each calendar quarter, i.e., the report date. The specific reporting requirements for a bank depend upon the size of the bank, whether it has any "foreign" offices, and the capital standards applicable to the bank. Banks must file the appropriate report form as described below:

(1) **BANKS WITH FOREIGN OFFICES:** Banks of any size that have any "foreign" offices (as defined below) must file quarterly the [Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices \(FFIEC 031\)](#). For purposes of these reports, all of the following constitute "foreign" offices:

- (a) An International Banking Facility (IBF);
- (b) A branch or consolidated subsidiary in a foreign country; and
- (c) A majority-owned Edge or Agreement subsidiary.

In addition, for banks chartered and headquartered in the 50 states of the United States and the District of Columbia, a branch or consolidated subsidiary in Puerto Rico or a U.S. territory or possession is a "foreign" office. However, for purposes of these reports, a branch at a U.S. military facility located in a foreign country is a "domestic" office.

(2) **BANKS WITHOUT FOREIGN OFFICES:** Banks that have domestic offices only must file quarterly:

- (a) The [Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices \(FFIEC 031\)](#) if the bank:
 - (i) Is an advanced approaches institutions for regulatory capital purposes,¹ regardless of asset size; or

¹ An advanced approaches institution as defined in the federal supervisor's regulatory capital rules is (i) a subsidiary of a global systemically important bank holding company, as identified pursuant to [12 CFR 217.402](#); (ii) a Category II institution; (iii) a subsidiary of a depository institution that uses the advanced approaches pursuant to subpart E of [12 CFR part 3](#) (OCC), [12 CFR part 217](#) (Board), or [12 CFR part 324](#) (FDIC) to calculate its risk-based capital requirements; (iv) a subsidiary of a bank holding company or savings and loan holding company that uses the advanced approaches pursuant to [subpart E of 12 CFR part 217](#) to calculate its risk-based capital requirements; or (v) an institution that elects to use the advanced approaches to calculate its risk-based capital requirements.

Category II institutions include institutions that have (1) at least \$700 billion in total consolidated assets or (2) at least \$75 billion in cross-jurisdictional activity and at least \$100 billion in total consolidated assets. In addition, depository institution subsidiaries of Category II institutions are considered Category II institutions.

- (ii) Has total consolidated assets of \$100 billion or more,¹ including a bank of this size that is subject to Category III capital standards²;
- (b) The [Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only \(FFIEC 041\)](#) if the bank has total consolidated assets less than \$100 billion, including a bank of this size that is subject to Category III capital standards, but excluding a bank of this size that is an advanced approaches institution; or
- (c) The [Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only and Total Assets Less than \\$5 Billion \(FFIEC 051\)](#) subject to the eligibility criteria discussed below,

as appropriate to the reporting institution. An institution eligible to file the [FFIEC 051](#) report may choose instead to file the [FFIEC 041](#) report.

For banks chartered and headquartered in Puerto Rico or a U.S. territory or possession, a branch or consolidated subsidiary in one of the 50 states of the United States, the District of Columbia, Puerto Rico, or a U.S. territory or possession is a "domestic" office.

For those institutions filing the [FFIEC 051](#), a separate instruction book covers this report form. Please refer to this separate instruction book for the General Instructions for the [FFIEC 051](#) report form.

Eligibility to File the FFIEC 051

Institutions with domestic offices only and total assets less than \$5 billion, excluding (1) those that are advanced approaches institutions or are subject to Category III capital standards for regulatory capital purposes and (2) those that are large or highly complex institutions for deposit insurance assessment purposes,³ are eligible to file the [FFIEC 051](#) Call Report. An institution's total assets are measured as of June 30 each year to determine the institution's eligibility to file the [FFIEC 051](#) beginning in March of the following year. Institutions are expected to file the same report form, either the [FFIEC 051](#) or the [FFIEC 041](#), for each quarterly report date in a given year.

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

Close of Business

The term "close of business" refers to the time established by the reporting bank as the cut-off time for receipt of work for posting transactions to its general ledger accounts for that day. The time designated as the close of business should be reasonable and applied consistently. The posting of a transaction to the general ledger means that both debit and credit entries are recorded as of the same date. In addition, entries made to general ledger accounts in the period subsequent to the close of business on the report date that are applicable to the period covered by the Call Report (e.g., adjustments of accruals, posting of

¹ The \$100 billion asset-size test is based on the total assets reported as of June 30 each year to determine whether the institution must file the FFIEC 031 report form beginning in March of the following year.

² Category III institutions include institutions, which are not advanced approaches institutions, that have (1) at least \$250 billion in average total consolidated assets or (2) at least \$100 billion in average total consolidated assets and at least \$75 billion in average total nonbank assets, average weighted short-term wholesale funding, or average off-balance sheet exposure. In addition, depository institution subsidiaries of Category III institutions are considered Category III institutions.

³ See [12 CFR § 327.8](#) and [12 CFR § 327.16\(f\)](#).

Item No. Caption and Instructions

- 1.a**
(cont.)
- (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) 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 (6) below.
- (6) Interest income earned on loans that are reported at fair value under a fair value option.

Exclude from interest and fee income on loans:

- (1) Fees for servicing real estate mortgages or other loans that are not assets of the bank (report in Schedule RI, item 5.f, "Net servicing fees").
- (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 noninterest income" in Schedule RI, item 5.l). Banks may report this income net of the expenses (except salaries) related to the handling of these credit card or charge sales.
- (3) Loan origination fees, direct loan origination costs, and purchase premiums and discounts on loans held for sale, all of which should be deferred until the loan is sold (rather than amortized). The net fees or costs and purchase premium or discount are part of the recorded investment in the loan. When the loan is sold, the difference between the sales price and the recorded investment in the loan is the gain or loss on the sale of the loan. See exclusion (4) below.
- (4) Net gains (losses) from the sale of all assets reportable as loans (report in Schedule RI, item 5.i, "Net gains (losses) on sales of loans and leases"). Refer to the Glossary entry for "transfers of financial assets."
- (5) Reimbursements for out-of-pocket expenditures (e.g., for the purchase of fire insurance on real estate securing a loan) made by the bank for the account of its customers. If the bank's expense accounts were charged with the amount of such expenditures, the reimbursements should be credited to the same expense accounts.
- (6) Transaction or per item charges levied against deposit accounts for the processing of checks drawn against insufficient funds that the bank assesses regardless of whether it decides to pay, return, or hold the check, so-called "NSF check charges" (report as "Service charges on deposit accounts (in domestic offices)," in Schedule RI, item 5.b, or, if levied against deposit accounts in foreign offices, as "Other noninterest income" in Schedule RI, item 5.l). See inclusion (5) above.
- (7) Interchange fees earned from credit card transactions (report as "Other noninterest income" in Schedule RI, item 5.l).

FFIEC 041 FFIEC 031**Item No. Item No. Caption and Instructions**

- **1.a.(1)** **Interest and fee income on loans in domestic offices.** Report in the appropriate subitem all interest, fees, and similar charges levied against or associated with all loans in domestic offices reportable in Schedule RC-C, part I, items 1 through 9, column B.
- 1.a.(1)** **1.a.(1)(a)** **Interest and fee income on loans secured by real estate:**

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Item No. Item No. Caption and Instructions

- 1.a.(1)(a) 1.a.(1)(a)(1) Interest and fee income on loans secured by 1-4 family residential properties.** Report all interest, fees, and similar charges levied against or associated with all loans secured by 1-4 family residential properties (in domestic offices) reportable in Schedule RC-C, part I, item 1.c, column B.
- 1.a.(1)(b) 1.a.(1)(a)(2) Interest and fee income on all other loans secured by real estate.** Report all interest, fees, and similar charges levied against or associated with all loans secured by real estate (in domestic offices) reportable in Schedule RC-C, part I, items 1.a, 1.b, 1.d, and 1.e, column B. Include interest and fee income on loans secured by 1-4 family residential construction loans, but exclude such income on all other loans secured by 1-4 family residential properties.
- **1.a.(1)(b) Interest and fee income on loans to finance agricultural production and other loans to farmers.** Report all interest, fees, and similar charges levied against or associated with all loans (in domestic offices) reportable in Schedule RC-C, part I, item 3, "Loans to finance agricultural production and other loans to farmers."
- 1.a.(2) 1.a.(1)(c) Interest and fee income on commercial and industrial loans.** Report all interest, fees, and similar charges levied against or associated with all loans (in domestic offices) reportable in Schedule RC-C, part I, item 4, "Commercial and industrial loans."
- 1.a.(3) 1.a.(1)(d) Interest and fee income on loans to individuals for household, family, and other personal expenditures.** Report in the appropriate subitem all interest, fees, and similar charges levied against or associated with all loans (in domestic offices) reportable in Schedule RC-C, part I, item 6, "Loans to individuals for household, family, and other personal expenditures."
- 1.a.(3)(a) 1.a.(1)(d)(1) Interest and fee income on credit cards.** Report all interest, fees, and similar charges levied against or associated with all extensions of credit to individuals for household, family, and other personal expenditures arising from credit cards (in domestic offices) reportable in Schedule RC-C, part I, item 6.a, "Credit cards." Include in this item any reversals of uncollectible credit card fees and finance charges and any additions to a contra-asset account for uncollectible credit card fees and finance charges that the bank maintains and reports separately from its allowance for loan and lease losses.
- Exclude annual or other periodic fees paid by holders of credit cards issued by the bank (report in Schedule RI, item 5.I, "Other noninterest income").
- 1.a.(3)(b) 1.a.(1)(d)(2) Interest and fee income on other loans to individuals for household, family, and other personal expenditures.** Report all interest, fees, and similar charges levied against or associated with all other loans to individuals for household, family, and other personal expenditures (in domestic offices) reportable in Schedule RC-C, part I, item 6.b, "Other revolving credit plans," item 6.c, "Automobile loans," and item 6.d, "Other consumer loans."
- **1.a.(1)(e) Interest and fee income on loans to foreign governments and official institutions.** Report all interest, fees, and similar charges levied against or associated with all loans (in domestic offices) reportable in Schedule RC-C, Part I, item 7, "Loans to foreign governments and official institutions."

FFIEC 041 FFIEC 031**Item No. Item No. Caption and Instructions**

- 1.a.(5) 1.a.(1)(f) Interest and fee income on all other loans.** On the FFIEC 041, report interest, fees, and similar charges levied against or associated with loans reportable in Schedule RC-C, Part I, item 2, "Loans to depository institutions and acceptances of other banks," item 3, "Loans to finance agricultural production and other loans to farmers," item 8, "Obligations (other than securities and leases) of states and political subdivisions in the U.S.," and item 9, "Loans to nondepository financial institutions and other loans."
- On the FFIEC 031, report interest, fees, and similar charges levied against or associated with loans in domestic offices reportable in Schedule RC-C, Part I, item 2, "Loans to depository institutions and acceptances of other banks," item 8, "Obligations (other than securities and leases) of states and political subdivisions in the U.S.," and item 9, "Loans to nondepository financial institutions and other loans."
- **1.a.(2) Interest and fee income on loans in foreign offices, Edge and Agreement subsidiaries, and IBFs.** Report all interest, fees, and similar charges levied against or associated with all loans in foreign offices, Edge and Agreement subsidiaries, and IBFs reportable in Schedule RC-C, Part I, items 1 through 9.
- 1.a.(6) 1.a.(3) Total interest and fee income on loans.** On the FFIEC 041, report the sum of items 1.a.(1) through 1.a.(5) in item 1.a.(6). On the FFIEC 031, report the sum of items 1.a.(1)(a) through 1.a.(2) in item 1.a.(3).

FFIEC 031 and 041**Item No. Caption and Instructions**

- 1.b Income from lease financing receivables.** Report all income from leases reportable in Schedule RC-C, Part I, item 10, "Lease financing receivables (net of unearned income)." (See the Glossary entry for "lease accounting.")
- Include income from:
- (1) Direct financing leases accounted for under ASC Topic 840, Leases, by an institution that has not adopted ASC Topic 842, Leases;
 - (2) Direct financing and sales-type leases accounted for under ASC Topic 842 by an institution that has adopted ASC Topic 842; and
 - (3) Leveraged leases accounted for under ASC Topic 840 (including leveraged leases that were grandfathered upon the adoption of ASC Topic 842 and remain grandfathered).
- Exclude from income from lease financing receivables:
- (1) Any investment tax credits associated with leased property (include in Schedule RI, item 9, "Applicable income taxes (on item 8.c)").
 - (2) Provisions for losses on leases (report in Schedule RI, item 4, "Provision for loan and lease losses").
 - (3) Rental fees applicable to operating leases for furniture and equipment rented to others (report as "Other noninterest income" in Schedule RI, item 5.I).
- 1.c Interest income on balances due from depository institutions.** Report all income on assets reportable in Schedule RC, item 1.b, "Interest-bearing balances due from depository institutions," including interest-bearing balances maintained to satisfy reserve balance requirements, excess balances, and term deposits due from Federal Reserve Banks. Include interest income earned on interest-bearing balances due from depository institutions that are reported at fair value under a fair value option.

Item No. Caption and Instructions

- 1.d Interest and dividend income on securities.** Report in the appropriate subitem all income on assets that are reportable in Schedule RC-B, Securities. Include accretion of discount and deduct amortization of premium on securities. Refer to the Glossary entry for "premiums and discounts."

For institutions that have adopted FASB [Accounting Standards Update No. 2016-01](#) (ASU 2016-01), which includes provisions governing the accounting for investments in equity securities and eliminates the concept of available-for-sale equity securities (see the Note preceding the instructions for Schedule RI, item 8.b), also include dividend income on equity securities with readily determinable fair values not held for trading that are reportable in Schedule RC, item 2.c.

Include interest and dividends on securities held in the bank's held-to-maturity and available-for-sale portfolios, even if such securities have been lent, sold under agreements to repurchase that are treated as borrowings, or pledged as collateral for any purpose.

Include interest received at the sale of securities to the extent that such interest had not already been accrued on the bank's books.

Do not deduct accrued interest included in the purchase price of securities from income on securities and do not charge to expense. Record such interest in a separate asset account (to be reported in Schedule RC, item 11, "Other assets") to be offset upon collection of the next interest payment.

Report income from detached U.S. Government security coupons and ex-coupon U.S. Government securities not held for trading in Schedule RI, item 1.d.(3), as interest and dividend income on "All other securities." Refer to the Glossary entry for "coupon stripping, Treasury receipts, and STRIPS."

Exclude from interest and dividend income on securities:

- (1) Realized gains (losses) on held-to-maturity securities and on available-for-sale securities (report in Schedule RI, items 6.a and 6.b, respectively).
- (2) Net unrealized holding gains (losses) on available-for-sale securities (include the amount of such net unrealized holding gains (losses) in Schedule RC, item 26.b, "Accumulated other comprehensive income," and the calendar year-to-date change in such net unrealized holding gains (losses) in Schedule RI-A, item 10, "Other comprehensive income").
- (3) For institutions that have adopted ASU 2016-01, realized and unrealized gains (losses) on equity securities with readily determinable fair values not held for trading (report in Schedule RI, item 8.b).
- (4) Income from advances to, or obligations of, majority-owned subsidiaries not consolidated, associated companies, and those corporate joint ventures over which the bank exercises significant influence (report as "Noninterest income" in the appropriate subitem of Schedule RI, item 5).

- 1.d.(1) Interest and dividend income on U.S. Treasury securities and U.S. Government agency obligations (excluding mortgage-backed securities).** Report income from all securities reportable in Schedule RC-B, item 1, "U.S. Treasury securities," and item 2, "U.S. Government agency obligations." Include accretion of discount on U.S. Treasury bills.

FFIEC 041 FFIEC 031

<u>Item No.</u>	<u>Item No.</u>	<u>Caption and Instructions</u>
-	2.a.(1)	<u>Interest on deposits in domestic offices:</u>
2.a.(1)	2.a.(1)(a)	<u>Interest on transaction accounts.</u> Report interest expense on all interest-bearing transaction accounts (interest-bearing demand deposits, NOW accounts, ATS accounts, and telephone and preauthorized transfer accounts) reportable in Schedule RC-E, (part I,) items 1 through 6, column A, "Total transaction accounts." <u>Exclude</u> all costs incurred by the bank in connection with noninterest-bearing demand deposits. See the Glossary entry for "deposits" for the definitions of "interest-bearing deposit accounts," "demand deposits," "NOW accounts," "ATS accounts," and "telephone or preauthorized transfer accounts."
2.a.(2)	2.a.(1)(b)	<u>Interest on nontransaction accounts.</u> Report in the appropriate subitem interest expense on all deposits reportable in Schedule RC-E, (part I,) items 1 through 6, column C, "Total nontransaction accounts."
2.a.(2)(a)	2.a.(2)(b)(1)	<u>Interest on savings deposits.</u> Report interest expense on all deposits reportable in Schedule RC-E, (Part I,) Memorandum item 2.a.(1), "Money market deposit accounts (MMDAs)," and Memorandum item 2.a.(2), "Other savings deposits."
2.a.(2)(b)	2.a.(1)(b)(2)	<u>Interest on time deposits of \$250,000 or less.</u> Report interest expense on all deposits reportable in Schedule RC-E, (Part I,) Memorandum item 2.b, "Total time deposits of less than \$100,000," and Memorandum item 2.c, "Total time deposits of \$100,000 through \$250,000."
2.a.(2)(c)	2.a.(1)(b)(3)	<u>Interest on time deposits of more than \$250,000.</u> Report interest expense on all deposits reportable in Schedule RC-E, (Part I,) Memorandum item 2.d, "Total time deposits of more than \$250,000."
-	2.a.(2)	<u>Interest on deposits in foreign offices, Edge and Agreement subsidiaries, and IBFs.</u> Report interest expense on all deposits in foreign offices reportable in Schedule RC, item 13.b.(2), "Interest-bearing deposits in foreign offices, Edge and Agreement subsidiaries, and IBFs."

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<u>Item No.</u>	<u>Caption and Instructions</u>
2.b	<u>Expense of federal funds purchased and securities sold under agreements to repurchase.</u> Report the <u>gross</u> expense of all liabilities reportable in Schedule RC, item 14, "Federal funds purchased and securities sold under agreements to repurchase." Include interest expense incurred on federal funds purchased and securities sold under agreements to repurchase that are reported at fair value under a fair value option. Report the income of federal funds sold and securities purchased under agreements to resell in Schedule RI, item 1.f; do <u>not</u> deduct from the gross expense reported in this item. However, if amounts recognized as payables under repurchase agreements have been offset against amounts recognized as receivables under reverse repurchase agreements and reported as a net amount in Schedule RC, Balance Sheet, in accordance with ASC Subtopic 210-20, Balance Sheet – Offsetting (formerly FASB Interpretation No. 41, "Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements"), the income and expense from these agreements may be reported on a net basis in Schedule RI, Income Statement.

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- 2.c Interest on trading liabilities and other borrowed money.** Report the interest expense on all liabilities reportable in Schedule RC, item 15, "Trading liabilities," and item 16, "Other borrowed money." Include interest expense incurred on other borrowed money reported at fair value under a fair value option.

Include amortization of debt issuance costs associated with other borrowed money (unless the borrowed money is reported at fair value under a fair value option, in which case issuance costs should be expensed as incurred).

- 2.d Interest on subordinated notes and debentures.** Report the interest expense on all liabilities reportable in Schedule RC, item 19, "Subordinated notes and debentures." Include interest expense incurred on subordinated notes and debentures reported at fair value under a fair value option.

Include amortization of debt issuance costs associated with subordinated notes and debentures (unless the notes and debentures are reported at fair value under a fair value option, in which case issuance costs should be expensed as incurred).

Exclude dividends declared or paid on limited-life preferred stock (report dividends declared in Schedule RI-A, item 8).

- 2.e Total interest expense.** Report the sum of Schedule RI, items 2.a through 2.d.

- 3 Net interest income.** Report the difference between Schedule RI, item 2.e, "Total interest expense," and Schedule RI, item 1.h, "Total interest income." If the amount is negative, report it with a minus (-) sign.

- 4 Provision for loan and lease losses.** Institutions that have not adopted FASB [Accounting Standards Update No. 2016-13](#) (ASU 2016-13), which governs the accounting for credit losses, should report the amount needed to make the allowance for loan and lease losses, as reported in Schedule RC, item 4.c, adequate to absorb estimated credit losses, based upon management's evaluation of the reporting institution's loans and leases held for investment, excluding such loans and leases reported at fair value under a fair value option. Loans and leases held for investment are those that the reporting institution has the intent and ability to hold for the foreseeable future or until maturity or payoff. Also include in this item any provision for allocated transfer risk related to loans and leases. The amount reported in this item must equal Schedule RI-B, Part II, item 5, column A, "Provision for credit losses." Report negative amounts with a minus (-) sign.

Institutions that have adopted ASU 2016-13 should report amounts expensed as provisions for credit losses (or reversals of provisions) during the calendar year to date on assets within the scope of the ASU, i.e., financial assets measured at amortized cost (including loans held for investment and held-to-maturity debt securities), net investments in leases, and available-for-sale debt securities. Provisions for credit losses (or reversals of provisions) on financial assets measured at amortized cost and net investments in leases represent the amounts necessary to adjust the related allowances for credit losses at the quarter-end report date for management's current estimate of expected credit losses on these assets. Provisions for credit losses (or reversals of provisions) on available-for-sale debt securities represent changes during the calendar year to date in the amount of impairment related to credit losses on individual available-for-sale debt securities. Exclude the initial allowance gross-up amounts established upon the purchase of credit-deteriorated financial assets, which are recorded at the date of acquisition as an addition to the purchase price to determine the initial amortized cost basis of the assets. The amount reported in this item must equal the sum of Schedule RI-B, Part II, item 5, columns A through C, plus Schedule RI-B, Part II, Memorandum item 5. Report negative amounts with a minus (-) sign.

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6.b Exclude from this item:
(cont.)

- (1) (a) For institutions that have not adopted ASU 2016-01, the change in net unrealized holding gains (losses) on available-for-sale debt and equity securities during the calendar year to date (report in Schedule RI-A, item 10, "Other comprehensive income").
- (b) For institutions that have adopted ASU 2016-01, the change in net unrealized holding gains (losses) on available-for-sale debt securities during the calendar year to date (report in Schedule RI-A, item 10, "Other comprehensive income").
- (2) Realized gains (losses) on held-to-maturity securities (report in Schedule RI, item 6.a, above) and on trading securities (report in Schedule RI, item 5.c, "Trading revenue").
- (3) For institutions that have adopted ASU 2016-13, provisions for credit losses (and reversals of provisions) that increase (and decrease) the allowance for credit losses on available-for-sale debt securities (report in Schedule RI, item 4, "Provision for loan and lease losses").

7 Noninterest expense:

7.a Salaries and employee benefits. Report salaries and benefits of all officers and employees of the bank and its consolidated subsidiaries including guards and contracted guards, temporary office help, dining room and cafeteria employees, and building department officers and employees (including maintenance personnel). Include as employees individuals who, in form, are employed by an affiliate but who, in substance, do substantially all of their work for the reporting bank. However, banking organizations should not segregate the compensation component of other intercompany cost allocations arising from arrangements other than that described in the preceding sentence for purposes of this item.

Include as salaries and employee benefits:

- (1) Gross salaries, wages, overtime, bonuses, incentive compensation, and extra compensation.
- (2) Social security taxes and state and federal unemployment taxes paid by the bank.
- (3) Costs of the bank's retirement plan, pension fund, profit-sharing plan, employee stock ownership plan, employee stock purchase plan, and employee savings plan. For defined benefit pension plans and other postretirement plans, institutions that have adopted [Accounting Standards Update No. 2017-07](#), "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost" (ASU 2017-17),¹ should report only the service cost component of net benefit cost for such plans in this item 7.a; the other cost components of net benefit cost should be reported in Schedule RI, item 7.d, "Other noninterest expense."

¹ For institutions that are public business entities, ASU 2017-07 was effective for fiscal years beginning after December 15, 2017, including interim periods within those annual periods. For institutions that are not public business entities, ASU 2017-07 is effective for fiscal years beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

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- 7.a**
(cont.)
- (4) Premiums (net of dividends received) on health and accident, hospitalization, dental, disability, and life insurance policies for which the bank is not the beneficiary.
 - (5) Cost of office temporaries whether hired directly by the bank or through an outside agency.
 - (6) Workmen's compensation insurance premiums.
 - (7) The net cost to the bank for employee dining rooms, restaurants, and cafeterias.
 - (8) Accrued vacation pay earned by employees during the calendar year-to-date.
 - (9) The cost of medical or health services, relocation programs and reimbursements of moving expenses, tuition reimbursement programs, and other so-called fringe benefits for officers and employees.
 - (10) Compensation expense (service component and interest component) related to deferred compensation agreements.

Exclude from salaries and employee benefits (report in Schedule RI, item 7.d, "Other noninterest expense"):

- (1) Amounts paid to attorneys, accountants, management consultants, investment counselors, and other professionals who are not salaried officers or employees of the bank (except if these professionals, in form, are employed by an affiliate of the reporting bank but, in substance, do substantially all of their work for the reporting bank).
- (2) Expenses related to the testing and training of officers and employees.
- (3) The cost of bank newspapers and magazines prepared for distribution to bank officers and employees.
- (4) Expenses of life insurance policies for which the bank is the beneficiary. (However, when these expenses relate to bank-owned life insurance policies with cash surrender values, banks may report the net earnings on or the net increases in the value of these cash surrender values in Schedule RI, item 5.I, above.)
- (5) The cost of athletic activities in which officers and employees participate when the purpose may be construed to be for marketing or public relations, and employee benefits are only incidental to the activities.
- (6) Dues, fees and other expenses associated with memberships in country clubs, social or private clubs, civic organizations, and similar clubs and organizations.

- 7.b** **Expenses of premises and fixed assets.** Report all noninterest expenses related to the use of premises, equipment, furniture, and fixtures reportable in Schedule RC, item 6, "Premises and fixed assets," net of rental income. If this net amount is a credit balance, report it with a minus (-) sign.

Deduct rental income from gross premises and fixed asset expense. Rental income includes all rentals charged for the use of buildings not incident to their use by the reporting institution and its consolidated subsidiaries, including rentals by regular tenants of the institution's buildings, income received from short-term rentals of other bank facilities, and income from subleases. Also deduct income from stocks and bonds issued by nonmajority-owned corporations and investments in limited partnerships or limited liability companies whose

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7.b
(cont.) principal activity is the ownership of premises, equipment, furniture, or fixtures occupied or used (or to be occupied or used) by the institution, its branches, or its consolidated subsidiaries and are reportable in Schedule RC, item 6, "Premises and fixed assets."

Include as expenses of premises and fixed assets:

- (1) Normal and recurring depreciation and amortization charges against, and any impairments on, assets reportable in Schedule RC, item 6, "Premises and fixed assets," including capital lease assets accounted for in accordance with ASC Topic 840, Leases, and right-of-use (ROU) assets for finance leases accounted for in accordance with ASC Topic 842, as applicable. Include depreciation and amortization charges regardless of whether they represent direct reductions in the carrying value of the assets or additions to accumulated depreciation or amortization accounts. 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.
- (2) For operating leases accounted for in accordance with:
 - (a) ASC Topic 840 by a lessee institution that has not adopted ASC Topic 842, rental expense for leased premises (including parking lots), equipment (including data processing equipment), furniture, and fixtures.
 - (b) ASC Topic 842 by a lessee institution that has adopted this topic, a single lease cost for the expenses related to lease liabilities and the amortization of ROU assets for leased premises, equipment, furniture, and fixtures; variable lease payments not included in lease liabilities; and any impairments of ROU assets.
- (3) Cost of ordinary repairs to premises (including leasehold improvements), equipment, furniture, and fixtures.
- (4) Cost of service or maintenance contracts for equipment, furniture, and fixtures.
- (5) Cost of leasehold improvements, equipment, furniture, and fixtures charged directly to expense and not placed on the bank's books as assets.
- (6) Insurance expense related to the use of premises, equipment, furniture, and fixtures including such coverages as fire, multi-peril, boiler, plate glass, flood, and public liability.
- (7) All property tax and other tax expense related to premises (including leasehold improvements), equipment, furniture, and fixtures, including deficiency payments, net of all rebates, refunds, or credits.
- (8) Any portion of a lessee institution's payments to lessors representing executory costs such as insurance, maintenance, and taxes.
- (9) Cost of heat, electricity, water, and other utilities connected with the use of premises and fixed assets.
- (10) Cost of janitorial supplies and outside janitorial services.
- (11) Fuel, maintenance, and other expenses related to the use of the bank-owned automobiles, airplanes, and other vehicles for bank business.

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7.b Exclude from expenses of premises and fixed assets:
(cont.)

- (1) Salaries and employee benefits (report such expenses for all officers and employees of the bank and its consolidated subsidiaries in Schedule RI, item 7.a, "Salaries and employee benefits").
- (2) Interest on mortgages, liens, or other encumbrances on premises or equipment owned, including the portion of lease payments representing interest expense for capital leases accounted for in accordance with ASC Topic 840 and the interest expense on lease liabilities for finance leases accounted for in accordance with ASC Topic 842 (report in Schedule RI, item 2.c, "Interest on trading liabilities and other borrowed money").
- (3) All expenses associated with other real estate owned (report in Schedule RI, item 7.d, "Other noninterest expense").
- (4) Gross rentals from other real estate owned and fees charged for the use of parking lots properly reported as other real estate owned, as well as safe deposit box rentals and rental fees applicable to operating leases for furniture and equipment rented to others (report in Schedule RI, item 5.l).

7.c.(1) **Goodwill impairment losses.** Report any impairment losses recognized during the period on goodwill. Exclude goodwill impairment losses associated with discontinued operations (report such losses on a net-of-tax basis in Schedule RI, item 11, "Discontinued operations, net of applicable income taxes").

An institution that meets the definition of a private company in U.S. generally accepted accounting principles and has elected the accounting alternative for the amortization of goodwill in ASC Subtopic 350-20, Intangibles-Goodwill and Other – Goodwill (formerly FASB Statement No. 142, "Goodwill and Other Intangible Assets"), as amended by Accounting Standards Update No. 2014-02, "Accounting for Goodwill," should report the amortization expense of goodwill in this item. Exclude goodwill amortization expense associated with discontinued operations (report such expense on a net-of-tax basis in Schedule RI, item 11, "Discontinued operations, net of applicable income taxes"). A private company that elects the accounting alternative for the subsequent measurement of goodwill should amortize each amortizable unit of goodwill on a straight-line basis over ten years (or less than ten years if the private company demonstrates that another useful life is more appropriate).

Except when the private company accounting alternative described above has been elected, goodwill should not be amortized. However, regardless of whether goodwill is amortized, it must be tested for impairment as described in the Glossary entry for "goodwill."

7.c.(2) **Amortization expense and impairment losses for other intangible assets.** Report the amortization expense of and any impairment losses on intangible assets (other than goodwill and servicing assets) reportable in Schedule RC-M, item 2.c. Under ASC Topic 350, Intangibles-Goodwill and Other (formerly FASB Statement No. 142, "Goodwill and Other Intangible Assets"), intangible assets that have indefinite useful lives should not be amortized, but must be tested at least annually for impairment. Intangible assets that have finite useful lives must be amortized over their useful lives and must be reviewed for impairment in accordance with ASC Topic 360, Property, Plant, and Equipment (formerly FASB Statement No. 144, "Accounting for the Impairment of Long-Lived Assets").

Exclude the amortization expense of and any impairment losses on servicing assets, which should be netted against the servicing income reported in Schedule RI, item 5.f, "Net servicing fees," above.

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- 7.d Other noninterest expense.** Report all operating expenses of the bank for the calendar year-to-date not required to be reported elsewhere in Schedule RI.

Disclose in Schedule RI-E, items 2.a through 2.p, each component of other noninterest expense, and the dollar amount of such component, that is greater than \$100,000 and exceeds 7 percent of the other noninterest expense reported in this item. If net gains have been reported in this item for a component of "Other noninterest expense," use the absolute value of such net gains to determine whether the amount of the net gains is greater than \$100,000 and exceeds 7 percent of "Other noninterest expense" and should be reported in Schedule RI-E, item 2. (The absolute value refers to the magnitude of the dollar amount without regard to whether the amount represents net gains or net losses.)

For each component of other noninterest expense that exceeds the disclosure threshold in the preceding paragraph and for which a preprinted caption has not been provided in Schedule RI-E, items 2.a.through 2.m, describe the component with a clear but concise caption in Schedule RI-E, items 2.n through 2.p. These descriptions should not exceed 50 characters in length (including spacing between words).

For disclosure purposes in Schedule RI-E, items 2.a through 2.m, when components of "Other noninterest expense" reflect a single charge for separate "bundled services" provided by third party vendors, disclose such amounts in the item with the preprinted caption that most closely describes the predominant type of expense incurred, and this categorization should be used consistently over time.

Include as other noninterest expense:

- (1) Fees paid to directors and advisory directors for attendance at board of directors' or committee meetings (including travel and expense allowances). (Report the amount of such fees in Schedule RI-E, item 2.c, if this amount is greater than \$100,000 and exceeds 7 percent of the amount reported in Schedule RI, item 7.d.)
- (2) Cost of data processing services performed for the bank by others. (Report the amount of such expenses in Schedule RI-E, item 2.a, if this amount is greater than \$100,000 and exceeds 7 percent of the amount reported in Schedule RI, item 7.d.)
- (3) Advertising, promotional, public relations, marketing, and business development expenses. Such expenses include the cost of athletic activities in which officers and employees participate when the purpose may be construed to be for marketing or public relations, and employee benefits are only incidental to the activities. (Report the amount of such expenses in Schedule RI-E, item 2.b, if this amount is greater than \$100,000 and exceeds 7 percent of the amount reported in Schedule RI, item 7.d.)
- (4) Cost of gifts or premiums (whether in the form of merchandise, credit, or cash) given to depositors at the time of the opening of a new account or an addition to, or renewal of, an existing account, if not included in advertising and marketing expenses above.
- (5) Retainer fees, legal fees, and other fees and expenses paid to attorneys who are not bank officers or employees and to outside law firms. (Report the amount of such expenses in Schedule RI-E, item 2.f, if this amount is greater than \$100,000 and exceeds 7 percent of the amount reported in Schedule RI, item 7.d.)

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- 7.e Total noninterest expense.** Report the sum of items 7.a through 7.d.
- 8.a Income (loss) before unrealized holding gains (losses) on equity securities not held for trading, applicable income taxes, and discontinued operations.** Report the institution's pretax income from continuing operations before unrealized holding gains (losses) on equity securities not held for trading. This amount is determined by taking item 3, "Net interest income," minus item 4, "Provision for loan and lease losses,"¹ plus item 5.m, "Total noninterest income," plus item 6.a, "Realized gains (losses) on held-to-maturity securities," plus item 6.b, "Realized gains (losses) on available-for-sale securities," minus item 7.e, "Total noninterest expense." If the result is negative, report it with a minus (-) sign.

NOTE: Item 8.b is to be completed only by institutions that are required to have adopted FASB [Accounting Standards Update No. 2016-01](#) (ASU 2016-01), as discussed below. ASU 2016-01 includes provisions governing the accounting for investments in equity securities and eliminates the concept of available-for-sale equity securities. ASU 2016-01 requires holdings of equity securities (except those accounted for under the equity method or that result in consolidation), including other ownership interests (such as partnerships, unincorporated joint ventures, and limited liability companies), to be measured at fair value with changes in the fair value recognized through net income. However, an institution may choose to measure equity securities and other equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

Institutions that are not yet required to have adopted ASU 2016-01, as discussed below, should leave item 8.b blank and report their unrealized gains (losses) on available-for-sale equity securities during the year-to-date reporting period in Schedule RI-A, item 10, "Other comprehensive income."

All institutions that are public business entities, as defined in U.S. GAAP, were required to have adopted ASU 2016-01 for Call Report purposes as of the beginning of their 2018 fiscal year. For all other institutions, ASU 2016-01 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Thus, an institution with a fiscal year that ended between December 15, 2019, and September 30, 2020, and is not a public business entity is required to have adopted ASU 2016-01 for Call Report purposes. An institution with a fiscal year that ends after September 30, 2020, but before December 15, 2020 (and did not early adopt ASU 2016-01), must begin to apply ASU 2016-01 in its Call Report for December 31, 2020.

- 8.b Change in net unrealized holding gains (losses) on equity securities not held for trading.** Report the year-to-date change in net unrealized holding gains (losses) on equity securities with readily determinable fair values not held for trading. Include the year-to-date change in net unrealized holding gains (losses) on equity securities and other equity investments without readily determinable fair values not held for trading that are measured at fair value through earnings. Also include impairment, if any, plus or minus changes resulting from observable price changes during the year-to-date reporting period on equity securities and other equity investments without readily determinable fair values not held for trading for which this measurement election is made.

Include realized gains (losses) on equity securities and other equity investments during the year-to-date reporting period. A realized gain (loss) arises if an institution sells an equity security or other equity investment, but had not yet recorded in earnings the change in value to the point of sale since the last value change was recorded.

¹ Note: Institutions that have adopted ASU 2016-13 should report provisions for credit losses on all assets within the scope of the ASU in Schedule RI, item 4.

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- 8.c Income (loss) before applicable income taxes and discontinued operations.** Report the institution's pretax income from continuing operations as the sum of Schedule RI, item 8.a, "Income (loss) before unrealized holding gains (losses) on equity securities not held for trading, applicable income taxes, and discontinued operations," and Schedule RI, item 8.b, "Change in net unrealized holding gains (losses) on equity securities not held for trading." If the amount is negative, report it with a minus (-) sign.
- 9 Applicable income taxes (on item 8.c).** Report the total estimated federal, state and local, and foreign income tax expense applicable to item 8.c, "Income (loss) before applicable income taxes and discontinued operations." Include both the current and deferred portions of these income taxes. If the amount is a tax benefit rather than tax expense, report it with a minus (-) sign.

Include as applicable income taxes all taxes based on a net amount of taxable revenues less deductible expenses. Exclude from applicable income taxes all taxes based on gross revenues or gross receipts (report such taxes in Schedule RI, item 7.d, "Other noninterest expense").

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- 5 Trading assets.** Trading activities typically include (a) regularly underwriting or dealing in securities; interest rate, foreign exchange rate, commodity, equity, and credit derivative contracts; other financial instruments; and other assets for resale; (b) acquiring or taking positions in such items principally for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements; or (c) acquiring or taking positions in such items as accommodations to customers, provided that acquiring or taking such positions meets the definition of "trading" in ASC Topic 320, Investments–Debt Securities, and ASC Topic 815, Derivatives and Hedging, and the definition of "trading purposes" in ASC Topic 815. Assets and other financial instruments held for trading shall be consistently valued at fair value as defined by ASC Topic 820, Fair Value Measurement.

For purposes of the Consolidated Reports of Condition and Income, all debt securities within the scope of ASC Topic 320, Investments–Debt Securities, that a bank has elected to report at fair value under a fair value option with changes in fair value reported in current earnings should be classified as trading securities. In addition, for purposes of these reports, banks may classify assets (other than debt securities within the scope of ASC Topic 320 for which a fair value option is elected) as trading if the bank applies fair value accounting, with changes in fair value reported in current earnings, and manages these assets as trading positions, subject to the controls and applicable regulatory guidance related to trading activities. For example, a bank would generally not classify a loan to which it has applied the fair value option as a trading asset unless the bank holds the loan, which it manages as a trading position, for one of the following purposes: (1) for market making activities, including such activities as accumulating loans for sale or securitization; (2) to benefit from actual or expected price movements; or (3) to lock in arbitrage profits.

Do not include in this item the carrying value of any available-for-sale securities, any loans that are held for sale (and are not classified as trading in accordance with the preceding instruction), and any leases that are held for sale. Available-for-sale debt securities are reported in Schedule RC, item 2.b, and in Schedule RC-B, columns C and D. Loans (not classified as trading) and leases held for sale should be reported in Schedule RC, item 4.a, "Loans and leases held for sale," and in Schedule RC-C.

Trading assets also include derivatives with a positive fair value resulting from the "marking to market" of interest rate, foreign exchange rate, commodity, equity, and credit derivative contracts held for trading purposes as of the report date. Derivative contracts with the same counterparty that have positive fair values and negative fair values and meet the criteria for a valid right of setoff contained in ASC Subtopic 210-20, Balance Sheet – Offsetting (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, "Trading liabilities," as appropriate. (See the Glossary entry for "offsetting.")

For those banks that must complete Schedule RC-D, this item must equal Schedule RC-D, item 12, "Total trading assets," and Schedule RC-Q, sum of items 5.a and 5.b, column A.

- 6 Premises and fixed assets.** Report on a consolidated basis the book value, less accumulated depreciation or amortization and any impairment losses, of all premises, equipment, furniture, and fixtures purchased directly or acquired by means of a capital lease accounted for in accordance with ASC Topic 840, Leases, or in the form of a right-of-use (ROU) asset accounted for in accordance with ASC Topic 842, Leases, as applicable.

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.

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6 Do not deduct mortgages or other liens on such property (report in Schedule RC, item 16,
(cont.) "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 institution, its branches, or its consolidated subsidiaries.
- (2) Leasehold improvements, vaults, and fixed machinery and equipment.
- (3) Capitalized remodeling costs to existing premises.
- (4) Real estate acquired and intended to be used for future expansion.
- (5) Parking lots owned by the institution that are used by customers or employees of the institution, its branches, and its consolidated subsidiaries.
- (6) Furniture, fixtures, and movable equipment of the institution, its branches, and its consolidated subsidiaries.
- (7) Automobiles, airplanes, and other vehicles owned by the institution and used in the conduct of its business.
- (8) For a lessee institution that has not adopted ASC Topic 842, the amount of capital lease property, and for a lessee institution that has adopted ASC Topic 842, the amount of ROU assets that represents premises, equipment, furniture, and fixtures.

In general, under ASC Topic 842 for an institution as lessee, the ROU asset for a finance lease should be reported at cost less any accumulated amortization and any accumulated impairment losses; the ROU asset for an operating lease (not previously impaired) should be reported at the book value of the related lease liability adjusted for the remaining balance of any lease incentives received, any prepaid or accrued lease payments, any unamortized initial direct costs, and any current period impairment. After an ROU asset for an operating lease is impaired, it should be reported at its carrying amount immediately after the impairment less any accumulated amortization. See the discussion of accounting by an institution as lessee in the Glossary entry for "lease accounting."

- (9) (a) Stocks and bonds issued by nonmajority-owned corporations and
(b) Investments in limited partnerships or limited liability companies (other than investments so minor that the institution has virtually no influence over the partnership or company)
whose principal activity is the ownership of land, buildings, equipment, furniture, or fixtures occupied or used (or to be occupied or used) by the institution, its branches, or its consolidated subsidiaries. For institutions that have adopted ASU 2016-01 (see the Note preceding the instructions for Schedule RC, item 2.c), report such stocks and investments at (i) fair value or (ii) if chosen by the reporting institution for an equity investment that does not have a readily determinable fair value, at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

Part I. (cont.)**Item No. Caption and Instructions**

- 9**
(cont.) (2) Loans (other than those that meet the definition of a "loan secured by real estate") to nonprofit organizations (e.g., churches, hospitals, educational and charitable institutions, clubs, and similar associations) except those collateralized by production payments where the proceeds ultimately go to a commercial or industrial organization (which are to be reported in Schedule RC-C, part I, item 4).
- (3) Loans to individuals for investment purposes (as distinct from commercial, industrial, or professional purposes), other than those that meet the definition of a "loan secured by real estate."
- (4) On the FFIEC 041, loans to foreign governments, their official institutions, and international and regional institutions, other than those that meet the definition of a "loan secured by real estate".
- (5) On the FFIEC 041, bankers acceptances accepted by the reporting bank and held in its portfolio when the account party is a foreign government or official institution, including such acceptances for the purpose of financing dollar exchange (except acceptances held for trading, which are to be reported in Schedule RC, item 5).

Exclude from all other loans extensions of credit initially made in the form of planned or "advance agreement" overdrafts other than those made to borrowers of the types whose obligations are specifically reportable in this item (report such planned overdrafts in other items of Schedule RC-C, part I, as appropriate). For example, report advances to banks in foreign countries in the form of "advance agreement" overdrafts as loans to depository institutions in Schedule RC-C, part I, item 2, and overdrafts under consumer check-credit plans as "Other revolving credit plans" to individuals in Schedule RC-C, part I, item 6.b. Report both planned and unplanned overdrafts on "due to" deposit accounts of depository institutions in Schedule RC-C, part I, item 2.

- 9.a** **Loans to nondepository financial institutions.** Report in column B all loans to nondepository financial institutions (on the FFIEC 031, in domestic offices) as described above.

NOTE: Item 9.b is not applicable to banks filing the FFIEC 031 report forms.

- 9.b** **Other loans.** On the FFIEC 041, report in column B other loans as described above.

NOTE: Items 9.b.(1) and 9.b.(2) are not applicable to banks filing the FFIEC 041 report forms that have less than \$300 million in total assets.

- 9.b.(1)** **Loans for purchasing or carrying securities.** Report (on the FFIEC 041, in column A; on the FFIEC 031, in column B) all loans for purchasing or carrying securities (on the FFIEC 031, in domestic offices) as described above.
- 9.b.(2)** **All other loans.** Report (on the FFIEC 041, in column A; on the FFIEC 031, in column B) all other loans (on the FFIEC 031, in domestic offices) as described above.

Part I. (cont.)**Item No. Caption and Instructions**

- 10 Lease financing receivables (net of unearned income).** Report the net investments in all:
- (1) Direct financing leases accounted for under ASC Topic 840, Leases, by an institution that has not adopted ASC Topic 842, Leases, including the estimated residual value of leased property and any unamortized initial direct costs, net of unearned income;
 - (2) Direct financing and sales-type leases accounted for under ASC Topic 842 by an institution that has adopted ASC Topic 842, including the lease receivable, unamortized initial direct costs (if applicable), and the unguaranteed residual asset, net of any deferred selling profit on a direct financing lease; and
 - (3) Leveraged leases accounted for under ASC Topic 840 (including leveraged leases that were grandfathered upon the adoption of ASC Topic 842 and remain grandfathered).

On the FFIEC 041, all banks should report the total amount of these leases in column B, and banks with \$300 million or more in total assets should also report in the appropriate subitems of column A a breakdown of these leases between leases to individuals for household, family, and other personal expenditures and all other leases. On the FFIEC 031, all banks should report the total amount of these leases in domestic offices in column B and a breakdown of these leases for the fully consolidated bank between leases to individuals for household, family, and other personal expenditures and all other leases in column A. For further discussion of leases where the bank is the lessor, refer to the Glossary entry for "lease accounting."

Include all leases to states and political subdivisions in the U.S. in this item.

NOTE: Items 10.a and 10.b are not applicable to banks filing the FFIEC 041 report forms that have less than \$300 million total assets.

- 10.a Leases to individuals for household, family, and other personal expenditures.** Report in column A the net investments in all leases to individuals for household, family, and other personal expenditures (i.e., consumer leases). Include direct financing leases accounted for under ASC Topic 840, Leases, by an institution that has not adopted ASC Topic 842, Leases; direct financing and sales-type leases accounted for under ASC Topic 842 by an institution that has adopted this topic; and leveraged leases accounted for under ASC Topic 840 (including those that were grandfathered upon the adoption of ASC Topic 842 and remain grandfathered). For further information on extending credit to individuals for consumer purposes, refer to the instructions for Schedule RC-C, part I, items 6.c, "Automobile loans," and 6.d, "Other consumer loans."
- 10.b All other leases.** Report in column A the net investments in all leases to lessees other than for household, family, and other personal expenditure purposes. Include direct financing leases accounted for under ASC Topic 840, Leases, by an institution that has not adopted ASC Topic 842, Leases; direct financing and sales-type leases accounted for under ASC Topic 842 by an institution that has adopted this topic; and leveraged leases accounted for under ASC Topic 840 (including those that were grandfathered upon the adoption of ASC Topic 842 and remain grandfathered).

Part I. (cont.)**Item No. Caption and Instructions**

- 11** **LESS: Any unearned income on loans reflected in items 1-9 above.** To the extent possible, the preferred treatment is to report the specific loan categories net of both unearned income and net unamortized loan fees. A reporting bank should enter (on the FFIEC 041, in column B; on the FFIEC 031, in columns A and B, as appropriate) unearned income and net unamortized loan fees only to the extent that these amounts are included in (i.e., not deducted from) the various loan items of this schedule (Schedule RC-C, part I, items 1 through 9). If a bank reports each loan item of this schedule net of both unearned income and net unamortized loan fees, enter a zero in this item.

Do not include net unamortized direct loan origination costs in this item; such costs must be added to the related loan balances reported in Schedule RC-C, part I, items 1 through 9. In addition, do not include unearned income on lease financing receivables in this item. Leases should be reported net of unearned income in Schedule RC-C, part I, item 10.

- 12** **Total loans and leases held for investment and held for sale.** On the FFIEC 041, report in column B the sum of items 1.a.(1) through 10, column B, less item 11, column B. On the FFIEC 031, for large institutions and highly complex institutions – as defined for assessment purposes – with foreign offices, report in column A the sum of items 1.a.(1) through 10.b, column A, less item 11, column A; report in column B the sum of items 1.a.(1) through 10, column B, less item 11, column B. On the FFIEC 031, for all other institutions with foreign offices, report in column A the sum of item 1 and items 2.a.(1) through 10.b, column A, less item 11, column A; report in column B the sum of items 1.a.(1) through 10, column B, less item 11, column B.

The amount reported for this item (on the FFIEC 041, in column B; on the FFIEC 031 must equal Schedule RC, item 4.a, plus item 4.b.

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SCHEDULE RC-D – TRADING ASSETS AND LIABILITIES

General Instructions

Schedule RC-D is to be completed by banks that:

- (1) Reported total trading assets of \$10 million or more in any of the four preceding calendar quarters, or
- (2) Meet the FDIC's definition of a large or highly complex institution for deposit insurance assessment purposes.¹

Memorandum items 2 through 10 of Schedule RC-D are not applicable to banks filing the FFIEC 041 report form. On the FFIEC 031 report form, Memorandum items 2 through 10 of Schedule RC-D are to be completed by banks with \$10 billion or more in total trading assets.

Trading activities typically include (a) regularly underwriting or dealing in securities; interest rate, foreign exchange rate, commodity, equity, and credit derivative contracts; other financial instruments; and other assets for resale, (b) acquiring or taking positions in such items principally for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements, and (c) acquiring or taking positions in such items as accommodations to customers, provided that acquiring or taking such positions meets the definition of "trading" in ASC Topic 320, Investments–Debt Securities, and ASC Topic 815, Derivatives and Hedging, and the definition of "trading purposes" in ASC Topic 815.

For purposes of the Consolidated Reports of Condition and Income, all debt securities within the scope of ASC Topic 320, Investments–Debt Securities, that a bank has elected to report at fair value under a fair value option with changes in fair value reported in current earnings should be classified as trading securities. In addition, for purposes of these reports, banks may classify assets (other than debt securities within the scope of ASC Topic 320) and liabilities (other than deposit liabilities required to be reported in Schedule RC-E) as trading if the bank applies fair value accounting, with changes in fair value reported in current earnings, and manages these assets and liabilities as trading positions, subject to the controls and applicable regulatory guidance related to trading activities. For example, a bank would generally not classify a loan to which it has applied the fair value option as a trading asset unless the bank holds the loan, which it manages as a trading position, for one of the following purposes: (a) for market making activities, including such activities as accumulating loans for sale or securitization; (b) to benefit from actual or expected price movements; or (c) to lock in arbitrage profits. When reporting loans classified as trading in Schedule RC-D, banks should include only the fair value of the funded portion of the loan in item 6 of this schedule. If the unfunded portion of the loan, if any, is classified as trading (and does not meet the definition of a derivative), the fair value of the commitment to lend should be reported as an "Other trading asset" or an "Other trading liability," as appropriate, in Schedule RC-D, item 9 or item 13.b, respectively.

Assets, liabilities, and other financial instruments classified as trading shall be consistently valued at fair value as defined by ASC Topic 820, Fair Value Measurement.

Exclude from this schedule all available-for-sale securities and all loans and leases that do not satisfy the criteria for classification as trading as described above. (Also see the Glossary entry for "trading account.") Available-for-sale securities are generally reported 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 ASC Topic 320 (e.g., nonrated industrial development obligations) that the bank has designated as "available-for-sale" which are reported for purposes of the Consolidated Report of Condition in a balance sheet category other than "Securities" (e.g., "Loans and lease financing receivables"). Loans and leases that do not satisfy the criteria for the trading account should be reported in Schedule RC, item 4.a or item 4.b, and in Schedule RC-C.

¹ See [12 CFR § 327.8](#) and [12 CFR § 327.16\(f\)](#).

Item Instructions**Item No. Caption and Instructions****ASSETS**

- 1** **U.S. Treasury securities.** Report the total fair value of securities issued by the U.S. Treasury (as defined for Schedule RC-B, item 1, "U.S. Treasury securities") held for trading.
- 2** **U.S. Government agency obligations.** Report the total fair value of all obligations of U.S. Government agencies (as defined for Schedule RC-B, item 2, "U.S. Government agency and sponsored agency obligations") held for trading. Exclude mortgage-backed securities.
- 3** **Securities issued by states and political subdivisions in the U.S.** Report the total fair value of all securities issued by states and political subdivisions in the United States (as defined for Schedule RC-B, item 3, "Securities issued by states and political subdivisions in the U.S.") held for trading.
- 4** **Mortgage-backed securities.** Report in the appropriate subitem the total fair value of all mortgage-backed securities held for trading.
- 4.a** **Residential mortgage pass-through securities issued or guaranteed by FNMA, FHLMC, or GNMA.** Report the total fair value of all residential mortgage pass-through securities issued or guaranteed by FNMA, FHLMC, or GNMA (as defined for Schedule RC-B, item 4.a.(1), Residential mortgage pass-through securities "Guaranteed by GNMA," and item 4.a.(2), Residential pass-through securities "Issued by FNMA and FHLMC") held for trading.
- 4.b** **Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored agencies.** Report the total fair value of all other residential mortgage-backed securities issued or guaranteed by U.S. Government agencies or U.S. Government-sponsored agencies (as defined for Schedule RC-B, item 4.b.(1), Other residential mortgage-backed securities "Issued or guaranteed by U.S. Government agencies or sponsored agencies") held for trading.
- U.S. Government agencies include, but are not limited to, such agencies as the Government National Mortgage Association (GNMA), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA). U.S. Government-sponsored agencies include, but are not limited to, such agencies as the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA).
- 4.c** **All other residential MBS.** Report the total fair value of all other residential mortgage-backed securities (as defined for Schedule RC-B, item 4.a.(3), "Other [residential mortgage] pass-through securities," item 4.b.(2), Other residential mortgage-backed securities "Collateralized by MBS issued or guaranteed by U.S. Government agencies or sponsored agencies," and item 4.b.(3), "All other residential MBS") held for trading.
- 4.d** **Commercial MBS issued or guaranteed by U.S. Government agencies or sponsored agencies.** Report the total fair value of all commercial mortgage-backed securities (as defined for Schedule RC-B, item 4.c, "Commercial MBS") issued or guaranteed by U.S. Government agencies or U.S. Government-sponsored agencies that are held for trading. Also include commercial mortgage pass-through securities guaranteed by the Small Business Administration.

Memoranda**Item No. Caption and Instructions**

- 4.a** (cont.) (2) Securities held for trading by consolidated variable interest entities (VIEs) that can be used only to settle obligations of the same consolidated VIEs (the amount of which is also reported in Schedule RC-V, item 1.e).
- (3) Securities held for trading owned by consolidated insurance subsidiaries and held in custodial trusts that are pledged to insurance companies external to the consolidated bank.
- 4.b** **Pledged loans.** Report the total fair value of all loans held for trading included in Schedule RC-D above that are pledged to secure deposits, repurchase transactions, or other borrowings (regardless of the balance of the deposits or other liabilities against which the loans are pledged) or for any other purpose. Include loans held for trading that have been transferred in transactions that are accounted for as secured borrowings with a pledge of collateral because they do not qualify as sales under ASC Topic 860, Transfers and Servicing (formerly FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," as amended). Also include loans held for trading by consolidated variable interest entities (VIEs) that can be used only to settle obligations of the same consolidated VIEs (the amount of which is also reported in Schedule RC-V, item 1.h). In general, the pledging of loans is the act of setting aside certain loans to secure or collateralize bank transactions with the bank continuing to own the loans unless the bank defaults on the transaction.
- 5** **Asset-backed securities.** Report in the appropriate subitem the total fair value of all asset-backed securities (other than mortgage-backed securities), including asset-backed commercial paper, held for trading that are included in Schedule RC-D, item 5.b, above.
- 5.a** **Credit card receivables.** Report the total fair value of all asset-backed securities collateralized by credit card receivables, i.e., extensions of credit to individuals for household, family, and other personal expenditures arising from credit cards as defined for Schedule RC-C, part I, item 6.a.
- 5.b** **Home equity lines.** Report the total fair value of all asset-backed securities collateralized by home equity lines of credit, i.e., revolving, open-end lines of credit secured by 1-to-4 family residential properties as defined for Schedule RC-C, part I, item 1.c.(1).
- 5.c** **Automobile loans.** Report the total fair value of all asset-backed securities collateralized by automobile loans, i.e., loans to individuals for the purpose of purchasing private passenger vehicles, including minivans, vans, sport-utility vehicles, pickup trucks, and similar light trucks for personal use as defined for Schedule RC-C, part I, item 6.c.
- 5.d** **Other consumer loans.** Report the total fair value of all asset-backed securities collateralized by other consumer loans, i.e., loans to individuals for household, family, and other personal expenditures as defined for Schedule RC-C, part I, items 6.b and 6.d.
- 5.e** **Commercial and industrial loans.** Report the total fair value of all asset-backed securities collateralized by commercial and industrial loans, i.e., loans for commercial and industrial purposes to sole proprietorships, partnerships, corporations, and other business enterprises, whether secured (other than by real estate) or unsecured, single-payment or installment, as defined for Schedule RC-C, part I, item 4.

Memoranda**Item No. Caption and Instructions**

- 5.f **Other.** Report the total fair value of all asset-backed securities collateralized by loans other than those included in Schedule RC-D, Memorandum items 5.a through 5.e, above, i.e., loans as defined for Schedule RC-C, part I, items 2, 3, 7 (on the FFIEC 031 only), 8, and 9, and lease financing receivables as defined for Schedule RC-C, part I, item 10.
- 6 Not applicable.
- 7 **Equity securities.** Report in the appropriate subitem the total fair value of all equity securities held for trading that are included in Schedule RC-D, item 9, above.
- 7.a **Readily determinable fair values.** Report the total fair value of all equity securities held for trading that have readily determinable fair values, as defined by ASC Topic 321, Investments—Equity Securities, regardless of whether such equity securities are within or outside the scope of ASC Topic 321.
- 7.b **Other.** Report the total fair value of all equity securities held for trading not included in Schedule RC-D, Memorandum item 7.a, above.
- 8 **Loans pending securitization.** Report the total fair value of all loans included in Schedule RC-D, items 6.a through 6.d, that are held for securitization purposes. Report such loans in this item only if the bank expects the securitization transaction to be accounted for as a sale under ASC Topic 860, Transfers and Servicing (formerly FASB Statement No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” as amended).
- 9 **Other trading assets.** Disclose in Memorandum items 9.a through 9.c each component of Schedule RC-D, item 9, “Other trading assets,” and the fair value of such component, that is greater than \$1,000,000 and exceeds 25 percent of the amount reported for this item. Exclude equity securities reported in Schedule RC-D, Memorandum items 7.a and 7.b. For each component of other trading assets that exceeds the disclosure threshold for this Memorandum item, describe the component with a clear but concise caption in Memorandum items 9.a through 9.c. These descriptions should not exceed 50 characters in length (including spacing between words).
- 10 **Other trading liabilities.** Disclose in Memorandum items 10.a through 10.c each component of Schedule RC-D, item 13.b, “Other trading liabilities,” and the fair value of such component, that is greater than \$1,000,000 and exceeds 25 percent of the amount reported for this item. For each component of other trading liabilities that exceeds this disclosure threshold, describe the component with a clear but concise caption in Memorandum items 10.a through 10.c. These descriptions should not exceed 50 characters in length (including spacing between words).

Column Instructions

Deposits as summarized above are divided into two general categories, "Transaction Accounts" (columns A and B) and "Nontransaction Accounts (including MMDAs)" (column C).

Column A - Total transaction accounts. Report in column A the total of all transaction accounts as summarized above and fully defined in the Glossary entry for "deposits." With the exceptions noted in the item instructions and the Glossary entry, the term "transaction account" is defined as a deposit or account from which the depositor or account holder is permitted to make transfers or withdrawals by negotiable or transferable instruments, payment orders of withdrawal, telephone transfers, or other similar devices for the purpose of making third party payments or transfers to third persons or others, or from which the depositor may make third party payments at an automated teller machine (ATM), a remote service unit (RSU), or another electronic device, including by debit card.

Column B - Memo: Total demand deposits. Report in item 7, column B, the total of all demand deposits, both interest-bearing and noninterest-bearing. Also include any matured time or savings deposits without automatic renewal provisions, unless the deposit agreement specifically provides for the funds to be transferred at maturity to another type of account (i.e., other than a demand deposit). (See the Glossary entry for "deposits.")

NOTE: Demand deposits are, of course, one type of transaction account. Therefore, the amount reported in item 7, column B, should be included by category of depositor in the breakdown of transaction accounts by category of depositor that is reported in column A.

Column C - Total nontransaction accounts (including MMDAs). Report in column C all deposits other than transaction accounts as summarized above and defined in the Glossary entry for "deposits." Include in column C all interest-bearing and noninterest-bearing savings deposits and time deposits together with all interest paid by crediting savings and time deposit accounts.

Item Instructions

In items 1 through 6 of Schedule RC-E, banks report separate breakdowns of their transaction and nontransaction accounts by category of depositor. When reporting brokered deposits in these items, the funds should be categorized as deposits of "Individuals, partnerships, and corporations," "States and political subdivisions in the U.S.," or "Commercial banks and other depository institutions in the U.S." based on the beneficial owners of the funds that the broker has placed in the bank. However, if this information is not readily available to the issuing bank for certain brokered deposits because current deposit insurance rules do not require the deposit broker to provide information routinely on the beneficial owners of the deposits and their account ownership capacity to the bank issuing the deposits, these brokered deposits may be rebuttably presumed to be deposits of "Individuals, partnerships, and corporations" and reported in Schedule RC-E, item 1, below. For further information, see the Glossary entry for "brokered deposits."

Item No. Caption and Instructions

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|----------|---|
| 1 | <u>Deposits of individuals, partnerships, and corporations (include all certified and official checks).</u> Report in the appropriate column all deposits of individuals, partnerships, and corporations, wherever located, and all certified and official checks. |
|----------|---|

Item No. **Caption and Instructions****1**
(cont.)Include in this item:

- (1) Deposits related to the personal, household, or family activities of both farm and nonfarm individuals and to the business activities of sole proprietorships.
- (2) Deposits of corporations and organizations (other than depository institutions), regardless of whether they are operated for profit, including but not limited to:
 - (a) mutual funds and other nondepository financial institutions;
 - (b) foreign government-owned nonbank commercial and industrial enterprises; and
 - (c) quasi-governmental organizations such as post exchanges on military posts and deposits of a company, battery, or similar organization (unless the reporting bank has been designated by the U.S. Treasury as a depository for such funds and appropriate security for the deposits has been pledged, in which case, report in Schedule RC-E, item 2).
- (3) Dealer reserve accounts (see the Glossary entry for "dealer reserve accounts" for the definition of this term).
- (4) Deposits of U.S. Government agencies and instrumentalities such as the:
 - (a) Banks for Cooperatives,
 - (b) Export-Import Bank of the U.S.,
 - (c) Federal Deposit Insurance Corporation,
 - (d) Federal Financing Bank,
 - (e) Federal Home Loan Banks,
 - (f) Federal Home Loan Mortgage Corporation,
 - (g) Federal Intermediate Credit Banks,
 - (h) Federal Land Banks,
 - (i) Federal National Mortgage Association,
 - (j) National Credit Union Administration Central Liquidity Facility, and
 - (k) National Credit Union Share Insurance Fund.
- (5) Deposits of trust funds standing to the credit of other banks and all trust funds held or deposited in any department (except the trust department) of the reporting bank if the beneficiary is an individual, partnership, or corporation.
- (6) Credit balances on credit cards and other revolving credit plans as a result of customer overpayments.
- (7) Deposits of a federal or state court held for the benefit of individuals, partnerships, or corporations, such as bankruptcy funds and escrow funds.
- (8) Deposits of a pension fund held for the benefit of individuals.

Item No. Caption and Instructions**1**
(cont.)

- (9) Certified and official checks, which include the following:
- (a) Unpaid depositors' checks that have been certified.
 - (b) Cashiers' checks, money orders, and other officers' checks issued for any purpose including those issued in payment for services, dividends, or purchases that are drawn on the reporting bank by any of its duly authorized officers and that are outstanding on the report date.
 - (c) Funds received or held 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 drawn in the normal course of business (including accounts where funds are remitted by the reporting bank only when it has been advised that the checks or drafts have been presented).
 - (d) Funds received or held in connection with traveler's checks and money orders sold (but not drawn) by the reporting bank, until the proceeds of the sale are remitted to another party, and funds received or held in connection with other such checks used (but not drawn) by the reporting bank, until the amount of the checks is remitted to another party.
 - (e) Checks drawn by the reporting bank on, or payable at or through, a Federal Reserve Bank or a Federal Home Loan Bank.

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Item No. Caption and Instructions

1.e.(3) **All other unused commitments.** Report the unused portions of commitments not reportable in Schedule RC-L, items 1.a through 1.e.(2), above.

Include commitments to extend credit secured by 1-4 family residential properties, except (a) revolving, open-end lines of credit secured by 1-4 family residential properties (e.g., home equity lines), which should be reported in Schedule RC-L, item 1.a, above, (b) commitments for 1-4 family residential construction and land development loans (that are secured by such properties), which should be reported in Schedule RC-L, item 1.c.(1), above, and (c) commitments that meet the definition of a derivative and must be accounted for in accordance with ASC Topic 815, Derivatives and Hedging (formerly FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended), which should be reported in Schedule RC-L, item 12.

2 and 3 **General Instructions for Standby Letters of Credit** – Originating banks must report in items 2 and 3 the full amount outstanding and unused of financial and performance standby letters of credit, respectively. Include those standby letters of credit that are collateralized by cash on deposit, that have been acquired from others, and in which participations have been conveyed to others where (a) the originating and issuing bank is obligated to pay the full amount of any draft drawn under the terms of the standby letter of credit and (b) the participating banks have an obligation to partially or wholly reimburse the originating bank, either directly in cash or through a participation in a loan to the account party.

For syndicated standby letters of credit where each bank has a direct obligation to the beneficiary, each bank must report only its share in the syndication. Similarly, if several banks participate in the issuance of a standby letter of credit under a bona fide binding agreement which provides that (a) regardless of any event, each participant shall be liable only up to a certain percentage or to a certain amount and (b) the beneficiary is advised and has agreed that each participating bank is only liable for a certain portion of the entire amount, each bank shall report only its proportional share of the total standby letter of credit.

For a financial or performance standby letter of credit that is in turn backed by a financial standby letter of credit issued by another bank, each bank must report the entire amount of the standby letter of credit it has issued in either item 2 or item 3 below, as appropriate. The amount of the reporting bank's financial or performance standby letter of credit that is backed by the other bank's financial standby letter of credit must also be reported in either item 2.a or 3.a, as appropriate, since the backing of standby letters of credit has substantially the same effect as the conveying of participations in standby letters of credit.

On the FFIEC 031, also include all financial and performance guarantees issued by foreign offices of the reporting bank pursuant to Federal Reserve Regulation K or Section 347.103(a)(1) of the FDIC Rules and Regulations.

2 **Financial standby letters of credit (and foreign office guarantees – for the FFIEC 031).** Report the amount outstanding and unused as of the report date of all financial standby letters of credit (and all legally binding commitments to issue financial standby letters of credit) issued by any office of the bank. A financial standby letter of credit irrevocably obligates the bank to pay a third-party beneficiary when a customer (account party) fails to repay an outstanding loan or debt instrument. (See the Glossary entry for "letter of credit" for further information.)

Exclude from financial standby letters of credit:

- (1) Financial standby letters of credit where the beneficiary is a consolidated subsidiary of the reporting bank.
- (2) Financial standby letters of credit issued by another depository institution (such as a correspondent bank), a Federal Home Loan Bank, or any other entity on behalf of the

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2 reporting bank, which is the account party on the letters of credit and therefore is
(cont.) obligated to reimburse the issuing entity for all payments made under the standby letters of credit (report such standby letters of credit in Schedule RC-L, item 9).

(3) Performance standby letters of credit (report such standby letters of credit in Schedule RC-L, item 3).

(4) Signature or endorsement guarantees of the type associated with the clearing of negotiable instruments or securities in the normal course of business.

2.a **Amount of financial standby letters of credit conveyed to others.** Item 2.a is to be completed by banks with \$1 billion or more in total assets.

Report that portion of the bank's total contingent liability for financial standby letters of credit reported in Schedule RC-L, item 2, above, that the bank has conveyed to others. Also include that portion of the reporting bank's financial standby letters of credit that are backed by other banks' financial standby letters of credit, as well as the portion that participating banks have reparticipated to others. Participations and backings may be for any part or all of a given obligation.

3 **Performance standby letters of credit (and foreign office guarantees – for the FFIEC 031).** Report the amount outstanding and unused as of the report date of all performance standby letters of credit (and all legally binding commitments to issue performance standby letters of credit) issued by any office of the bank. A performance standby letter of credit irrevocably obligates the bank to pay a third-party beneficiary when a customer (account party) fails to perform some contractual non-financial obligation. (See the Glossary entry for "letter of credit" for further information.)

Exclude from performance standby letters of credit:

(1) Performance standby letters of credit where the beneficiary is a consolidated subsidiary of the reporting bank.

(2) Financial standby letters of credit.

(3) Signature or endorsement guarantees of the type associated with the clearing of negotiable instruments or securities in the normal course of business.

3.a **Amount of performance standby letters of credit conveyed to others.** Item 3.a is to be completed by banks with \$1 billion or more in total assets.

Report that portion of the bank's total contingent liability for performance standby letters of credit reported in Schedule RC-L, item 3, above, that the bank has conveyed to others. Also include that portion of the reporting bank's performance standby letters of credit that are backed by other banks' financial standby letters of credit, as well as the portion that participating banks have reparticipated to others. Participations and backings may be for any part or all of a given obligation.

4 **Commercial and similar letters of credit.** Report the amount outstanding and unused as of the report date of issued or confirmed commercial letters of credit, travelers' letters of credit not issued for money or its equivalent, and all similar letters of credit, but excluding standby letters of credit (which are to be reported in Schedule RC-L, items 2 and 3, above). (See the Glossary entry for "letter of credit.") Legally binding commitments to issue commercial letters of credit are to be reported in this item.

Travelers' letters of credit and other letters of credit issued for money or its equivalent by the reporting bank or its agents should be reported as demand deposit liabilities in Schedule RC-E.

Item No. Caption and Instructions

- 13** **Total gross notional amount of derivative contracts held for trading.** Report, in the appropriate column, the total notional amount or par value of those derivative contracts reported in Schedule RC-L, item 12, above that are held for trading purposes. Contracts held for trading purposes include those used in dealing and other trading activities. Derivative instruments used to hedge trading activities should also be reported in this item.

Derivative trading activities include (a) regularly dealing in interest rate contracts, foreign exchange contracts, equity derivative contracts, and commodity and other contracts meeting the definition of a “derivative instrument” in, and accounted for in accordance with, ASC Topic 815, Derivatives and Hedging, (b) acquiring or taking positions in such items principally for the purpose of selling in the near term or otherwise with the intent to resell (or repurchase) in order to profit from short-term price movements, and (c) acquiring or taking positions in such items as accommodations to customers, provided that acquiring or taking such positions meets the definitions of “trading” and “trading purposes” in ASC Topic 815. The notional amount of those derivative positions acquired or taken as accommodations to customers not meeting the definitions of “trading” and “trading purposes” in ASC Topic 815 should be reported in Schedule RC-L, item 14, “Total gross notional amount of derivative contracts held for purposes other than trading.”

The reporting bank's trading department may have entered into a derivative contract with another department or business unit within the consolidated bank (and which has been reported on a net basis in accordance with the instructions to Schedule RC-L, item 12, above). If the trading department has also entered into a matching contract with a counterparty outside the consolidated bank, the contract with the outside counterparty should be designated as held for trading or as held for purposes other than trading consistent with the contract's designation for other financial reporting purposes.

- 14** **Total gross notional amount of derivative contracts held for purposes other than trading.** Report, in the appropriate column, the total notional amount or par value of those contracts reported in Schedule RC-L, item 12, above, that are held for purposes other than trading, including those contracts acquired or taken as accommodations to customers not reported in Schedule RC-L, item 13, above.

- 14.a** **Interest rate swaps where the bank has agreed to pay a fixed rate.** Report the notional amount of all outstanding interest rate swaps included in Schedule RC-L, item 14, column A, above, on which the reporting bank is obligated to pay a fixed rate. The interest rate swaps that are reported in this item will also have been reported in Schedule RC-L, item 12.e, column A. Interest rate swaps that are held for trading should not be reported in this item 14.a.

A fixed interest rate is a rate that is specified at the origination of the transaction, is fixed and invariable during the term of the interest rate swap, and is known to both the bank and the swap counterparty. Also treated as a fixed interest rate is a predetermined interest rate which is a rate that changes during the term of the interest rate swap on a predetermined basis, with the exact rate of interest over the life of the swap known with certainty to both the bank and the swap counterparty at the origination of the transaction.

- 15** **Gross fair values of derivative contracts.** Report in the appropriate column and subitem the fair value of all derivative contracts reported in Schedule RC-L, items 13 and 14, above. For each of the four types of underlying risk exposure in columns A through D, the gross positive and gross negative fair values will be reported separately for (i) contracts held for trading purposes (in item 15.a) and (ii) contracts held for purposes other than trading (in item 15.b). Guidance for reporting by type of underlying risk exposure is provided in the instructions for Schedule RC-L, item 12, above. Guidance for reporting by purpose is provided in the instructions for Schedule RC-L, items 13 and 14, above.

Item No. Caption and Instructions

- 15**
(cont.) All transactions within the consolidated bank should be reported on a net basis. No other netting of contracts is permitted for purposes of this item. Therefore, do not net (1) obligations of the reporting bank to buy against the bank's obligations to sell, (2) written options against purchased options, (3) positive fair values against negative fair values, or (4) contracts subject to bilateral netting agreements.
- According to ASC Topic 820, Fair Value Measurement, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the asset's or liability's principal (or most advantageous) market at the measurement date. For purposes of item 15, the reporting bank should determine the fair value of its derivative contracts in the same manner that it determines the fair value of these contracts for other financial reporting purposes, consistent with the guidance in ASC Topic 820.
- 15.a** **Contracts held for trading.** Report in the appropriate column and subitem the gross positive and gross negative fair values of those contracts held for trading that are reported in Schedule RC-L, item 13, above.
- 15.a.(1)** **Gross positive fair value.** Report in the appropriate column the total fair value of those contracts reported in Schedule RC-L, item 13, above, with positive fair values.
- 15.a.(2)** **Gross negative fair value.** Report in the appropriate column the total fair value of those contracts reported in Schedule RC-L, item 13, above, with negative fair values. Report the total fair value as an absolute value, do not report with a minus (-) sign.
- 15.b** **Contracts held for purposes other than trading.** Report in the appropriate column and subitem the gross positive and gross negative fair values of those contracts held for purposes other than trading that are reported in Schedule RC-L, item 14, above.
- 15.b.(1)** **Gross positive fair value.** Report in the appropriate column the total fair value of those contracts reported in Schedule RC-L, item 14, above, with positive fair values.
- 15.b.(2)** **Gross negative fair value.** Report in the appropriate column the total fair value of those contracts reported in Schedule RC-L, item 14, above, with negative fair values. Report the total fair value as an absolute value, do not report with a minus (-) sign.

Item No. Caption and Instructions

- 7 Unsecured "Other borrowings" with a remaining maturity of.** Report on an unconsolidated single FDIC certificate number basis the amount of the bank's unsecured "Other borrowings" (as defined for Schedule RC-M, item 5.b) in the appropriate subitems according to the amount of time remaining until their final contractual maturities. Include both fixed rate and floating rate "Other borrowings" that are unsecured. In general, "Other borrowings" are unsecured if the bank (or a consolidated subsidiary) has not pledged securities, loans, or other assets as collateral for the borrowing.

The sum of Schedule RC-O, items 7.a through 7.d, must be less than or equal to Schedule RC-M, items 5.b.(1)(a) through (d) minus item 10.b.

Exclude from items 7.a through 7.d all borrowings reported in Schedule RC-M, item 10.b, "Amount of 'Other borrowings' that are secured," including all obligations under capital leases accounted for under ASC Topic 840, Leases, and lease liabilities for finance leases accounted for under ASC Topic 842, Leases, as applicable. Also exclude from items 7.a through 7.d all lease liabilities for operating leases accounted for under ASC Topic 842, which are reported in Schedule RC-G, item 4, "All other liabilities."

- 7.a One year or less.** Report on an unconsolidated single FDIC certificate number basis all unsecured "Other borrowings" with a remaining maturity of one year or less. Include unsecured "Other borrowings" with a remaining maturity of over one year for which the holder has the option to redeem the debt instrument within one year of the report date. Except for such optionally redeemable borrowings, the unsecured "Other borrowings" that should be included in this item will also have been reported in Schedule RC-M, item 5.b.(2), "Other borrowings with a remaining maturity of one year or less."
- 7.b Over one year through three years.** Report on an unconsolidated single FDIC certificate number basis all unsecured "Other borrowings" with a remaining maturity of over one year through three years.
- 7.c Over three years through five years.** Report on an unconsolidated single FDIC certificate number basis all unsecured "Other borrowings" with a remaining maturity of over three years through five years.
- 7.d Over five years.** Report on an unconsolidated single FDIC certificate number basis all unsecured "Other borrowings" with a remaining maturity of over five years.
- 8 Subordinated notes and debentures with a remaining maturity of.** Report on an unconsolidated single FDIC certificate number basis the amount of the bank's subordinated notes and debentures (as defined for Schedule RC, item 19, and in the Glossary entry for "subordinated notes and debentures") in the appropriate subitems according to the amount of time remaining until their final contractual maturities. Include both fixed rate and floating rate subordinated notes and debentures.
- The sum of Schedule RC-O, items 8.a through 8.d, must be less than or equal to Schedule RC, item 19, "Subordinated notes and debentures."
- 8.a One year or less.** Report on an unconsolidated single FDIC certificate number basis all subordinated notes and debentures with a remaining maturity of one year or less. Include subordinated notes and debentures with a remaining maturity of over one year for which the holder has the option to redeem the subordinated debt within one year of the report date.
- 8.b Over one year through three years.** Report on an unconsolidated single FDIC certificate number basis all subordinated notes and debentures with a remaining maturity of over one year through three years.

Item No. Caption and Instructions

- 8.c Over three years through five years.** Report on an unconsolidated single FDIC certificate number basis all subordinated notes and debentures with a remaining maturity of over three years through five years.
- 8.d Over five years.** Report on an unconsolidated single FDIC certificate number basis all subordinated notes and debentures with a remaining maturity of over five years.
- 9 Brokered reciprocal deposits.** Report on an unconsolidated single FDIC certificate number basis the amount of brokered reciprocal deposits included in the amount of brokered deposits reported in Schedule RC-E, Memorandum item 1.b, “Total brokered deposits.” Exclude reciprocal deposits that are not brokered reciprocal deposits. The amount reported in this item for brokered reciprocal deposits should be less than or equal to Schedule RC-E, Memorandum item 1.g, “Total reciprocal deposits.”

As defined in [Section 327.8\(q\) of the FDIC’s regulations](#), “brokered reciprocal deposits” are “reciprocal deposits as defined in [Section 337.6\(e\)\(2\)\(v\) of the FDIC’s regulations](#) that are not excepted from the institution’s brokered deposits pursuant to [Section 337.6\(e\)](#)” of the FDIC’s regulations.

As defined in [Section 337.6\(e\)\(2\)\(v\)](#) of the FDIC’s regulations, “reciprocal deposits” means “deposits received by an agent institution through a deposit placement network with the same maturity (if any) and in the same aggregate amount as covered deposits placed by the agent institution in other network member banks.” All reciprocal deposits, whether they are brokered reciprocal deposits or not, should be reported in Schedule RC-E, Memorandum item 1.g. The definitions of the terms “covered deposit,” “deposit placement network,” and “network member bank” are included in the instructions for Schedule RC-E, Memorandum item 1.g.

Limited Exception for Reciprocal Deposits

An “agent institution,” as defined in [Section 337.6\(b\)\(2\)\(ii\)\(e\)\(1\) of FDIC regulations](#), can except reciprocal deposits from being classified (and reported in Schedule RC-E, Memorandum item 1.b) as brokered deposits up to its applicable statutory caps, described below.

Under the *general cap*, an agent institution may except reciprocal deposits from treatment as brokered deposits up to the lesser of \$5 billion or an amount equal to 20 percent of the agent institution’s total liabilities. Reciprocal deposits in excess of the *general cap*, as well as those reciprocal deposits that do not meet the definition of “covered deposit” under [Section 337.6\(b\)\(2\)\(ii\)\(e\)\(2\)\(ii\) of the FDIC’s regulations](#), are brokered deposits and must be reported in Schedule RC-E, Memorandum item 1.b.

Definition of Special Cap – A *special cap* applies if the institution is either not well rated or not well capitalized.¹ The special cap is defined as:

“the average amount of reciprocal deposits held by the agent institution on the last day of each of the 4 calendar quarters preceding the calendar quarter in which the agent institution was found not to have a composite condition of outstanding or good or was determined to be not well capitalized.”

In no event, however, can an institution’s non-brokered reciprocal deposits exceed the *general cap*.

¹ See generally, [12 CFR Part 324, Subpart H](#) (FDIC); [12 CFR Part 208, Subpart D](#) (Federal Reserve Board); [12 CFR Part 6](#) (OCC). [12 U.S.C. 1831o](#). “Well capitalized” is defined in [12 CFR 337.6\(a\)\(3\)\(i\)](#).

SCHEDULE RC-Q – ASSETS AND LIABILITIES MEASURED AT FAIR VALUE ON A RECURRING BASIS

General Instructions

Schedule RC-Q is required to be completed only by institutions that:

- (1) Have elected to report financial instruments or servicing assets and liabilities at fair value under a fair value option with changes in fair value recognized in earnings, or
- (2) Are required to complete Schedule RC-D, Trading Assets and Liabilities, i.e., institutions that:
 - (a) Reported total trading assets of \$10 million or more in any of the four preceding calendar quarters, or
 - (b) Meet the FDIC's definition of a large or highly complex institution for deposit insurance assessment purposes.¹

Your institution is not required to complete Schedule RC-Q if the only financial instruments that your institution measures at fair value in the financial statements on a recurring basis are:

- (1) Available-for-sale securities (reported in Schedule RC, item 2.b), and
- (2) For institutions that have adopted FASB [Accounting Standards Update No. 2016-01](#) (ASU 2016-01), which includes provisions governing the accounting for investments in equity securities,
 - (a) Equity securities with readily determinable fair values not held for trading (reported in Schedule RC, item 2.c), and
 - (b) Equity securities and other equity investments that do not have readily determinable fair values that your institution measures at fair value (i.e., equity securities and other equity investments that do not have readily determinable values that your institution has not elected to measure at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer) (reported in Schedule RC, item 9, or Schedule RC-F, item 4, as appropriate).

An institution that is required to complete Schedule RC-Q should report all assets and liabilities that are measured at fair value in the financial statements on a recurring basis. Exclude from Schedule RC-Q those assets and liabilities that are measured at fair value on a nonrecurring basis. Recurring fair value measurements of assets or liabilities are those fair value measurements that applicable accounting standards and these instructions require or permit in the balance sheet at the end of each reporting period. In contrast, nonrecurring fair value measurements of assets or liabilities are those fair value measurements that applicable accounting standards and these instructions require or permit in the balance sheet in particular circumstances (for example, when an institution subsequently measures foreclosed real estate at the lower of cost or fair value less estimated costs to sell).

Column Instructions

Column A, Total Fair Value Reported on Schedule RC

Report in Column A the total fair value, as defined by ASC Topic 820, Fair Value Measurement (formerly FASB Statement No. 157, "Fair Value Measurements"), of those assets and liabilities reported on Schedule RC, Balance Sheet, that the bank reports at fair value on a recurring basis.

¹ See [12 CFR § 327.8](#) and [12 CFR § 327.16\(f\)](#).

Column Instructions (cont.)**Columns B through E, Fair Value Measurements and Netting Adjustments**

For items reported in Column A, report in Columns C, D, and E the fair value amounts which fall in their entirety in Levels 1, 2, and 3, respectively. The level in the fair value hierarchy within which a fair value measurement in its entirety falls should be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Thus, for example, if the fair value of an asset or liability has elements of both Level 2 and Level 3 measurement inputs, report the entire fair value of the asset or liability in Column D or Column E based on the lowest level measurement input with the most significance to the fair value of the asset or liability in its entirety as described in ASC Topic 820. For assets and liabilities that the bank has netted under legally enforceable master netting agreements in accordance with ASC Subtopic 210-20, Balance Sheet – Offsetting (formerly FASB Interpretation No. 39, “Offsetting of Amounts Related to Certain Contracts,” and FASB Interpretation No. 41, “Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements”), report the gross amounts in Columns C, D, and E and the related netting adjustment in Column B. For more information on Level 1, 2, and 3 measurement inputs, see the Glossary entry for “fair value.”

ASC Topic 820 permits an institution, as a practical expedient, to measure the fair value of investments in investment companies and real estate funds that meet criteria specified in this topic using the investment’s net asset value (NAV) per share (or its equivalent). When an institution has elected to measure the fair value of such an investment using the NAV per share practical expedient and the fair value is measured on a recurring basis, the institution should report the investment’s fair value in column A of the appropriate asset item of Schedule RC-Q. However, the institution should exclude the investment from the Level 1, 2, and 3 disclosures in columns C, D, and E of Schedule RC-Q.¹ Instead, the institution should report the fair value measured using the NAV per share practical expedient in column B along with the netting adjustments reported in column B. In contrast, for an investment measured at fair value on a recurring basis that meets the criteria specified in Topic 820, if the institution does not elect to measure fair value using the NAV per share practical expedient, it should report the investment’s fair value in column A of Schedule RC-Q and disclose this fair value in column C, D, or E, as appropriate, based on the lowest level input that is significant to the fair value measurement in its entirety.

Item Instructions

For each item in Schedule RC-Q, the sum of columns C, D, and E less column B must equal column A.

Item No. Caption and Instructions**1 Available-for-sale debt securities and equity securities with readily determinable fair values not held for trading.**

For institutions that have adopted FASB [Accounting Standards Update No. 2016-01](#) (ASU 2016-01), which includes provisions governing the accounting for investments in equity securities, including investment in mutual funds, and eliminates the concept of available-for-sale equity securities (see the Note preceding the instructions for Schedule RC, item 2.c), report in column A the sum of Schedule RC, items 2.b and 2.c.

For institutions that have not adopted ASU 2016-01, report in column A the amount reported in Schedule RC, item 2.b.

¹ Refer to FASB [Accounting Standards Update \(ASU\) No. 2015-07](#), “Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent),” which removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the NAV per share (or its equivalent) practical expedient described in ASC Topic 820.

Item No. **Caption and Instructions**

- 1** Report in columns B through E, as appropriate, the fair values of the debt and equity securities reported in column A determined using Level 1, Level 2, and Level 3 measurement inputs and any netting adjustments.
- (cont.)
- 2** **Federal funds sold and securities purchased under agreements to resell.** Report in the appropriate column the total fair value of those federal funds sold and securities purchased under agreements to resell reported in Schedule RC, items 3.a and 3.b, that the bank has

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Part I. (cont.)**Item No. Caption and Instructions****Common Equity Tier 1 Capital: Adjustments and Deductions****General Instructions for Common Equity Tier 1 Capital: Adjustments and Deductions**

Note 1: As described in section 22(b) of the regulatory capital rules, regulatory adjustments to common equity tier 1 capital must be made net of associated deferred tax effects.

Note 2: As described in section 22(e) of the regulatory capital rules, netting of deferred tax liabilities (DTLs) against assets that are subject to deduction is permitted if the following conditions are met:

- (i) The DTL is associated with the asset;
- (ii) The DTL would be extinguished if the associated asset becomes impaired or is derecognized under GAAP; and
- (iii) A DTL can only be netted against a single asset.

The amount of deferred tax assets (DTAs) that arise from net operating loss and tax credit carryforwards, net of any related valuation allowances, and of DTAs arising from temporary differences that the institution could not realize through net operating loss carrybacks, net of any related valuation allowances, may be offset by DTLs (that have not been netted against assets subject to deduction) subject to the following conditions:

- (i) Only the DTAs and DTLs that relate to taxes levied by the same taxation authority and that are eligible for offsetting by that authority may be offset for purposes of this deduction.
- (ii) The amount of DTLs that the institution nets against DTAs that arise from net operating loss and tax credit carryforwards, net of any related valuation allowances, and against DTAs arising from temporary differences that the institution could not realize through net operating loss carrybacks, net of any related valuation allowances, must be allocated in proportion to the amount of DTAs that arise from net operating loss and tax credit carryforwards (net of any related valuation allowances, but before any offsetting of DTLs) and of DTAs arising from temporary differences that the institution could not realize through net operating loss carrybacks (net of any related valuation allowances, but before any offsetting of DTLs), respectively.

Part I. (cont.)**General Instructions for Common Equity Tier 1 Capital: Adjustments and Deductions (cont.)**

An institution may offset DTLs embedded in the carrying value of a leveraged lease portfolio acquired in a business combination (whether accounted for under ASC Topic 840, Leases, or grandfathered and accounted for under ASC Topic 842, Leases, as applicable) that are not recognized under GAAP against DTAs that are subject to section 22(d) of the regulatory capital rules in accordance with section 22(e).

An institution must net DTLs against assets subject to deduction in a consistent manner from reporting period to reporting period. An institution may change its DTL netting preference only after obtaining the prior written approval of the primary federal supervisor.

In addition, note that even though certain deductions may be net of associated DTLs, the risk-weighted portion of those items may not be reduced by the associated DTLs.

Item Instructions for Common Equity Tier 1 Capital: Adjustments and Deductions**Item No. Caption and Instructions**

- 6** **LESS: Goodwill net of associated deferred tax liabilities (DTLs).** Report the amount of goodwill included in Schedule RC-M, item 2.b.

However, if the institution has a DTL that is specifically related to goodwill that it chooses to net against the goodwill, the amount of disallowed goodwill to be reported in this item should be reduced by the amount of the associated DTL.

If an advanced approaches institution has significant investments in the capital of unconsolidated financial institutions in the form of common stock, the institution should report in this item goodwill embedded in the valuation of a significant investment in the capital of an unconsolidated financial institution in the form of common stock (embedded goodwill). Such deduction of embedded goodwill would apply to investments accounted for under the equity method. Under GAAP, if there is a difference between the initial cost basis of the investment and the amount of underlying equity in the net assets of the investee, the resulting difference should be accounted for as if the investee were a consolidated subsidiary (which may include imputed goodwill).

- 7** **LESS: Intangible assets (other than goodwill and mortgage servicing assets (MSAs)), net of associated DTLs.** Report all intangible assets (other than goodwill and MSAs) included in Schedule RC-M, item 2.c, that do not qualify for inclusion in common equity tier 1 capital based on the regulatory capital rules of the institution's primary federal supervisor. Generally, all purchased credit card relationships (PCCRs), nonmortgage servicing assets, and all other intangibles reported in Schedule RC-M, item 2.c, do not qualify for inclusion in common equity tier 1 capital and should be included in this item.

However, if the institution has a DTL that is specifically related to an intangible asset (other than goodwill and MSAs) that it chooses to net against the intangible asset for regulatory capital purposes, the amount of disallowed intangibles to be reported in this item should be

Part II. (cont.)**Item No. Caption and Instructions**

- 2.b**
(cont.)
- Significant investments in the capital of unconsolidated financial institutions in the form of common stock reported in Schedule RC, item 2.b (for a bank that is not yet required to adopt ASU 2016-01) or item 2.c (for a bank that is required to have adopted ASU 2016-01), that are subject to the 10 percent and 15 percent common equity tier 1 capital threshold limitations and have been deducted for risk-based capital purposes in Schedule RC-R, Part I, items 13.b and 16, column B, on the FFIEC 031.
 - *In column C—0% risk weight*, the zero percent risk weight applies to exposures to the U.S. government, a U.S. government agency, or a Federal Reserve Bank, and those exposures otherwise unconditionally guaranteed by the U.S. government. Include exposures to or unconditionally guaranteed by the FDIC or the NCUA. Certain foreign government exposures and certain entities listed in §.32 of the regulatory capital rules may also qualify for zero percent risk weight. Include the exposure amounts of those debt securities reported in Schedule RC-B, column C, that do not qualify as securitization exposures that qualify for the zero percent risk weight. Such debt securities may include portions of, but may not be limited to:
 - Item 1, "U.S. Treasury securities,"
 - Item 2, those obligations issued by U.S. Government agencies,
 - Item 4.a.(1), Residential mortgage pass-through securities "Guaranteed by GNMA,"
 - Portions of item 4.b.(1), Other residential mortgage-backed securities (MBS) "Issued or guaranteed by U.S. Government agencies or sponsored agencies," such as GNMA exposures,
 - Item 4.c.(1)(a), certain portions of commercial MBS "Issued or guaranteed by FNMA, FHLMC, or GNMA" that represent GNMA securities, and
 - Item 4.c.(2)(a), certain portions of commercial MBS "Issued or guaranteed by U.S. Government agencies or sponsored agencies" that represent GNMA securities.
 - The portion of any exposure reported in Schedule RC, item 2.b, that is secured by collateral or has a guarantee that qualifies for the zero percent risk weight.
 - *In column G—20% risk weight*, the 20 percent risk weight applies to general obligations of U.S. states, municipalities, and U.S. public sector entities. It also applies to exposures to U.S. depository institutions and credit unions, exposures conditionally guaranteed by the U.S. government, as well as exposures to U.S. government sponsored enterprises. Certain foreign government and foreign bank exposures may qualify for the 20 percent risk weight as indicated in §.32 of the regulatory capital rules. Include the exposure amounts of those debt securities reported in Schedule RC-B, column C, that do not qualify as securitization exposures that qualify for the 20 percent risk weight. Such debt securities may include portions of, but may not be limited to:
 - Item 2, those obligations issued by U.S. Government-sponsored agencies (exclude interest-only securities),
 - Item 3, "Securities issued by states and political subdivisions in the U.S." that represent general obligation securities,
 - Item 4.a.(2), Residential mortgage pass-through securities "Issued by FNMA and FHLMC" (exclude interest-only securities),
 - Item 4.b.(1), Other residential MBS "Issued or guaranteed by U.S. Government agencies or sponsored agencies," (exclude interest-only securities),
 - Item 4.c.(1)(a), those commercial MBS "Issued or guaranteed by FNMA, FHLMC, or GNMA" that represent FHLMC and FNMA securities (exclude interest-only securities),
 - Item 4.c.(2)(a), those commercial MBS "Issued or guaranteed by U.S. Government agencies or sponsored agencies" that represent FHLMC and FNMA securities (exclude interest-only securities),

Part II. (cont.)**Item No. Caption and Instructions**

- 2.b**
(cont.)
- Item 4.b.(2), Other residential MBS "Collateralized by MBS issued or guaranteed by U.S. Government agencies or sponsored agencies" (exclude interest-only securities), and
 - Any securities categorized as "structured financial products" on Schedule RC-B that are not securitization exposures and qualify for the 20 percent risk weight. Note: Many of the structured financial products would be considered securitization exposures and must be reported in Schedule RC-R, Part II, item 9.b, for purposes of calculating risk-weighted assets. Exclude interest-only securities.
 - The portion of any exposure reported in Schedule RC, item 2.b, that is secured by collateral or has a guarantee that qualifies for the 20 percent risk weight.
- *In column H—50% risk weight*, include the exposure amounts of those debt securities reported in Schedule RC-B, column C, that do not qualify as securitization exposures that qualify for the 50 percent risk weight. Such debt securities may include portions of, but may not be limited to:
 - Item 3, "Securities issued by states and political subdivisions in the U.S.," that represent revenue obligation securities,
 - Item 4.a.(3), "Other [residential mortgage] pass-through securities," (that represent residential mortgage exposures that qualify for the 50 percent risk weight. (Pass-through securities that do not qualify for the 50 percent risk weight should be assigned to the 100 percent risk weight category.)
 - Item 4.b.(2), Other residential MBS "Collateralized by MBS issued or guaranteed by U.S. Government agencies or sponsored agencies" (exclude portions subject to an FDIC loss-sharing agreement and interest-only securities) that represent residential mortgage exposures that qualify for the 50 percent risk weight, and
 - Item 4.b.(3), "All other residential MBS." Include only those MBS that qualify for the 50 percent risk weight. Refer to §.32(g), (h) and (i) of the regulatory capital rules. Note: Do not include MBS that are tranching for credit risk; those should be reported as securitization exposures in Schedule RC-R, Part II, item 9.b. Do not include interest-only securities.
 - The portion of any exposure reported in Schedule RC, item 2.b, that is secured by collateral or has a guarantee that qualifies for the 50 percent risk weight.
 - *In column I—100% risk weight*, include the exposure amounts of those debt securities reported in Schedule RC-B, column C, that do not qualify as securitization exposures that qualify for the 100 percent risk weight. Such debt securities may include portions of, but may not be limited to:
 - Item 4.a.(3), "Other [residential mortgage] pass-through securities," that represent residential mortgage exposures that qualify for the 100 percent risk weight,
 - Item 4.b.(2), Other residential MBS "Collateralized by MBS issued or guaranteed by U.S. Government agencies or sponsored agencies" (excluding portions subject to an FDIC loss-sharing agreement) that represent residential mortgage exposures that qualify for the 100 percent risk weight,
 - Item 4.b.(3), "All other residential MBS." Include only those MBS that qualify for the 100 percent risk weight. Refer to §.32(g), (h) and (i) of the regulatory capital rules. Note: Do not include MBS portions that are tranching for credit risk; those should be reported as securitization exposures in Schedule RC-R, Part II, item 9.b.
 - Item 4.c.(1)(b), "Other [commercial mortgage] pass-through securities,"
 - Item 4.c.(2)(b), "All other commercial MBS,"
 - Item 5.a, "Asset-backed securities,"

Part II. (cont.)**Item No. Caption and Instructions**

- 21** • *In column G–20% risk weight*, include the credit equivalent amount of centrally cleared derivative contracts with CCPs and other counterparties who meet, or that have guarantees or collateral that meets, the criteria for the 20 percent risk-weight category as described in the instructions for Risk-Weighted Assets and for Schedule RC-R, Part II, items 1 through 8, above.
- (cont.) • *In column H–50% risk weight*, include the credit equivalent amount of centrally cleared derivative contracts with CCPs and other counterparties who meet, or that have guarantees or collateral that meets, the criteria for the 50 percent risk-weight category as described in the instructions for Risk-Weighted Assets and for Schedule RC-R, Part II, items 1 through 8, above.
- *In column I–100% risk weight*, include the credit equivalent amount of centrally cleared derivative contracts with CCPs and other counterparties who meet, or that have guarantees or collateral that meets, the criteria for the 100 percent risk-weight category as described in the instructions for Risk-Weighted Assets and for Schedule RC-R, Part II, items 1 through 8, above. Also include the portion of the credit equivalent amount reported in column B that is not included in columns C through H and J.
- *In column J–150% risk weight*, include the credit equivalent amount of centrally cleared derivative contracts with CCPs and other counterparties who meet, or that have guarantees or collateral that meets, the criteria for the 150 percent risk-weight category as described in the instructions for Risk-Weighted Assets and for Schedule RC-R, Part II, items 1 through 8, above.

- 22** **Unsettled transactions (failed trades).** NOTE: This item includes unsettled transactions in the reporting bank's trading book and in its banking book. Report as unsettled transactions all on- and off-balance sheet transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery, or are already delayed, and against which the reporting bank must hold risk-based capital as described in §.38 of the regulatory capital rules.

For delivery-versus-payment (DvP) transactions¹ and payment-versus-payment (PvP) transactions,² report in column A the positive current exposure of those unsettled transactions with a normal settlement period in which the reporting bank's counterparty has not made delivery or payment within five business days after the settlement date, which are the DvP and PvP transactions subject to risk weighting under §.38 of the regulatory capital rules. Positive current exposure is equal to the difference between the transaction value at the agreed settlement price and the current market price of the transaction, if the difference results in a credit exposure of the bank to the counterparty.

¹ DvP transaction means a securities or commodities transaction in which the buyer is obligated to make payment only if the seller has made delivery of the securities or commodities and the seller is obligated to deliver the securities or commodities only if the buyer has made payment.

² PvP transaction means a foreign exchange transaction in which each counterparty is obligated to make a final transfer of one or more currencies only if the other counterparty has made a final transfer of one or more currencies.

Part II. (cont.)**Item No. Caption and Instructions****22**
(cont.)

For delayed non-DvP/non-PvP transactions,¹ also include in column A the current fair value of the deliverables owed to the bank by the counterparty in those transactions with a normal settlement period in which the reporting bank has delivered cash, securities, commodities, or currencies to its counterparty, but has not received its corresponding deliverables, which are the non-DvP/non-PvP transactions subject to risk weighting under §.38 of the regulatory capital rules.

Do not include in this item: (1) cleared transactions that are marked-to-market daily and subject to daily receipt and payment of variation margin; (2) repo-style transactions, including unsettled repo-style transactions; (3) one-way cash payments on over-the-counter derivatives; and (4) transactions with a contractual settlement period that is longer than the normal settlement period (generally greater than 5 business days).

- *In column C—0% risk weight*, include the fair value of deliverables owed to the bank by a counterparty that qualifies for a zero percent risk weight under §.32 of the regulatory capital rules that have been delayed one to four business days for non-DvP/non-PvP transactions.
- *In column G—20% risk weight*, include the fair value of deliverables owed to the bank by a counterparty that qualifies for a 20 percent risk weight under §.32 of the regulatory capital rules that have been delayed one to four business days for non-DvP/non-PvP transactions.
- *In column H—50% risk weight*, include the fair value of deliverables owed to the bank by a counterparty that qualifies for a 50 percent risk weight under §.32 of the regulatory capital rules that have been delayed one to four business days for non-DvP/non-PvP transactions.
- *In column I—100% risk weight*, include:
 - The fair value of deliverables owed to the bank by a counterparty that qualifies for a 100 percent risk weight under §.32 of the regulatory capital rules that have been delayed one to four business days for non-DvP/non-PvP transactions.
 - The positive current exposure of DvP and PvP transactions in which the counterparty has not made delivery or payment within 5 to 15 business days after the contractual settlement date.
- *In column J—150% risk weight*, include the fair value of deliverables owed to the bank by a counterparty that qualifies for a 150 percent risk weight under §.32 of the regulatory capital rules that have been delayed one to four business days for non-DvP/non-PvP transactions.
- *In column O—625% risk weight*, include the positive current exposure of DvP and PvP transactions in which the counterparty has not made delivery or payment within 16 to 30 business days after the contractual settlement date.
- *In column P—937.5% risk weight*, include the positive current exposure of DvP and PvP transactions in which the counterparty has not made delivery or payment within 31 to 45 business days after the contractual settlement date.

¹ Non-DvP/non-PvP transaction means any other delayed or unsettled transaction that does not meet the definition of a DvP or a PvP transaction.

Part II. (cont.)**Item No. Caption and Instructions**

- 22
(cont.)
- *In column Q—1250% risk weight, include:*
 - The positive current exposure of DvP and PvP transactions in which the counterparty has not made delivery or payment within 46 or more business days after the contractual settlement date.
 - The fair value of the deliverables in Non-DvP/non-PvP transactions in which the bank has not received deliverables from the counterparty five or more business days after which the delivery was due.

Totals**Item No. Caption and Instructions**

- 23 **Total assets, derivatives, off-balance sheet items, and other items subject to risk weighting by risk weight category.** For each of columns C through P, report the sum of items 11 through 22. For column Q, report the sum of items 10 through 22.
- 24 **Risk weight factor.**
- 25 **Risk-weighted assets by risk weight category.** For each of columns C through Q, multiply the amount in item 23 by the risk weight factor specified for that column in item 24.
- 26 **Risk-weighted assets base for purposes of calculating the allowance for loan and lease losses 1.25 percent threshold.** Report the sum of:
- Schedule RC-R, Part II:
 - Items 2.b through 20, column S,
 - Items 9.a, 9.b, 9.c, 9.d, and 10, columns T and U, and
 - Item 25, columns C through Q
 - Schedule RC-R, Part I:
 - The portion of item 10.b composed of “Investments in the institution’s own shares to the extent not excluded as part of treasury stock,”
 - The portion of item 10.b composed of “Reciprocal cross-holdings in the capital of financial institutions in the form of common stock,”
 - Item 11 (advanced approaches institutions only),
 - Items 13.a, 14.a, and 15.a, column A, on the FFIEC 031 for non-advanced approaches institutions; items 13.b, 14.b, 15.b, and 16, column B, for advanced approaches institutions; and items 13 through 15 on the FFIEC 041,

Part II. (cont.)**Item No. Caption and Instructions**

- 26**
(cont.)
- Item 24, excluding the portion of item 24 composed of tier 2 capital deductions reported in Part I, item 45, for which the institution does not have a sufficient amount of tier 2 capital before deductions reported in Part I, item 44.a on the FFIEC 031; item 44 on the FFIEC 041, to absorb these deductions, and
 - Item 45.

For institutions that have adopted the current expected credit losses methodology (CECL), the risk-weighted assets base reported in this item 26 is for purposes of calculating the adjusted allowances for credit losses (AACL) 1.25 percent threshold.

NOTE: Item 27 is applicable only to banks that are subject to the market risk capital rule.

- 27** **Standardized market risk-weighted assets.** Report the amount of the bank's standardized market risk-weighted assets. This item is applicable only to those banks covered by Subpart F of the regulatory capital rules (i.e., the market risk capital rule), as provided in §.201 of the regulatory capital rules.

A bank's measure for market risk for its covered positions is the sum of its value-at-risk (VaR)-based, stressed VaR-based, incremental risk, and comprehensive risk capital requirements plus its specific risk add-ons and any capital requirement for de minimis exposures. A bank's market risk-weighted assets equal its measure for market risk multiplied by 12.5 (the reciprocal of the minimum 8.0 percent capital ratio).

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

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

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

A covered position does not include:

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

- 28** **Risk-weighted assets before deductions for excess allowance for loan and lease losses and allocated transfer risk reserve.** Report the sum of items 2.b through 20, column S; items 9.a, 9.b, 9.c, 9.d, and 10, columns T and U; item 25, columns C through Q;

Part II. (cont.)**Memoranda****Item No. Caption and Instructions**

1 Do not include derivative contracts that meet the definition of a *securitization exposure* as described in §.2 of the regulatory capital rules; such derivative contracts must be reported in Schedule RC-R, Part II, item 10.
(cont.)

Current credit exposure, when using CEM, or replacement cost, when using SA-CCR, should be derived as follows: Determine whether a qualifying master netting agreement, as defined in §.2 of the regulatory capital rules, is in place between the reporting bank and a counterparty. If such an agreement is in place, the fair values of all applicable derivative contracts with that counterparty that are included in the netting agreement are netted to a single amount.

Next, for all other derivative contracts covered by the regulatory capital rules that have positive fair values, the total of the positive fair values is determined. Then, report in this item the sum of (i) the net positive fair values of applicable derivative contracts subject to qualifying master netting agreements and (ii) the total positive fair values of all other contracts covered by the regulatory capital rules for both OTC and centrally cleared contracts. The current credit exposure reported in this item is a component of the credit equivalent amount of derivative contracts that is to be reported in Schedule RC-R, items 20 or 21, column B, depending on whether the contracts are centrally cleared.

2 **Notional principal amounts of over-the-counter derivative contracts.** Report in the appropriate subitem and column the notional amount or par value of all over-the-counter (OTC) derivative contracts, including credit derivatives, that are subject to §.34 or §.132 of the regulatory capital rules.¹ Such contracts include swaps, forwards, and purchased options. Do not include OTC derivative contracts that meet the definition of a *securitization exposure* as described in §.2 of the regulatory capital rules; such derivative contracts must be reported in Schedule RC-R, Part II, item 10. Report notional amounts and par values in the column corresponding to the OTC derivative contract's remaining term to maturity from the report date. Remaining maturities are to be reported as (1) one year or less in column A, (2) over one year through five years in column B, or (3) over five years in column C.

Regardless of whether an institution uses the standardized approach for counterparty credit risk (SA-CCR) or the current exposure methodology (CEM) to calculate exposure amounts for its derivative contracts, report in Memorandum items 2.a through 2.g the notional amounts of the contracts, as this term is defined in U.S. generally accepted accounting principles, unless a derivative contract has a multiplier component as discussed in the following paragraph.

The notional amount or par value to be reported under SA-CCR and CEM for an OTC derivative contract with a multiplier component is the contract's effective notional amount or par value. (For example, a swap contract with a stated notional amount of \$1,000,000 whose terms call for quarterly settlement of the difference between 5 percent and LIBOR multiplied by 10 has an effective notional amount of \$10,000,000.)

The notional amount to be reported under SA-CCR and CEM for an amortizing OTC derivative contract is the contract's current (or, if appropriate, effective) notional amount. This notional amount should be reported in the column corresponding to the contract's remaining term to final maturity.

¹ See the instructions for Schedule RC-R, Part II, item 20, for the definition of an OTC derivative contract.

Part II. (cont.)**Memoranda****Item No. Caption and Instructions**

2
(cont.) For descriptions of "interest rate contracts," "foreign exchange contracts," "commodity and other contracts," and "equity derivative contracts," refer to the instructions for Schedule RC-L, item 12. For a description of "credit derivative contracts," refer to the instructions for Schedule RC-L, item 7.

Exclude from this item the notional amount of OTC written option contracts, including so-called "derivative loan commitments," which are not subject to §.34 of the regulatory capital rules.

When using SA-CCR, include gold in the metals category for Memorandum item 2.f and exclude gold from the exchange rate category for Memorandum item 2.b.

When using SA-CCR, a bank may elect to treat a credit or equity derivative contract that references an index as if it were multiple derivative contracts each referencing one component of the index. Thus, under this election, a banking organization would apply the SA-CCR methodology to each decomposed component of the index instead of applying the SA-CCR methodology to the index derivative contract.

When using SA-CCR, a bank may elect to treat a commodity derivative contract that references an index as if it were multiple derivative contracts each referencing one component of the index.

3 **Notional principal amounts of centrally cleared derivative contracts.** Report in the appropriate subitem and column the notional amount or par value of all derivative contracts, including credit derivatives, that are cleared transactions (as described in §.2 of the regulatory capital rules) and are subject to §.35 or §.133 of the regulatory capital rules.¹ Such centrally cleared derivative contracts include swaps, forwards, and purchased options. Do not include centrally cleared derivative contracts that meet the definition of a securitization exposure as described in §.2 of the regulatory capital rules; such derivative contracts must be reported in Schedule RC-R, Part II, item 10. Report notional amounts and par values in the column corresponding to the centrally cleared derivative contract's remaining term to maturity from the report date. Remaining maturities are to be reported as (1) one year or less in column A, (2) over one year through five years in column B, or (3) over five years in column C.

Regardless of whether an institution uses the standardized approach for counterparty credit risk (SA-CCR) or the current exposure methodology (CEM) to calculate exposure amounts for its derivative contracts, report in Memorandum items 3.a through 3.g the notional amounts of the contracts, as this term is defined in U.S. generally accepted accounting principles, unless a derivative contract has a multiplier component as discussed in the following paragraph.

The notional amount or par value to be reported under SA-CCR and CEM for a centrally cleared derivative contract with a multiplier component is the contract's effective notional amount or par value. (For example, a swap contract with a stated notional amount of \$1,000,000 whose terms call for quarterly settlement of the difference between 5 percent and LIBOR multiplied by 10 has an effective notional amount of \$10,000,000.)

¹ See the instructions for Schedule RC-R, Part II, item 21, for the description of derivative contracts that are cleared transactions, referred to hereafter as centrally cleared derivative contracts.

GLOSSARY

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

Acceptances: See "Bankers Acceptances."

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

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

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

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

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

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

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

Accounting Changes (cont.):

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

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

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

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

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

- The rollover approach “quantifies a misstatement based on the amount of the error originating in the current year income statement” only and ignores the “carryover effects” of any related prior year misstatements. The primary weakness of the rollover approach is that it fails to consider the effects of correcting the portion of the current year balance sheet misstatement that originated in prior years.
- The iron curtain approach “quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement’s year(s) of origination.” The primary weakness of the iron curtain approach is that it does not consider the correction of prior year misstatements in the current year financial statements to be errors because the prior year misstatements were considered immaterial in the year(s) of origination. Thus, there could be a material misstatement in the current year income statement because the correction of the accumulated immaterial amounts from prior years is not evaluated as an error.

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

Accounting Changes (cont.):

For purposes of the Consolidated Reports of Condition and Income, all banks should follow the sound accounting practices described in SAB 108 and SAB 99. Accordingly, banks should quantify the impact of correcting misstatements, including both the carryover and reversing effects of prior year misstatements, on their current year reports by applying both the “rollover” and “iron curtain” approaches and evaluating the impact of the error measured under each approach. When the misstatement that exists after recording the adjustment in the current year Consolidated Reports of Condition and Income is material (considering all relevant quantitative and qualitative factors), the appropriate prior year report(s) should be amended, even though such revision previously was and continues to be immaterial to the prior year report(s). If the misstatement that exists after recording the adjustment in the current year Consolidated Reports of Condition and Income is not material, then amending the immaterial errors in prior year reports would not be necessary.

When a bank's primary federal bank regulatory agency determines that the bank's Consolidated Reports of Condition and Income contain a material accounting error, the bank may be directed to file amended condition and/or income report data for each prior period that was significantly affected by the error. Normally, such re filings will not result in restatements of reports for periods exceeding five years. If amended reports are not required, the bank should report the effect of such corrections on retained earnings at the beginning of the year, net of applicable income taxes, in Schedule RI-A, item 2, "Cumulative effect of changes in accounting principles and corrections of material accounting errors," and in Schedule RI-E, item 4. The effect of such corrections on income and expenses since the beginning of the year in which the error is discovered should be reflected in each affected income and expense account on a year-to-date basis in the next quarterly Consolidated Report of Income to be filed and not as a direct adjustment to retained earnings.

In addition, a change from an accounting principle that is neither accepted nor sanctioned by bank supervisors to one that is acceptable to supervisors is to be reported as a correction of an error. When such a change is implemented, the cumulative effect that applies to prior periods, calculated in the same manner as described above for other changes in accounting principles, should be reported in Schedule RI-A, item 2, "Cumulative effect of changes in accounting principles and corrections of material accounting errors," and in Schedule RI-E, item 4. In most cases of this kind undertaken voluntarily by the reporting bank in order to adopt more acceptable accounting practices, such a change will not result in a request for amended reports for prior periods unless substantial distortions in the bank's previously reported results are in evidence.

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

For further information on these three topics, see ASC Topic 250, Accounting Changes and Error Corrections.

Accounting Errors, Corrections of: See "Accounting Changes."

Accounting Estimates, Changes in: See "Accounting Changes."

Accounting Principles, Changes in: See "Accounting Changes."

Accrued Interest Receivable: Accrued interest receivable is the recorded amount of interest that has been earned in current or prior periods on interest-bearing assets that has not yet been collected.

For institutions that have not adopted ASC Topic 326, Financial Instruments–Credit Losses, refer to the Glossary entry on “Nonaccrual Status” for the treatment of previously accrued interest. Accrued interest receivable that is not reported elsewhere on Schedule RC, Balance Sheet, as a component of the balance sheet amount of the associated financial asset should be reported in Schedule RC-F, item 1, “Accrued interest receivable.”

For institutions that have adopted ASC Topic 326, ASC Topic 326 permits a series of accounting policy elections related to accrued interest receivable. These elections are made upon adoption of ASC Topic 326 and may differ by class of financing receivable or major security-type level. The available accounting policy elections are:

- (1) Institutions may elect to separately present accrued interest receivable from the associated financial asset. The accrued interest receivable is presented net of an allowance for credit losses (ACL), if any. An institution that elects to present accrued interest receivable separately from the amount reported for the related financial asset (e.g., loans, leases, debt securities, and other interest-bearing assets) on Schedule RC, Balance Sheet (rather than as a component of the balance sheet amount reported for the related financial asset), should report the accrued interest receivable in Schedule RC-F, item 1, “Accrued interest receivable.”
- (2) Institutions that charge off uncollectible accrued interest receivable in a timely manner, i.e., in accordance with the Glossary entry for “Nonaccrual Status,” may elect to not measure an ACL for accrued interest receivable. For purposes of these reports, if an institution makes this policy election, the institution should debit (i.e., reduce) the appropriate category of interest income on Schedule RI, Income Statement, for the amount of uncollectible accrued interest receivable being charged off. If an institution does not make this policy election, the institution should measure an allowance for credit losses on accrued interest receivable and should charge off any uncollectible accrued interest receivable against the allowance for credit losses.

See also the Glossary entries for “Allowance for Loan and Lease Losses” or “Allowance for Credit Losses,” as applicable, “Amortized Cost Basis,” and “Nonaccrual Status.”

Accrued Interest Receivable Related to Credit Card Securitizations: In a typical credit card securitization, an institution transfers a pool of receivables and the right to receive the future collections of principal (credit card purchases and cash advances), finance charges, and fees on the receivables to a trust. If a securitization transaction qualifies as a sale under ASC Topic 860, Transfers and Servicing, the selling institution removes the receivables that were sold from its reported assets and continues to carry any retained interests in the transferred receivables on its balance sheet. The “accrued interest receivable” (AIR) asset typically consists of the seller’s retained interest in the investor’s portion of (1) the accrued fees and finance charges that have been billed to customer accounts, but have not yet been collected (“billed but uncollected”), and (2) the right to finance charges that have been accrued on cardholder accounts, but have not yet been billed (“accrued but unbilled”).

While the selling institution retains a right to the excess cash flows generated from the fees and finance charges collected on the transferred receivables, the institution generally subordinates its right to these cash flows to the investors in the securitization. If and when cash payments on the accrued fees and finance charges are collected, they flow through the trust, where they are available to satisfy more senior obligations before any excess amount is remitted to the seller. Only after trust expenses (such as servicing fees, investor certificate interest, and investor principal charge-offs) have been paid will the trustee distribute any excess fee and finance charge cash flow back to the seller. Since investors are paid from these cash collections before the selling institution receives the amount of AIR that is due, the seller may or may not realize the full amount of its AIR asset.

Accrued Interest Receivable Related to Credit Card Securitizations (cont.):

Accounting at Inception of the Securitization Transaction – Generally, if a securitization transaction meets the criteria for sale treatment and the AIR is subordinated either because the asset has been isolated from the transferor¹ or because of the operation of the cash flow distribution (or “waterfall”) through the securitization trust, the total AIR asset (both the “billed and uncollected” and “accrued and unbilled”) should be considered one of the components of the sale transaction. Thus, when accounting for a credit card securitization, an institution should allocate the previous carrying amount of the AIR (net of any related allowance for uncollectible amounts) and the other transferred assets between the assets that are sold and the retained interests, based on their relative fair values at the date of transfer. As a result, after a securitization, the allocated carrying amount of the AIR asset will typically be lower than its face amount.

Subsequent Accounting – After securitization, the AIR asset should be accounted for at its allocated cost basis (as discussed above). In addition, an institution should treat the AIR asset as a retained (subordinated) beneficial interest. Accordingly, it should be reported as an “All other asset” in Schedule RC-F, item 6, and in Schedule RC-S, item 2, column C on the FFIEC 031; column G on the FFIEC 041, (if reported as a stand-alone asset) and not as a loan receivable.

Although the AIR asset is a retained beneficial interest in transferred assets, it is not required to be subsequently measured like an investment in debt securities classified as available for sale or trading under ASC Topic 320, Investments–Debt Securities and ASC Topic 860 because the AIR asset cannot be contractually prepaid or settled in such a way that the holder would not recover substantially all of its recorded investment. Rather, institutions should follow existing applicable accounting standards, including ASC Subtopic 450-20, Contingencies–Loss Contingencies, in subsequent accounting for the AIR asset. ASC Subtopic 450-20 addresses the accounting for various loss contingencies, including the collectibility of receivables.

For further guidance, banks should refer to the [Interagency Advisory on the Accounting Treatment of Accrued Interest Receivable Related to Credit Card Securitizations](#) dated December 4, 2002. See also the Glossary entry for “Transfers of Financial Assets.”

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

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

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

¹ See ASC Subtopic 860-10.

Acquisition, Development, or Construction (ADC) Arrangements (cont.):

consideration for purposes of determining whether a credit facility is an HVCRE exposure for regulatory capital purposes. Thus, a loan can be treated as an HVCRE exposure for regulatory capital purposes even though it does not provide for the institution to participate in the property's expected residual profit.

Agreement Corporation: See "Edge and Agreement Corporation."

Allowance for Credit Losses: This entry applies to institutions that have adopted ASC Topic 326 (introduced by Accounting Standards Update No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13)). Institutions that have not adopted ASC Topic 326 should continue to refer to the Glossary entry for "Allowance for Loan and Lease Losses." For more information on the allowance for credit losses (ACL), institutions should also refer to the [Interagency Policy Statement on Allowances for Credit Losses](#) issued in May 2020.

Standards for accounting for an ACL for financial assets measured at amortized cost and net investments in leases (hereafter referred to collectively as financial assets measured at amortized cost), as well as certain off-balance sheet credit exposures, are set forth in ASC Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost. For financial assets measured at amortized cost, the ACL is a valuation account that is deducted from, or added to, the amortized cost basis of financial assets to present the net amount expected to be collected over the contractual term of the financial assets.

For institutions that have adopted ASC Topic 326, standards for measuring credit losses on available-for-sale (AFS) debt securities are set forth in ASC Subtopic 326-30, Financial Instruments—Credit Losses—Available-for-Sale Debt Securities. See the Glossary entry for "Securities Activities" for guidance on allowances for credit losses on AFS debt securities.

The following sections of this Glossary entry apply to financial assets measured at amortized cost and also to off-balance sheet credit exposures within the scope of ASC Subtopic 326-20.

Measurement— An ACL shall be established upon the origination or acquisition of a financial asset(s) measured at amortized cost. A separate ACL shall be reported for each type of financial asset measured at amortized cost (e.g., loans and leases held for investment, held-to-maturity (HTM) debt securities, and receivables that relate to repurchase agreements and securities lending agreements) as of the end of each reporting period.

As of the end of each quarter, or more frequently if warranted, each institution must evaluate the collectability of its financial assets measured at amortized cost, including, if applicable, any recorded accrued interest receivable (i.e., not already reversed or charged off, as applicable), and make adjusting entries to maintain the balance of each of the separate ACLs reported on the balance sheet at an appropriate level.

An institution shall measure expected credit losses on a collective or pool basis when financial assets share similar risk characteristics. If a financial asset does not share similar risk characteristics with other assets, expected credit losses for that asset should be evaluated individually. Individually evaluated assets should not be included in a collective assessment of expected credit losses. If a financial asset ceases to share similar risk characteristics with other assets in its pool, it should be moved to a different pool with assets sharing similar risk characteristics, if such a pool exists.

ASC Subtopic 326-20 does not require the use of a specific loss estimation method for purposes of determining ACLs. Various methods may be used to estimate the expected collectability of financial assets measured at amortized cost, with those methods generally applied consistently over time. The same loss estimation method does not need to be applied to all financial assets. An institution is not precluded from selecting a different method when it determines the method will result in a better estimate of ACLs.

Allowance for Credit Losses (cont.):

ASC Subtopic 326-20 requires an institution to measure estimated expected credit losses over the contractual term of its financial assets, considering expected prepayments. Renewals, extensions, and modifications are excluded from the contractual term of a financial asset for purposes of estimating the ACL unless there is a reasonable expectation of executing a troubled debt restructuring or the renewal and extension options are part of the original or modified contract and are not unconditionally cancellable by the institution. If such renewal or extension options are present, an institution must evaluate the likelihood of a borrower exercising those options when determining the contractual term.

In estimating the net amount expected to be collected on financial assets measured at amortized cost, an institution should consider the effects of past events, current conditions, and reasonable and supportable forecasts on the collectibility of the institution's financial assets. Under ASC Subtopic 326-20, an institution is required to use relevant forward-looking information and expectations drawn from reasonable and supportable forecasts when estimating expected credit losses.

Expected recoveries, prior to collection, are a component of management's estimate of the net amount expected to be collected for a financial asset. Expected recoveries of amounts previously charged off or expected to be charged off that are included in ACLs may not exceed the aggregate amounts previously charged off or expected to be charged off.

Changes in the ACL – Additions to, or reductions of, the ACL to adjust its level to management's current estimate of expected credit losses are to be made through charges or credits to the "provision for credit losses on financial assets" (provision) in item 4 of Schedule RI, Income Statement, except for changes to adjust the level of the ACL for off-balance-sheet credit exposures. When available information confirms that specific financial assets measured at amortized cost, or portions thereof, are uncollectible, these amounts should be promptly charged off against the related ACL in the period in which the financial assets are deemed uncollectible. Under no circumstances can expected credit losses on financial assets measured at amortized cost be charged directly to "Retained earnings" after the initial adoption of ASC Topic 326, for which the change from the incurred loss to the current expected credit losses methodology is required to be recorded through a cumulative-effect adjustment to retained earnings. This cumulative-effect adjustment is reported in Schedule RI-A, item 2, "Cumulative effect of changes in accounting principles and corrections of material accounting errors," and disclosed in Schedule RI-E, item 4.a, "Effect of adoption of current expected credit losses methodology – ASU 2016-13."

Recoveries on financial assets measured at amortized cost represent collections on amounts that were previously charged off against the related ACL. Recoveries shall be credited to the ACL, provided that the total amount credited to the ACL as recoveries on a financial asset (which may include amounts representing principal, interest, and fees) is limited to the amount previously charged off against the ACL on that financial asset. Any amounts collected in excess of this limit should generally be recognized as noninterest income upon collection.

Charge-Offs and Establishment of a New Amortized Cost Basis – When an institution makes a full or partial charge-off of a financial asset measured at amortized cost that is deemed uncollectible, the institution establishes a new cost basis for that financial asset. Consequently, once a new cost basis has been established for a financial asset through a charge-off, this amortized cost basis may not be directly "written up" at a later date. Reversing the previous charge-off and "re-booking" the charged-off asset after the institution concludes that the prospects for recovering the charge-off have improved, regardless of whether the institution assigns a new account number to the asset or the borrower signs a new note, is not an acceptable accounting practice. Nevertheless, as stated above, management's estimate of the net amount expected to be collected for a financial asset, as reflected in the related ACL, considers expected recoveries.

Allowance for Credit Losses (cont.):

If losses charged off against an ACL exceed the amount of the ACL, a provision expense sufficient to restore the ACL to an appropriate level must be charged to a provision for credit losses on the income statement during the reporting period in which the charge-off is recorded. An institution shall not increase an ACL by transferring an amount from retained earnings or any segregation thereof to the ACL.

Collateral-Dependent Financial Assets – A collateral-dependent financial asset is a financial asset for which repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower, based on management's assessment, is experiencing financial difficulty as of the reporting date.

For purposes of these reports, the ACL for a collateral-dependent loan is measured using the fair value of collateral, regardless of whether foreclosure is probable. This application of this requirement for purposes of these reports is limited to collateral-dependent loans; it does not apply to other financial assets such as held-to-maturity debt securities that are collateral dependent.

When estimating the ACL for a collateral-dependent loan, the fair value of collateral should be adjusted to consider estimated costs to sell if repayment or satisfaction of the loan depends on the sale of the collateral. ACL adjustments for estimated costs to sell are not appropriate when the repayment of a collateral-dependent loan is expected from the operation of the collateral.

The fair value of collateral securing a collateral-dependent loan may change over time. If the fair value of the collateral as of the ACL evaluation date has decreased since the previous ACL evaluation date, the ACL should be increased to reflect the additional decrease in the fair value of the collateral. Likewise, if the fair value of the collateral has increased as of the ACL evaluation date, the increase in the fair value of the collateral is reflected through a reduction in the ACL. Any negative ACL that results is capped at the amount previously charged off. In general, any portion of the amortized cost basis in excess of the fair value of collateral less estimated costs to sell, if applicable, that can be identified as uncollectible should be promptly charged off against the ACL.

Financial Assets with Collateral Maintenance Agreements – Institutions may have financial assets that are secured by collateral (such as debt securities) and are subject to collateral maintenance agreements requiring the borrower to continuously replenish the amount of collateral securing the asset. If the fair value of the collateral declines, the borrower is required to provide additional collateral as specified by the agreement.

ASC Topic 326 includes a practical expedient for financial assets with collateral maintenance agreements where the borrower is required to provide collateral greater than or equal to the amortized cost basis of the asset and is expected to continuously replenish the collateral. In those cases, the institution may elect the collateral maintenance practical expedient and measure expected credit losses for these qualifying assets based on the fair value of the collateral. If the fair value of the collateral is greater than the amortized cost basis of the financial asset and the institution expects the borrower to replenish collateral as needed, the institution may record an ACL of zero for the financial asset when the collateral maintenance practical expedient is applied. Similarly, if the fair value of the collateral is less than the amortized cost basis of the financial asset and the institution expects the borrower to replenish collateral as needed, the ACL is limited to the difference between the fair value of the collateral and the amortized cost basis of the asset as of the reporting date when applying the collateral maintenance practical expedient.

Off-Balance-Sheet Credit Exposures – Each institution should also estimate, as a separate liability account, expected credit losses for off-balance-sheet credit exposures not accounted for as insurance, over the contractual period during which the institution is exposed to credit risk. The estimate of expected credit losses should take into consideration the likelihood that funding will occur as well as

Allowance for Credit Losses (cont.):

the amount expected to be funded over the estimated remaining contractual term of the off-balance-sheet credit exposures. Off-balance sheet credit exposures include loan commitments, financial standby letters of credit, and financial guarantees not accounted for as insurance, and other similar instruments except for those within the scope of ASC Topic 815 on derivatives and hedging. This separate allowance should be reported in Schedule RC-G, item 3, "Allowance for credit losses on off-balance-sheet credit exposures," not as part of the "Allowance for credit losses on loans and leases" in Schedule RC, item 4.c. Additions to, or reductions of, the allowance for credit losses on off-balance sheet credit exposures to adjust the balance of the allowance to an appropriate level are reported in net income.

Institutions should not record an estimate of expected credit losses for off-balance-sheet credit exposures that are unconditionally cancellable by the issuer. For example, for an institution that has unfunded commitments (i.e., available credit) on credit cards, the institution should not record an allowance for expected credit losses for unfunded commitments for which the institution has the ability to unconditionally cancel the available line of credit. In contrast, home equity lines of credit may be deemed unconditionally cancellable for regulatory capital purposes. However, unfunded commitments under home equity lines of credit are not considered unconditionally cancellable by the issuer for purposes of estimating expected credit losses under ASC Topic 326, because the lender may not unilaterally refuse to extend credit under the commitment.

Recourse Liability Accounts – Recourse liability accounts that arise from recourse obligations for any transfers of financial assets that are reported as sales should not be included in an ACL. These accounts are considered separate and distinct from ACLs and from the allowance for credit losses on off-balance sheet credit exposures. Recourse liability accounts should be reported in Schedule RC-G, item 4, "All other liabilities."

See also the Glossary entries for "Accrued Interest Receivable," "Amortized Cost Basis," "Business Combinations," "Foreclosed Assets," "Loan," "Loan Fees," "Nonaccrual Status," "Purchased Credit-Deteriorated Assets," "Securities Activities," "Transfers of Financial Assets," and "Troubled Debt Restructurings."

Allowance for Loan and Lease Losses: This Glossary entry applies to institutions that have not adopted ASC Topic 326, Financial Instruments–Credit Losses. Institutions that have adopted ASC Topic 326 should refer to the Glossary entry for "Allowance for Credit Losses."

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

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

As of the end of each quarter, or more frequently if warranted, the management of each bank must evaluate, subject to examiner review, the collectibility of the loan and lease portfolio, including any recorded accrued and unpaid interest (i.e., not already reversed or charged off), and make entries to

Allowance for Loan and Lease Losses (cont.):

maintain the balance of the allowance for loan and lease losses on the balance sheet at an appropriate level. Management must maintain reasonable records in support of their evaluations and entries. Furthermore, each bank is responsible for ensuring that controls are in place to consistently determine the allowance for loan and lease losses in accordance with GAAP (including ASC Subtopic 450-20, Contingencies – Loss Contingencies, and ASC Topic 310, Receivables), the bank's stated policies and procedures, management's best judgment and relevant supervisory guidance.

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

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

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

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

To the extent that a bank's reserve for bad debts for tax purposes is greater than or less than its "allowance for loan and lease losses" on the balance sheet of the Consolidated 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.

Allowance for Loan and Lease Losses (cont.):

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

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

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

Amortized Cost Basis: The amortized cost basis is the amount at which a financing receivable or investment is originated or acquired, adjusted for applicable accrued interest, accretion, or amortization of premium, discount and net deferred fees or costs, collection of cash, write-offs,¹ foreign exchange, and fair hedge accounting adjustments.

See also the Glossary entries for "Accrued Interest Receivable," "Loan," "Loan Fees," "Nonaccrual Status," and "Securities Activities."

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.

¹ The FASB's term "write-off" is used interchangeably with the term "charge-off" in these instructions. These terms can refer to both full and partial write-offs or charge-offs.

Bankers Acceptances (cont.):

The following description covers the treatment in the Consolidated 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, "Other liabilities" (Schedule RC, item 20), reflecting the accepting bank's obligation to put the holder of the acceptance in funds at maturity, and (2) the asset item, "Other assets" (Schedule RC, item 11), reflecting the account party's liability to put the accepting bank in funds at or before maturity. The acceptance liability and acceptance asset must also be reported in both Schedule RC-G, item 4, "All other liabilities," and Schedule RC-F, item 6, "All other assets," respectively.

Exceptions to the mandatory reporting by the accepting bank of the full amount of all outstanding drafts accepted by the reporting bank in both "Other liabilities" (Schedule RC, item 20) and "Other assets" (Schedule RC, item 11) on the balance sheet of the Consolidated Report of Condition occur in the following situations:

- (a) One exception occurs in situations where the accepting bank acquires – through initial discounting or subsequent purchase – and holds its own acceptance (i.e., a draft that it has itself accepted). In this case, the reporting bank's own acceptances that are held by it should not be reported in the "Other liabilities" and "Other assets" items noted above. The bank's holdings of its own acceptances should be reported in "Loans and leases held for sale" (Schedule RC, item 4.a), "Loans and leases held for investment" (Schedule RC, item 4.b), or "Trading assets" (Schedule RC, item 5), as appropriate.
- (b) Another exception occurs in situations where the account party anticipates its liability to the reporting bank on an acceptance outstanding by making a payment to the bank that reduces the customer's liability in advance of the maturity of the acceptance. In this case, the reporting bank should decrease "Other assets" (Schedule RC, item 11) by the amount of such prepayment; the prepayment will not affect the bank's "Other liabilities" (Schedule RC, item 20), which would continue to reflect the full amount of the acceptance until the bank has repaid the holder of the acceptance at the maturity date specified in the instrument. If the account party's payment to the accepting bank before the maturity date is not for the purpose of immediate reduction of its indebtedness to the reporting bank or if receipt of the payment does not immediately reduce or extinguish that indebtedness, such advance payment will not reduce item 11 of Schedule RC, but should be reflected in the bank's deposit liabilities.

In all situations other than these two exceptions just described, the accepting bank must report the full amount of its acceptances in "Other liabilities" (Schedule RC, item 20) and in "Other assets" (Schedule RC, item 11). There are no other circumstances in which the accepting bank can report as a balance sheet liability anything less than the full amount of the obligation to put the holder of the acceptance in funds at maturity. Moreover, there are no circumstances in which the reporting bank can net its acceptance assets against its acceptance liabilities.

NOTE: The amount of a reporting member (both national and state) bank's acceptances that are subject to statutory limitations on eligible acceptances as set forth in federal statute [12 USC 372](#) and in [Federal Reserve regulation 12 CFR Part 250](#) may differ from the required reporting of

Bankers Acceptances (cont.):

acceptances on the balance sheet of the Consolidated Report of Condition, as described above. These differences are mainly attributable to ineligible acceptances, to participations in the reporting bank's acceptances conveyed to others, to participations acquired by the reporting bank in other banks' acceptances, and to the effect of the consolidation of subsidiaries in the Consolidated Report of Condition.

- (2) "Participations" in acceptances – The general requirement for the accepting bank to report on its balance sheet the full amount of the total obligation to put the holder of the acceptance in funds applies also, in particular, to any situation in which the accepting bank enters into any kind of arrangement with others for the purpose of having the latter share, or participate, in the obligation to put the holder of the acceptance in funds at maturity or in the risk of loss in the event of default on the part of the account party.¹ In any such sharing arrangement or participation agreement -- regardless of its form or its contract provisions, regardless of the terminology (e.g., "funded," "risk," "unconditional," or "contingent") used to describe it and the relationships under it, regardless of whether it is described as a participation in the customer's liability or in the accepting bank's obligation or in the risk of default by the account party, and regardless of the system of debits and credits used by the accepting bank to reflect the participation arrangement -- the existence of the participation or other agreement does not reduce the accepting bank's obligation to honor the full amount of the acceptance at maturity nor change the requirement for the accepting bank to report the full amount of the acceptance in the liability and asset items described above.

The existence of such participations is not to be recorded on the balance sheet (Schedule RC) of the accepting bank that conveys shares in its obligation to put the holder of the acceptance in funds or shares in its risk of loss in the event of default on the part of the account party, and similarly is not to be recorded on the balance sheets (Schedule RC) of the other banks that are party to, or acquire, such participations. However, in such cases of agreements to participate, the nonaccepting bank acquiring the participation will report the participation in Schedule RC-R, Part II, item 17, "All other off-balance sheet liabilities." This same reporting treatment applies to a bank that acquires a participation in an acceptance of another (accepting) bank and subsequently conveys the participation to others and to a bank that acquires such a participation. Moreover, the bank that both acquires and conveys a participation in another bank's acceptance must report the amount of the participation in the "All other off-balance sheet liabilities" item in Schedule RC-R, Part II.

- (3) Acceptances owned by the reporting bank – The treatment of acceptances owned or held by the reporting bank (whether acquired by initial discount or subsequent purchase) depends upon whether the acceptances are held for trading, for sale, or in portfolio and upon whether the acceptances held have been accepted by the reporting bank or by other banks.

All acceptances held for trading by the reporting bank (whether acceptances of the reporting bank or of other banks) are to be reported in Schedule RC, item 5, "Trading assets." Banks that must complete Schedule RC-D, Trading Assets and Liabilities, should report other banks' acceptances held for trading in item 6.d, "Other loans," and its own acceptances held for trading according to the account party of the draft, generally in item 6.b, "Commercial and industrial loans," or item 6.d, "Other loans," as appropriate.

The reporting bank's holdings of acceptances other than those held for trading (whether acceptances of the reporting bank or of other banks) are to be reported in Schedule RC, item 4.a, "Loans and leases held for sale," or in item 4.b, "Loans and leases held for investment," as appropriate, and in Schedule RC-C, Part I, Loans and Leases.

¹ This discussion does not deal with participations in holdings of bankers acceptances, which are reportable as loans. Such participations are treated like any participations in loans as described in the Glossary entry for "Transfers of Financial Assets."

Bankers Acceptances (cont.):

In Schedule RC-C, Part I, the reporting bank's holdings of other banks' acceptances, other than those held for trading, are to be reported in "Loans to depository institutions and acceptances of other banks" (item 2). On the other hand, the bank's holdings of its own acceptances, other than those held for trading, are to be reported in Schedule RC-C, Part I, according to the account party of the draft. Thus, holdings of own acceptances for which the account parties are commercial or industrial enterprises are to be reported in Schedule RC-C, Part I, in "Commercial and industrial loans" (item 4); holdings of own acceptances for which the account parties are other banks (e.g., in connection with the refinancing of another acceptance or for the financing of dollar exchange) are to be reported in Schedule RC-C, Part I, in "Loans to depository institutions and acceptances of other banks" (item 2); and holdings of own acceptances for which the account parties are foreign governments or official institutions (e.g., for the financing of dollar exchange) are to be reported in Schedule RC-C, Part I, "Loans to foreign governments and official institutions" (item 7) on the FFIEC 031 and in Schedule RC-C, Part I, "Other loans" (item 9.b) on the FFIEC 041.

The difference in treatment between holdings of own acceptances and holdings of other banks' acceptances reflects the fact that, for other banks' acceptances, the holding bank's immediate claim is on the accepting bank, regardless of the account party or of the purpose of the loan. On the other hand, for its holdings of its own acceptances, the bank's immediate claim is on the account party named in the accepted draft.

If the account party prepays its acceptance liability on an acceptance of the reporting bank that is held by the reporting bank (in the held-for-sale account, in the loan portfolio, or as trading assets) so as to immediately reduce its indebtedness to the reporting bank, the recording of the holding – in "Commercial and industrial loans," "Loans to depository institutions and acceptances of other banks," or "Trading assets," as appropriate – is reduced by the prepayment.

Bank-Owned Life Insurance: ASC Subtopic 325-30, Investments-Other – Investments in Insurance Contracts, addresses the accounting for bank-owned life insurance. According to ASC Subtopic 325-30, only the amount that could be realized under the insurance contract as of the balance sheet date should be reported as an asset. In general, this amount is the cash surrender value reported to the institution by the insurance carrier less any applicable surrender charges not reflected by the insurance carrier in the reported cash surrender value, i.e., the net cash surrender value. An institution should also consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract in accordance with ASC Subtopic 325-30.

Because there is no right of offset, an investment in bank-owned life insurance should be reported as an asset separately from any related deferred compensation liability.

Banks that have entered into split-dollar life insurance arrangements should follow the guidance on the accounting for the deferred compensation and postretirement benefit aspects of such arrangements in ASC Subtopic 715-60, Compensation-Retirement Benefits – Defined Benefit Plans-Other Postretirement. In general, in an endorsement split-dollar arrangement, a bank owns and controls the insurance policy on the employee, whereas in a collateral assignment split-dollar arrangement, the employee owns and controls the insurance policy. According to ASC Subtopic 715-60, a bank should recognize a liability for the postretirement benefit related to a split-dollar life insurance arrangement if, based on the substantive agreement with the employee, the bank has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit. This liability should be measured in accordance with either ASC Topic 715, Compensation-Retirement Benefits (if, in substance, a postretirement benefit plan exists) or ASC Subtopic 710-10, Compensation-General – Overall (if the arrangement is, in substance, an individual deferred compensation contract), and reported on the balance sheet in Schedule RC, item 20, "Other liabilities," and in Schedule RC-G, item 4, "All other liabilities." In addition, for a collateral assignment split-dollar

Bank-Owned Life Insurance (cont.):

arrangement, ASC Subtopic 715-60 states that an employer such as a bank should recognize and measure an insurance asset based on the nature and substance of the arrangement.

The amount that could be realized under bank-owned life insurance policies as of the report date should be reported on the balance sheet in Schedule RC, item 11, "Other assets," and in Schedule RC-F, item 5, "Life insurance assets." The net earnings (losses) on or the net increases (decreases) in the bank's life insurance assets should be reported in the income statement in Schedule RI, item 5.I, "Other noninterest income." Alternatively, the gross earnings (losses) on or increases (decreases) in these life insurance assets may be reported in Schedule RI, item 5.I, and the life insurance policy expenses may be reported in Schedule RI, Item 7.d, "Other noninterest expense." If the absolute value of the earnings (losses) on or the increases (decreases) in the bank's life insurance assets reported in Schedule RI, item 5.I, "Other noninterest income," is greater than \$100,000 and exceeds 7 percent of "Other noninterest income," this amount should be reported in Schedule RI-E, item 1.b.

Banks, U.S. and Foreign: In the classification of banks as customers of the reporting bank, distinctions are drawn for purposes of the Consolidated Reports of Condition and Income between "U.S. banks" and "commercial banks in the U.S." and between "foreign banks" and "banks in foreign countries." Some report items call for one set of these categories and other items call for the other set. The distinctions center around the inclusion or exclusion of foreign branches of U.S. banks and U.S. branches and agencies of foreign banks. For purposes of describing the office location of banks as customers of the reporting bank, the term "United States" covers the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. (This is in contrast to the usage with respect to the offices of the reporting bank, where U.S.-domiciled Edge and Agreement subsidiaries and IBFs are included in "foreign" offices. Furthermore, for banks chartered and headquartered in the 50 states of the United States and the District of Columbia, offices of the reporting bank in Puerto Rico and U.S. territories and possessions are also included in "foreign" offices, but, for banks chartered and headquartered in Puerto Rico and U.S. territories and possessions, offices of the reporting bank in Puerto Rico and U.S. territories and possessions are included in "domestic" offices.)

U.S. banks – The term "U.S. banks" covers both the U.S. and foreign branches of banks chartered and headquartered in the U.S. (including U.S.-chartered banks owned by foreigners), but excluding U.S. branches and agencies of foreign banks. On the other hand, the term "banks in the U.S." or "commercial banks in the U.S." (the institutional coverage of which is described in detail later in this entry) covers the U.S. offices of U.S. banks (including their IBFs) and the U.S. branches and agencies of foreign banks, but excludes the foreign branches of U.S. banks.

Foreign banks – Similarly, the term "foreign banks" covers all branches of banks chartered and headquartered in foreign countries (including foreign banks owned by U.S. nationals and institutions), including their U.S.-domiciled branches and agencies, but excluding the foreign branches of U.S. banks. In contrast, the term "banks in foreign countries" covers foreign-domiciled branches of banks, including the foreign branches of U.S. banks, but excluding the U.S. branches and agencies of foreign banks.

Banks, U.S. and Foreign (cont.):

The following table summarizes these contrasting categories of banks considered as customers as used in the Consolidated Reports of Condition and Income ("X" indicates inclusion; no entry indicates exclusion.)

	<u>"U.S. banks"</u>	<u>"Commercial banks in the U.S."</u>	<u>"Foreign banks"</u>	<u>"Banks in foreign countries"</u>
U.S. branches of U.S. banks (including IBFs)	X	X		
Foreign branches of U.S. banks	X			X
Foreign branches of foreign banks			X	X
U.S. branches and agencies of foreign banks		X	X	

Commercial banks in the U.S. – The detailed institutional composition of "commercial banks in the U.S." includes:

(1) the U.S.-domiciled head offices and branches of:

- (a) national banks;
- (b) state-chartered commercial banks;
- (c) trust companies that perform a commercial banking business;
- (d) industrial banks;
- (e) private or unincorporated banks;
- (f) International Banking Facilities (IBFs) of U.S. banks;
- (g) Edge and Agreement corporations; and

(2) the U.S.-domiciled branches and agencies of foreign banks (as defined below).

This coverage includes the U.S. institutions listed above that are owned by foreigners. Excluded from commercial banks in the U.S. are branches located in foreign countries of U.S. banks.

U.S. savings and loan associations and savings banks are treated as "other depository institutions in the U.S." for purposes of the Consolidated Reports of Condition and Income.

U.S. branches and agencies of foreign banks – U.S. branches of foreign banks include any offices or places of business of foreign banks that are located in the United States at which deposits are accepted. U.S. agencies of foreign banks include any offices or places of business of foreign banks that are located in the United States at which credit balances are maintained incidental to or arising out of the exercise of banking powers but at which deposits may not be accepted from citizens or residents of the United States.

Banks, U.S. and Foreign (cont.):

For purposes of the Consolidated Reports of Condition and Income, the term "U.S. branches and agencies of foreign banks" covers:

- (1) the U.S. branches and agencies of foreign banks;
- (2) the U.S. branches and agencies of foreign official banking institutions, including central banks, nationalized banks, and other banking institutions owned by foreign governments; and
- (3) investment companies that are chartered under Article XII of the New York State banking law and that are majority-owned by one or more foreign banks.

Banks in foreign countries –The institutional composition of "banks in foreign countries" includes:

- (1) the foreign-domiciled head offices and branches of:
 - (a) foreign commercial banks (including foreign-domiciled banking subsidiaries of U.S. banks and Edge and Agreement corporations);
 - (b) foreign savings banks or discount houses;
 - (c) nationalized banks not functioning either as central banks, as foreign development banks, or as banks of issue;
 - (d) other similar foreign institutions that accept short-term deposits; and
- (2) the foreign-domiciled branches of U.S. banks.

See also "International Banking Facility (IBF)."

Banks in Foreign Countries: See "Banks, U.S. and Foreign."

Bill-of-Lading Draft: See "Commodity or Bill-of-Lading Draft."

Borrowings and Deposits in Foreign Offices: Borrowings in foreign offices include assets rediscounted with central banks, certain participations sold in loans and securities, government fundings of loans, borrowings from the Export-Import Bank, and rediscounted trade acceptances. Federal funds sold and repurchase agreements in foreign offices should be reported in accordance with the Glossary entries for "Federal Funds Transactions" and "Repurchase/Resale Agreements." Liability accounts such as accruals and allocated capital shall not be reported as borrowings. Deposits consist of such other short-term and long-term liabilities issued or undertaken as a means of obtaining funds to be used in the banking business and include those liabilities generally characterized as placements and takings, call money, and deposit substitutes.

Brokered Deposits: As defined in [Section 337.6\(a\) of the FDIC's regulations](#), the term "brokered deposit" means "any deposit that is obtained, directly or indirectly, by or through any deposit broker." Brokered deposits include both those in which the entire beneficial interest in a given bank deposit account or instrument is held by a single depositor and those in which the deposit broker sells participations in a given bank deposit account or instrument to one or more investors.

The meaning of the term "brokered deposit" depends on the meaning of the term "deposit broker." The term "deposit broker" is defined broadly in [Section 29\(g\) of the Federal Deposit Insurance Act](#) and [Section 337.6\(a\) of the FDIC's regulations](#) and means:

- (1) any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions, or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties, and
- (2) an agent or trustee who establishes a deposit account to facilitate a business arrangement with an insured depository institution to use the proceeds of the account to fund a prearranged loan.

Brokered Deposits (cont.):

[Section 337.6\(a\) of the FDIC's regulations](#) further provides that the definition of "deposit broker" is subject to a list of exceptions. According to the list of exceptions, the following parties are not treated as a deposit broker:

- (1) an insured depository institution, with respect to funds placed with that depository institution;
- (2) an employee of an insured depository institution, with respect to funds placed with the employing depository institution;
- (3) a trust department of an insured depository institution, if the trust or other fiduciary relationship in question has not been established for the primary purpose of placing funds with insured depository institutions;
- (4) the trustee of a pension or other employee benefit plan, with respect to funds of the plan;
- (5) a person acting as a plan administrator or an investment adviser in connection with a pension plan or other employee benefit plan provided that that person is performing managerial functions with respect to the plan;
- (6) the trustee of a testamentary account;
- (7) the trustee of an irrevocable trust (other than a trustee who establishes a deposit account to facilitate a business arrangement with an insured depository institution to use the proceeds of the account to fund a prearranged loan), as long as the trust in question has not been established for the primary purpose of placing funds with insured depository institutions;
- (8) a trustee or custodian of a pension or profit-sharing plan qualified under [Section 401\(d\)](#) or [403\(a\) of the Internal Revenue Code of 1986](#);
- (9) an agent or nominee whose primary purpose is not the placement of funds with depository institutions;¹ or
- (10) an insured depository institution acting as an intermediary or agent of a U.S. government department or agency for a government sponsored minority or women-owned depository institution deposit program.

Notwithstanding these ten exceptions, the term "deposit broker" (as amended on September 23, 1994, by the [Riegle Community Development and Regulatory Improvement Act of 1994](#)) includes any insured depository institution that is not well capitalized (as defined in [Section 38 of the Federal Deposit Insurance Act, Prompt Corrective Action](#)), and any employee of any such institution, which engages, directly or indirectly, in the solicitation of deposits by offering rates of interest (with respect to such deposits) which are significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions in such depository institution's normal market area.² Only those deposits accepted, renewed, or rolled over on or after June 16, 1992, in connection with this form of deposit solicitation are to be reported as brokered deposits. For further information on the solicitation and acceptance of brokered deposits by insured depository institutions, see [Section 337.6\(b\) of the FDIC's regulations](#).

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) 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.

¹ For purposes of applying this ninth exception from the definition of deposit broker, "primary purpose" does not mean "primary activity," but should be construed as "primary intent." Whether the "primary purpose" exception applies should be determined based on the meaning of this exception as stated in the FDIC's regulations and as interpreted in the FDIC's guidance.

² Any deposit accepted, renewed, or rolled over by a well capitalized institution before September 23, 1994, in connection with this form of deposit solicitation should continue to be reported as a brokered deposit as long as the deposit remains outstanding under the terms in effect before September 23, 1994. Notwithstanding the amendment to the "deposit broker" definition, all institutions that obtain deposits, directly or indirectly, by or through any other deposit broker must report such funds as brokered deposits in the Consolidated Report of Condition.

Brokered Deposits (cont.):

In some cases, brokered deposits are issued in the name of the depositor whose funds have been placed in a bank by a deposit broker. In other cases, a bank's deposit account records may indicate that the funds have been deposited in the name of a third party custodian for the benefit of others (e.g., "XYZ Corporation as custodian for the benefit of others," or "Custodial account of XYZ Corporation"). Unless the custodian meets one of the specific exceptions from the "deposit broker" definition in [Section 29 of the Federal Deposit Insurance Act](#) and [Section 337.6\(a\) of the FDIC's regulations](#), these custodial accounts should be reported as brokered deposits in Schedule RC-E, Deposit Liabilities.

A deposit listing service whose only function is to provide information on the availability and terms of accounts is not facilitating the placement of deposits and therefore is not a deposit broker per se. However, if a deposit broker uses a deposit listing service to identify an institution offering a high rate on deposits and then places its customers' funds at that institution, the deposits would be brokered deposits and the institution should report them as such in Schedule RC-E. The designation of these deposits as brokered deposits is based not on the broker's use of the listing service but on the placement of the deposits in the institution by the deposit broker.

[Section 202 of the Economic Growth, Regulatory Relief, and Consumer Protection Act](#), enacted on May 24, 2018, amends [Section 29 of the Federal Deposit Insurance Act](#) to except a capped amount of reciprocal deposits from treatment as, and from being reported as, brokered deposits for qualifying institutions. The FDIC has amended its regulations to conform to the treatment of reciprocal deposits set forth in Section 202. As defined in [Section 337.6\(e\)\(2\)\(v\) of the FDIC's regulations](#), "reciprocal deposits" means "deposits received by an agent institution through a deposit placement network with the same maturity (if any) and in the same aggregate amount as covered deposits placed by the agent institution in other network member banks." As defined in [Section 327.8\(g\) of the FDIC's regulations](#), "brokered reciprocal deposits" are "reciprocal deposits as defined in [Section 337.6\(e\)\(2\)\(v\) of the FDIC's regulations](#) that are not excepted from an institution's brokered deposits pursuant to [Section 337.6\(e\)](#)" of the FDIC's regulations. Brokered reciprocal deposits should be reported as (1) brokered deposits and included in Schedule RC-E, Memorandum item 1.b, and, if applicable, Memorandum items 1.c and 1.d, and (2) brokered reciprocal deposits and included in Schedule RC-O, item 9 and, if applicable, item 9.a. An institution should report its total reciprocal deposits, including any reciprocal deposits that are reported as brokered deposits, in Schedule RC-E, Memorandum item 1.g. For further information on reciprocal deposits and brokered reciprocal deposits, [see](#) the instructions for Schedule RC-E, Memorandum items 1.b and 1.g, and the examples after the instructions for Schedule RC-E, Memorandum item 7.

Fully insured brokered deposits are brokered deposits (including brokered deposits that represent retirement deposit accounts as defined in Schedule RC-O, Memorandum item 1) with balances of \$250,000 or less or with balances of more than \$250,000 that have been participated out by the deposit broker in shares of \$250,000 or less. As more fully described in the instructions for Schedule RC-E, (Part I on the FFIEC 031), Memorandum item 1.c, fully insured brokered deposits also include (a) certain brokered certificates of deposit issued in \$1,000 amounts under a master certificate of deposit issued by a bank to a deposit broker in an amount that exceeds \$250,000 and (b) certain brokered transaction accounts and money market deposit accounts denominated in amounts of \$0.01 and established and maintained by the deposit broker (or its agent) as agent, custodian, or other fiduciary for the broker's customers.

For additional information on brokered deposits, refer to the FDIC's "Identifying, Accepting and Reporting Brokered Deposits: Frequently Asked Questions" at <https://www.fdic.gov/news/news/financial/2016/fil16042b.pdf>.

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: The accounting and reporting standards for business combinations are set forth in ASC Topic 805, Business Combinations. ASC Topic 805 requires that all business combinations, which are defined as the acquisition of assets and assumption of liabilities that constitute a business, be accounted for using the acquisition method of accounting. The formation of a joint venture, the acquisition of a group of assets that do not constitute a business, and a transfer of net assets or exchange of equity interests between entities under common control are not considered business combinations and therefore are not accounted for using the acquisition method of accounting.

Acquisition method – Under the acquisition method, the acquirer in a business combination shall measure the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their acquisition-date fair values (with limited exceptions specified in ASC Topic 805) using the definition of fair value in ASC Topic 820, Fair Value Measurement. The acquisition date is generally the date on which the acquirer legally transfers the consideration, acquires the assets, and assumes the liabilities of the acquiree, i.e., the closing date. ASC Topic 805 requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values. If ASC Topic 326, Financial Instruments–Credit Losses, has not been adopted, the acquirer may not recognize a separate valuation allowance (e.g., allowance for loan and lease losses) for the contractual cash flows that are deemed to be uncollectible as of that date.

If ASC Topic 326 has been adopted, an institution is required to determine whether any acquired financial assets meet the definition of a purchased credit-deteriorated (PCD) asset. For a financial asset that meets the definition of a PCD asset, the institution applies the gross-up approach and records the acquired financial asset at its purchase price plus acquisition-date allowance for credit losses, which establishes the initial amortized cost basis of the PCD asset. For acquired financial assets that are not PCD assets, the acquirer records the purchased financial assets at their acquisition-date fair values. Additionally, for those acquired financial assets within the scope of ASC Subtopic 326-20 that are not PCD financial assets, an allowance is initially recorded with a corresponding charge to the provision for credit losses expense in the reporting period that includes the acquisition date. See also the Glossary entries for "Allowance for Credit Losses" and "Purchased Credit-Deteriorated Assets."

The consideration transferred in a business combination shall be calculated as the sum of the acquisition-date fair values of the assets (including any cash) transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree, and the equity interests issued by the acquirer. Acquisition-related costs are costs the acquirer incurs to effect a business combination such as finder's fees; advisory, legal, accounting, valuation, and other professional or consulting fees; and general administrative costs. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services received. The cost to register and issue debt or equity securities shall be recognized in accordance with other applicable generally accepted accounting principles.

At the acquisition date, an acquirer generally will not have obtained all of the information necessary to measure the fair values of the identifiable assets acquired, liabilities assumed, any noncontrolling interest in the acquiree, and consideration transferred for the acquiree. Under ASC Topic 805, if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer should report provisional amounts in its Consolidated Reports of Condition and Income for the items for which the accounting is incomplete. Provisional amounts should be based on the best information available. During the measurement period, the acquirer is required to adjust the provisional amounts recognized at the acquisition date, with a corresponding adjustment to goodwill, to reflect new information obtained about facts and circumstances that existed

Business Combinations (cont.):

as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. Topic 805 further requires an acquirer to recognize adjustments to provisional amounts identified during the measurement period in the reporting period in which adjustment amounts are determined. The acquirer also must recognize in the income statement for the same reporting period the effect on earnings, if any, resulting from the adjustments to the provisional amounts as if the accounting for the business combination had been completed as of the acquisition date. See ASC Topic 805 for additional guidance on the measurement period and adjustments to provisional amounts during this period.

ASC Topic 805 provides guidance for recognizing particular assets acquired and liabilities assumed in a business combination. Acquired assets may be tangible (such as securities or fixed assets) or intangible, as discussed in the following paragraph. An acquiring entity must not recognize the goodwill, if any, or the deferred income taxes recorded by an acquired entity before the business combination. However, a deferred tax liability or asset must be recognized for differences between the carrying values assigned in the business combination and the tax bases of the recognized assets acquired and liabilities assumed, in accordance with ASC Topic 740, Income Taxes. (For further information, see the Glossary entry for "Income Taxes.")

Under ASC Topic 805, an intangible asset must be recognized separately from goodwill if it arises from contractual or other legal rights, regardless of whether the rights are transferable or separable. Otherwise, an intangible asset must be recognized separately from goodwill only if it is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged individually or together with a related contract, identifiable asset, or liability. Examples of intangible assets that must be recognized separately from goodwill are core deposit intangibles, purchased credit card relationships, servicing assets, favorable leasehold rights, trademarks, trade names, internet domain names, and noncompetition agreements. However, an institution that is a private company, as defined in U.S. GAAP, may elect the private company accounting alternative for the recognition of certain identifiable intangible assets acquired in a business combination provided by ASC Subtopic 805-20, Business Combinations – Identifiable Assets and Liabilities, and Any Noncontrolling Interest, if it also has adopted the private company goodwill accounting alternative provided by ASC Subtopic 350-20, Intangibles–Goodwill and Other – Goodwill. Intangible assets that are recognized separately from goodwill must be reported in Schedule RC, item 10, "Intangible assets," and in Schedule RC-M, item 2.a or 2.c, as appropriate. Refer to the Glossary entry for "Goodwill" for further information on the private company accounting alternative for identifiable intangible assets. See also the Glossary entries for "Private Company" and "Public Business Entity."

In general, the amount recognized as goodwill in a business combination is the excess of the sum of the consideration transferred and the fair value of any noncontrolling interest in the acquiree over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. Goodwill is reported in Schedule RC, item 10, and in Schedule RC-M, item 2.b. An acquired intangible asset that does not meet the criteria described in the preceding paragraph must be treated as goodwill. After initial recognition, goodwill must be accounted for in accordance with ASC Topic 350, Intangibles–Goodwill and Other, and the Glossary entry for "Goodwill."

In contrast, if the total acquisition-date amount of the identifiable net assets acquired exceeds the consideration transferred plus the fair value of any noncontrolling interest in the acquiree (i.e., a

¹ In general, the measurement period in a business combination is the period after the acquisition date during which the acquirer may adjust provisional amounts recognized for a business combination. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

Business Combinations (cont.):

bargain purchase), the acquirer shall reassess whether it has correctly identified all of the assets acquired and all the liabilities assumed and shall recognize any additional assets or liabilities that are identified in that review. If that excess remains after the review, the acquirer shall recognize that excess in earnings as a gain attributable to the acquirer on the acquisition date and report the amount in Schedule RI, item 5.I, "Other noninterest income."

Under the acquisition method, the historical equity capital balances of the acquired business are *not* to be carried forward to the acquirer's consolidated balance sheet. The operating results of the acquiree are to be included in the income and expenses of the acquirer only from the acquisition date. In addition, if the ownership interests in the acquiree were obtained in a series of purchase transactions, the equity interest in the acquiree previously held by the acquirer is remeasured at its acquisition-date fair value and any resulting gain or loss is recognized in the acquirer's earnings.

Pushdown accounting – Pushdown accounting is an acquiree's establishment of a new accounting basis in its separate financial statements when an acquirer obtains control of the acquired entity. On November 18, 2014, the FASB issued ASU No. 2014-17, "Pushdown Accounting," which amended ASC Subtopic 805-50, Business Combinations–Related Issues, and took effect upon issuance. Under ASU 2014-17, an acquiree (e.g., an acquired institution) that retains its separate corporate existence may apply pushdown accounting upon a change-in-control event. A change-in-control event occurs when an acquirer obtains a controlling financial interest, as defined by ASC Subtopic 810-10, Consolidation–Overall, in the acquiree. A controlling financial interest typically requires ownership of more than 50 percent of the voting rights in an acquired entity.

An acquired institution that retains its separate corporate existence may, for purposes of its Call Report, elect pushdown accounting in accordance with ASU 2014-17 if the change-in-control event for the business combination occurred on or after October 1, 2014. Prior to the issuance of ASU 2014-17, pushdown accounting for business combinations, including those involving collaborative groups, was permitted for Call Report purposes when 80 percent or more voting control was obtained and required when voting control was 95 percent or more. An institution acquired in a business combination before October 1, 2014, that retained its separate legal existence should not change the pushdown treatment applied to the acquisition because of the issuance of ASU 2014-17. It should be noted that after a parent obtains a controlling financial interest in an entity through a business combination, any subsequent increase in the parent's ownership interest in the acquiree is not a change in control. However, if a parent's ownership becomes a noncontrolling interest and the parent later regains control of the acquiree, the latter transaction would be a change-in-control event at which a new pushdown election could be made in accordance with ASC Subtopic 805-50.

When an acquired institution that retains its separate corporate existence elects pushdown accounting, it must report in its Call Report the new basis of accounting established by the acquirer under which the acquired institution's identifiable assets, liabilities, and noncontrolling interests are restated to their acquisition-date fair values (with limited exceptions specified in ASC Topic 805) using the definition of fair value in ASC Topic 820. The assets acquired, including goodwill, and liabilities assumed, measured at their acquisition-date fair values, are reported in the Call Report balance sheet (Schedule RC) of the acquired institution and the consolidated financial statements of the institution's parent.

In addition, the pushdown adjusting entries must zero out the acquired institution's retained earnings account (Schedule RC, item 26.a). Therefore, the retained earnings of the acquired institution before the change-in-control event will not be available for the payment of dividends after the change-in-control event. When recording the pushdown adjusting entries, the acquired institution's common stock account should reflect the par value of its issued common shares. The acquired institution's surplus (additional paid-in capital) account should represent the difference between the restated amount of the institution's net assets (i.e., its assets less its liabilities) and the sum of the par value of its issued common shares and the amount of any perpetual preferred stock outstanding. The effect of

Business Combinations (cont.):

any bargain purchase gain recognized by the acquirer should be reflected in the acquisition-date measurement of the acquired institution's surplus (additional paid-in capital) account, not in the acquired institution's income statement (Schedule RI).

In the Call Report for the remainder of the year in which an acquired institution elects to apply pushdown accounting, the institution shall report the initial increase or decrease in its equity capital that results from the application of pushdown accounting in item 7, "Changes incident to business combinations, net," of Schedule RI-A, Changes in Bank Equity Capital. In addition, in the year an acquired institution elects pushdown accounting, its income statements (Schedule RI) for periods after its acquisition should only include amounts from the acquisition date through the end of the calendar year-to-date reporting period. No income or expense for the portion of the calendar year prior to the date of the change-in-control event should be included in these income statements. Also, when pushdown accounting is elected, the acquired institution should report the date of its acquisition in Schedule RI, Memoranda item 7, for each report date on or after the date of the change-in-control event through the end of the calendar year in which the acquisition took place.

The agencies note that the pushdown accounting election available under ASU 2014-17 can be used to produce a particular result in the Call Report that may not be reflective of the economic substance of the underlying business combination. Therefore, an institution's primary federal regulator reserves the right to require or prohibit the institution's use of pushdown accounting for Call Report purposes based on the regulator's evaluation of whether the election best reflects the facts and circumstances of the business combination.

Transactions between entities under common control – A transaction in which net assets or equity interests (e.g., voting shares) that constitute a business are transferred between entities under common control is not accounted for as a business combination. The method used to account for such transactions is similar to the pooling-of-interests method. In accordance with ASC Subtopic 805-50, when applying a method similar to the pooling-of-interests method to a transfer of net assets or an exchange of equity interests between entities under common control, the entity that receives the net assets or equity interests shall initially measure the recognized assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer. If the carrying amounts of the assets and liabilities transferred differ from the historical cost of the parent of the entities under common control, for example, because pushdown accounting had not been applied, then the financial statements of the receiving entity shall reflect the transferred assets and liabilities at the historical cost of the parent of the entities under common control. Consequently, and without regard to the pushdown accounting election made by the acquirer, if a parent transfers the acquiree to another entity under common control or merges the acquiree with another entity under common control, the receiving entity accounts for the acquiree using the parent's historical cost for the net assets or equity interests in the acquiree. The parent's historical cost includes the values of the acquiree's assets (including goodwill) and liabilities that were remeasured at fair value on the acquisition date of the business combination. If there has been a change in reporting entity as defined by ASC Subtopic 250-10, Accounting Changes and Error Corrections—Overall, for the year in which a transaction between entities under common control occurs, income and expenses must be reported in Schedule RI, Income Statement, as though the entities 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 expense for the period.

Call Option: See "Derivative Contracts."

Capital Contributions of Cash and Notes Receivable: An institution may receive cash or a note receivable as a contribution to its equity capital. The transaction may be a sale of capital stock or a contribution to paid-in capital (surplus), both of which are referred to hereafter as capital contributions. The accounting for capital contributions in the form of notes receivable is set forth in ASC Subtopic 505-10, Equity – Overall, and SEC Staff Accounting Bulletin No. 107 (Topic 4.E., Receivables from Sale of Stock, in the Codification of Staff Accounting Bulletins). This Glossary entry does not address other forms of capital contributions, for example, nonmonetary contributions to equity capital such as a building.

A capital contribution of cash should be recorded in an institution's financial statements and Consolidated Reports of Condition and Income when received. Therefore, a capital contribution of cash prior to a quarter-end report date should be reported as an increase in equity capital in the institution's reports for that quarter (in Schedule RI-A, item 5 or 11, as appropriate). A contribution of cash after quarter-end should not be reflected as an increase in the equity capital of an earlier reporting period.

When an institution receives a note receivable rather than cash as a capital contribution, ASC Subtopic 505-10 states that it is generally not appropriate to report the note as an asset. As a consequence, the predominant practice is to offset the note and the capital contribution in the equity capital section of the balance sheet, i.e., the note receivable is reported as a reduction of equity capital. In this situation, the capital stock issued or the contribution to paid-in capital should be reported in Schedule RC, item 23, 24, or 25, as appropriate, and the note receivable should be reported as a deduction from equity capital in Schedule RC, item 26.c, "Other equity capital components." No net increase in equity capital should be reported in Schedule RI-A, Changes in Bank Equity Capital. In addition, when a note receivable is offset in the equity capital section of the balance sheet, accrued interest receivable on the note also should be offset in equity (and reported as a deduction from equity capital in Schedule RC, item 26.c), consistent with the guidance in ASC Subtopic 505-10. Because a nonreciprocal transfer from an owner or another party to an institution does not typically result in the recognition of income or expense, the accrual of interest on a note receivable that has been reported as a deduction from equity capital should be reported as additional paid-in capital rather than interest income.

However, ASC Subtopic 505-10 provides that an institution may record a note received as a capital contribution as an asset, rather than a reduction of equity capital, only if the note is collected in cash "before the financial statements are issued." The note receivable must also satisfy the existence criteria described below, along with any applicable laws and regulations.¹ When these conditions are met, the note receivable should be reported separately from an institution's other loans and receivables in Schedule RC-F, item 6, "All other assets," and individually itemized and described in accordance with the instructions for item 6, if appropriate.

For purposes of these reports, the financial statements are considered issued at the earliest of the following dates:

- (1) The submission deadline for the Consolidated Reports of Condition and Income (30 calendar days after the quarter-end report date, except for an institution that has more than one foreign office, other than a "shell" branch or an International Banking Facility, for which the deadline is 35 calendar days after quarter-end);
- (2) Any other public financial statement filing deadline to which the institution or its parent holding company is subject; or
- (3) The actual filing date of the institution's public financial reports, including the filing of its Consolidated Reports of Condition and Income or a public securities filing by the institution or its parent holding company.

¹ For example, for national banks, [12 U.S.C. § 57](#) and [12 CFR § 5.46](#).

Capital Contributions of Cash and Notes Receivable (cont.):

To be reported as an asset, rather than a reduction of equity capital, as of a quarter-end report date, a note received as a capital contribution (that is collected in cash as described above) must meet the definition of an asset under generally accepted accounting principles by satisfying all of the following existence criteria:

- (1) There must be written documentation providing evidence that the note was contributed to the institution prior to the quarter-end report date by those with authority to make such a capital contribution on behalf of the issuer of the note (e.g., if the contribution is by the institution's parent holding company, those in authority would be the holding company's board of directors or its chief executive officer or chief financial officer);
- (2) The note must be a legally binding obligation of the issuer to fund a fixed and stated dollar amount by a specified date; and
- (3) The note must be executed and enforceable before quarter-end.

Although an institution's parent holding company may have a general intent to, or may have entered into a capital maintenance agreement with the institution that calls for it to, maintain the institution's capital at a specified level, this general intent or agreement alone would not constitute evidence that a note receivable existed at quarter-end. Furthermore, if a note receivable for a capital contribution obligates the note issuer to pay an amount that is variable or otherwise not specifically stated, the institution must offset the note and equity capital. Similarly, an obligor's issuance of several notes having fixed face amounts, taken together, would be considered a single note receivable having a variable payment amount, which would require all the notes to be offset in equity capital as of the quarter-end report date.

Capitalization of Interest Costs: Interest costs associated with the construction of a building shall, if material, be capitalized as part of the cost of the building. Such interest costs include both the actual interest incurred when the construction funds are borrowed and the interest costs imputed to internal financing of a construction project.

The interest rate utilized to capitalize interest on internally financed projects in a reporting period shall be the rate(s) applicable to the bank's borrowings outstanding during the period. For this purpose, a bank's borrowings include interest-bearing deposits and other interest-bearing liabilities.

The interest capitalized shall not exceed the total amount of interest cost incurred by the bank during the reporting period.

For further information, see ASC Subtopic 835-20, Interest – Capitalization of Interest.

Carrybacks and Carryforwards: See "Income Taxes."

Cash Management Arrangements: A cash management arrangement is a group of related transaction accounts of a single type maintained in the same right and capacity by a customer (a single legal entity), whereby the customer and the financial institution understand that payments from one account will be honored so long as a net credit balance exists in the group of related transaction accounts taken as a whole. Such accounts function as, and will be regarded for reporting and deposit insurance assessment purposes as, one account rather than separate accounts, provided adequate documentation of the arrangement is maintained as discussed below. (Note: For reporting and deposit insurance assessment purposes, transaction accounts of affiliates and subsidiaries of a parent company that are separate legal entities may not be offset because accounts of separate legal entities are not permitted within a bona fide cash management arrangement.)

"Transaction accounts of a single type" means demand deposit accounts or NOW accounts, but not a combination thereof. For purposes of cash management arrangements, the terms "right" and

Cash Management Arrangements (cont.):

"capacity" relate to the form of legal ownership such as being held in an agency or trust capacity, as a joint tenant, or as an individual. "Single legal entity" means a natural person, partnership, corporation, trust, or estate.

The reporting bank must maintain readily available records that will allow for the verification of cash management arrangements. Such documentation must provide account numbers, account titles, ownership of accounts, and the terms and conditions surrounding the management of the accounts, and must also clearly show that both the customer and the reporting bank have agreed to such terms and conditions. These terms and conditions must clearly indicate the understanding that payments from one account will be honored as long as a net credit balance exists within the group of related transaction accounts taken as a whole and maintained in the same right and capacity. A written cash management agreement, signed by both the customer (a single legal entity) and the reporting bank, accurately maintained and incorporating the above information, will be acceptable evidence of a bona fide cash management arrangement. In addition, the reporting bank must maintain readily available records that will allow for the verification of account balances within cash management arrangements.

See "Deposits" for the definitions of transaction account, demand deposit, and NOW account. See also "Overdraft."

Certificate of Deposit: See "Deposits."

Changes in Accounting Estimates: See "Accounting Changes."

Changes in Accounting Principles: See "Accounting Changes."

Clearing Accounts: See "Suspense Accounts."

Commercial Banks in the U.S.: See "Banks, U.S. and Foreign."

Commercial Letter of Credit: See "Letter of Credit."

Commercial Paper: Commercial paper consists of short-term negotiable promissory notes issued in the United States by commercial businesses, including finance companies and banks. Commercial paper usually matures in 270 days or less and is not collateralized. Commercial paper may be backed by a standby letter of credit from a bank, as in the case of documented discounted notes. Holdings of commercial paper are to be reported as "securities" in Schedule RC-B, normally in item 6, "Other debt securities," unless held for trading and therefore reportable in Schedule RC, item 5, "Trading assets."

Commodity or Bill-of-Lading Draft: A commodity or bill-of-lading draft is a draft that is issued in connection with the shipment of goods. If the commodity or bill-of-lading draft becomes payable only when the shipment of goods against which it is payable arrives, it is an arrival draft. Arrival drafts are usually forwarded by the shipper to the collecting depository institution with instructions to release the shipping documents (e.g., bill of lading) conveying title to the goods only upon payment of the draft. Payment, however, cannot be demanded until the goods have arrived at the drawee's destination. Arrival drafts provide a means of insuring payment of shipped goods at the time that the goods are released.

Common Stock of Unconsolidated Subsidiaries, Investments in: See "Equity Method of Accounting" and "Subsidiaries."

Continuing Contract: See "Federal Funds Transactions."

Corporate Joint Venture: See "Subsidiaries."

Corrections of Accounting Errors: See "Accounting Changes."

Coupon Stripping, Treasury Receipts, and STRIPS: Coupon stripping occurs when a security holder physically detaches unmatured coupons from the principal portion of a security and sells either the detached coupons or the ex-coupon security separately. (Such transactions are generally considered by federal bank supervisory agencies to represent "improper investment practices" for banks.) In accounting for such transactions, the carrying amount of the security must be allocated between the ex-coupon security and the detached coupons based on their relative fair values at the date of the sale in accordance with ASC Topic 860, Transfers and Servicing. (See the Glossary entry for "Transfers of Financial Assets.")

Detached U.S. Government security coupons and ex-coupon U.S. Government securities that are held for purposes other than trading, whether resulting from the coupon stripping activities of the reporting bank or from its purchase of stripped securities, shall be reported as "Other domestic debt securities" in Schedule RC-B, item 6.a. The amount of any discount or premium relating to the detached coupons or ex-coupon securities must be amortized. (See the Glossary entry for "Premiums and Discounts.")

A variation of coupon stripping has been developed by several securities firms which have marketed instruments with such names as CATS (Certificates of Accrual on Treasury Securities), TIGR (Treasury Investment Growth Receipts), COUGAR (Certificates on Government Receipts), LION (Lehman Investment Opportunity Notes), and ETR (East Treasury Receipts). A securities dealer purchases U.S. Treasury securities, delivers them to a trustee, and sells receipts representing the rights to future interest and/or principal payments on the U.S. Treasury securities held by the trustee. Such Treasury receipts are not an obligation of the U.S. Government and, when held for purposes other than trading, shall be reported as "Other domestic debt securities" in Schedule RC-B, item 6.a. The discount on these Treasury receipts must be accreted.

Under a program called Separate Trading of Registered Interest and Principal of Securities (STRIPS), the U.S. Treasury has issued certain long-term note and bond issues that are maintained in the book-entry system operated by the Federal Reserve Banks in a manner that permits separate trading and ownership of the interest and principal payments on these issues. Even after the interest or principal portions of U.S. Treasury STRIPS have been separately traded, they remain obligations of the U.S. Government. STRIPS held for purposes other than trading shall be reported as U.S. Treasury securities in Schedule RC-B, item 1. The discount on separately traded portions of STRIPS must be accreted.

Detached coupons, ex-coupon securities, Treasury receipts, and U.S. Treasury STRIPS held for trading purposes shall be reported at fair value in Schedule RC, item 5.

Custody Account: A custody account is one in which securities or other assets are held by a bank on behalf of a customer under a safekeeping arrangement. Assets held in such capacity are not to be reported in the balance sheet of the reporting bank nor are such accounts to be reflected as a liability. Assets of the reporting bank held in custody accounts at other banks are to be reported on the reporting bank's balance sheet in the appropriate asset categories as if held in the physical custody of the reporting bank.

Dealer Reserve Account: A dealer reserve account arises when a bank purchases at full face value a dealer's installment note receivables, but credits less than the full face value directly to the dealer's account. The remaining amount is credited to a separate dealer reserve account. That account is held by the bank as collateral for the installment notes and, for reporting purposes, is treated as a deposit in the appropriate items of Schedule RC-E. The bank will subsequently disburse to the dealer predetermined portions of the reserve as the purchased notes are paid in a timely manner.

Dealer Reserve Account (cont.):

For example, if a bank purchases \$100,000 in notes from a dealer for the full face amount (\$100,000) and pays to the dealer \$90,000 in cash or credits to his/her deposit account, the remaining \$10,000, which is held as collateral security, would be credited to the dealer reserve account.

See also "Deposits."

Debt Issuance Costs: Debt issuance costs include the underwriting, legal, accounting, printing, and other direct costs incurred in connection with the issuance of debt. ASC Subtopic 835-30, Interest – Imputation of Interest, requires debt issuance costs associated with a recognized debt liability (not measured at fair value under a fair value option) to be presented as a direct deduction from the face amount of the related debt liability, similar to debt discounts. Debt issuance costs, like debt discounts, in effect reduce the proceeds of the borrowing, thereby increasing the effective interest rate on the debt.

For purposes of these reports, institutions should report debt issuance costs as a direct deduction from the appropriate balance sheet liability category in Schedule RC, e.g., item 16, "Other borrowed money," or item 19, "Subordinated notes and debentures." However, debt issuance costs associated with a recognized liability reported at fair value under a fair value option should be expensed as incurred.

Debt issuance costs should be amortized using the effective interest method. The amortization of debt issuance costs should be reported as interest expense in the income statement category appropriate to the related liability in Schedule RI, e.g., item 2.c, "Interest on trading liabilities and other borrowed money," or item 2.d, "Interest on subordinated notes and debentures."

The guidance in ASC Subtopic 835-30 does not address the presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. The agencies would not object to an institution deferring and presenting debt issuance costs related to a line-of-credit arrangement as an "Other asset" and subsequently amortizing the deferred debt issuance costs ratably over the term of the arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement.

Deferred Compensation Agreements: Institutions often enter into deferred compensation agreements with selected employees as part of executive compensation and retention programs. These agreements are generally structured as nonqualified retirement plans for federal income tax purposes and are based upon individual agreements with selected employees. Institutions purchase life insurance in connection with many of these agreements. Bank-owned life insurance may produce attractive tax-equivalent yields that offset some or all of the costs of the agreements.

Deferred compensation agreements with select employees under individual contracts generally do not constitute postretirement income plans (i.e., pension plans) or postretirement health and welfare benefit plans. The accounting for individual contracts that, when taken together, do not represent a postretirement plan should follow ASC Subtopic 710-10, Compensation-General – Overall. If the individual contracts, taken together, are equivalent to a plan, the plan should be accounted for under ASC Topic 715, Compensation-Retirement Benefits.

ASC Subtopic 710-10 requires that an employer's obligation under a deferred compensation agreement be accrued according to the terms of the individual contract over the required service period to the date the employee is fully eligible to receive the benefits, i.e., the "full eligibility date." Depending on the individual contract, the full eligibility date may be the employee's expected retirement date, the date the employee entered into the contract, or a date between these two dates. ASC Subtopic 710-10 does not prescribe a specific accrual method for the benefits under deferred compensation contracts, stating only that the "cost of those benefits shall be accrued over that period of the employee's service

Deferred Compensation Agreements (cont.):

in a systematic and rational manner.” The amounts to be accrued each period should result in a deferred compensation liability at the full eligibility date that equals the then present value of the estimated benefit payments to be made under the individual contract.

ASC Subtopic 710-10 does not specify how to select the discount rate to measure the present value of the estimated benefit payments. Therefore, other relevant accounting literature must be considered in determining an appropriate discount rate. For purposes of these reports, an institution’s incremental borrowing rate¹ and the current rate of return on high-quality fixed-income debt securities² are acceptable discount rates to measure deferred compensation agreement obligations. An institution must select and consistently apply a discount rate policy that conforms with generally accepted accounting principles.

For each deferred compensation agreement to be accounted for in accordance with ASC Subtopic 710-10, an institution should calculate the present value of the expected future benefit payments under the agreement at the employee’s full eligibility date. The expected future benefit payments can be reasonably estimated and should be based on reasonable and supportable assumptions. The estimated amount of these benefit payments should be discounted because the benefits will be paid in periodic installments after the employee retires.

For deferred compensation agreements commonly referred to as revenue neutral or indexed retirement plans,³ the expected future benefits should include both the "primary benefit" and, if the employee is entitled to "excess earnings" that are earned after retirement, the "secondary benefit." The number of periods the primary and any secondary benefit payments should be discounted may differ because the discount period for each type of benefit payment should be based upon the length of time during which each type of benefit will be paid as specified in the deferred compensation agreement.

After the present value of the expected future benefit payments has been determined, an institution should accrue an amount of compensation expense and a liability each year from the date the employee enters into the deferred compensation agreement until the full eligibility date. The amount of

¹ ASC Subtopic 835-30, Interest – Imputation of Interest, states in part that “the rate used for valuation purposes will normally be at least equal to the rate at which the debtor can obtain financing of a similar nature from other sources at the date of the transaction.”

² Paragraph 186 in the Basis for Conclusions of former FASB Statement No. 106, “Employers’ Accounting for Postretirement Benefits Other Than Pensions,” states that “[t]he objective of selecting assumed discount rates is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due.”

³ Revenue neutral and indexed retirement plans are deferred compensation agreements that are typically designed so that the spread each year, if any, between the tax-equivalent earnings on bank-owned life insurance covering an individual employee and a hypothetical earnings calculation is deferred and paid to the employee as a postretirement benefit. This spread is commonly referred to as “excess earnings.” The hypothetical earnings are computed based on a pre-defined variable index rate (e.g., cost of funds or federal funds rate) times a notional amount. The agreement for this type of plan typically requires the excess earnings that accrue before an employee’s retirement to be recorded in a separate liability account. Once the employee retires, the balance in the liability account is generally paid to the employee in equal annual installments over a set number of years (e.g., 10 or 15 years). These payments are commonly referred to as the “primary benefit” or “preretirement benefit.” The employee may also receive the excess earnings that are earned after retirement. This benefit may continue until his or her death and is commonly referred to as the “secondary benefit” or “postretirement benefit.” The secondary benefit is paid annually, once the employee has retired, in addition to the primary benefit.

Deferred Compensation Agreements (cont.):

these annual accruals should be sufficient to ensure that a deferred compensation liability equal to the present value of the expected benefit payments is recorded by the full eligibility date. Any method of deferred compensation accounting that does not recognize some expense in each year from the date the employee enters into the agreement until the full eligibility date is not systematic and rational. (For indexed retirement plans, some expense should be recognized for the primary benefit and any secondary benefit in each of these years.)

Vesting provisions should be reviewed to ensure that the full eligibility date is properly determined because this date is critical to the measurement of the liability estimate. Because ASC Subtopic 710-10 requires that the present value of the expected benefit payments be recorded by the full eligibility date, institutions also need to consider changes in market interest rates to appropriately measure deferred compensation liabilities. Therefore, institutions should periodically review their estimates of the expected future benefits under deferred compensation agreements and the discount rates used to compute the present value of the expected benefit payments and revise the estimates and rates, when appropriate.

Deferred compensation agreements may include noncompete provisions or provisions requiring employees to perform consulting services during postretirement years. If the value of the noncompete provisions cannot be reasonably and reliably estimated, no value should be assigned to the noncompete provisions in recognizing the deferred compensation liability. Institutions should allocate a portion of the future benefit payments to consulting services to be performed in postretirement years only if the consulting services are determined to be substantive. Factors to consider in determining whether postretirement consulting services are substantive include, but are not limited to, whether the services are required to be performed, whether there is an economic benefit to the institution, and whether the employee forfeits the benefits under the agreement for failure to perform such services.

Deferred compensation liabilities should be reported on the balance sheet in Schedule RC, item 20, "Other liabilities," and in Schedule RC-G, item 4, "All other liabilities." If this amount is greater than \$100,000 and exceeds 25 percent of the amount reported in Schedule RC-G, item 4, it should be reported in Schedule RC-G, item 4.b. The annual compensation expense (service component and interest component) related to deferred compensation agreements should be reported in the income statement in Schedule RI, item 7.a, "Salaries and employee benefits."

See also "Bank-Owned Life Insurance."

Deferred Income Taxes: See "Income Taxes."

Defined Benefit Postretirement Plans: The accounting and reporting standards for defined benefit postretirement plans, such as pension plans and health care plans, are set forth in ASC Topic 715, Compensation-Retirement Benefits. ASC Topic 715 requires an institution that sponsors a single-employer defined benefit postretirement plan to recognize the funded status of each such plan on its balance sheet. The funded status of a benefit plan is measured as of the end of an institution's fiscal year as the difference between plan assets at fair value (with limited exceptions) and the benefit obligation. An overfunded plan is recognized as an asset, which should be reported in Schedule RC-F, item 6, "All other assets," while an underfunded plan is recognized as a liability, which should be reported in Schedule RC-G, item 4, "All other liabilities."

An institution should measure the net period benefit cost of a defined benefit plan for a reporting period in accordance with ASC Subtopic 715-30 for pension plans and ASC Subtopic 715-60 for other postretirement benefit plans. This cost should be reported in Schedule RI, item 7.a, "Salaries and employee benefits." However, an institution must recognize certain gains and losses and prior service costs or credits that arise on a defined benefit plan during each reporting period, net of tax, as a

Defined Benefit Postretirement Plans (cont.):

component of other comprehensive income (Schedule RI-A, item 10) and, hence, accumulated other comprehensive income (AOCI) (Schedule RC, item 26.b). Postretirement plan amounts carried in AOCI are adjusted as they are subsequently recognized in earnings as components of a plan's net periodic benefit cost.

For further information on accounting for defined benefit postretirement plans, institutions should refer to ASC Topic 715.

Impact on Regulatory Capital – An institution that has made the AOCI opt-out election in Schedule RC-R, Part I, item 3.a, should reverse the effects on AOCI of ASC Topic 715 for purposes of reporting and measuring the numerators and denominators for the leverage and risk-based capital ratios. The intent of the reversal is to neutralize for regulatory capital purposes the effects on AOCI of the application of ASC Topic 715. The instructions for Schedule RC-R, Part I, items 9.d and 26, and Schedule RC-R, Part II, item 8, provide guidance on how to report adjustments to Tier 1 capital and risk-weighted and total assets to reverse the effects of applying ASC Topic 715 for regulatory capital purposes.

Demand Deposits: See "Deposits."

Depository Institutions in the U.S.: Depository institutions in the U.S. consist of:

- (1) U.S. branches and agencies of foreign banks;
- (2) U.S.-domiciled head offices and branches of U.S. banks, i.e.,
 - (a) national banks,
 - (b) state-chartered commercial banks,
 - (c) trust companies that perform a commercial banking business,
 - (d) industrial banks,
 - (e) private or unincorporated banks,
 - (f) Edge and Agreement corporations, and
 - (g) International Banking Facilities (IBFs) of U.S. banks; and
- (3) U.S.-domiciled head offices and branches of other depository institutions in the U.S., i.e.,
 - (a) mutual or stock savings banks,
 - (b) savings or building and loan associations,
 - (c) cooperative banks,
 - (d) credit unions,
 - (e) homestead associations,
 - (f) other similar depository institutions in the U.S., and
 - (g) International Banking Facilities (IBFs) of other depository institutions in the U.S.

Deposits: The basic statutory and regulatory definitions of "deposits" are contained in [Section 3\(ℓ\) of the Federal Deposit Insurance Act](#) (FDI Act) and in [Federal Reserve Regulation D](#). The definitions in these two legal sources differ in certain respects. Furthermore, for purposes of these reports, the reporting standards for deposits specified in these instructions do not strictly follow the precise legal definitions in these two sources. The definitions of deposits to be reported in the deposit items of the Consolidated Reports of Condition and Income are discussed below under the following headings:

- (I) FDI Act definition of deposits.
- (II) Transaction-nontransaction deposit distinction.
- (III) Interest-bearing-noninterest-bearing deposit distinction.

Deposits (cont.):

- (l) FDI Act definition of deposits – [Section 3\(l\)](#) states that the term “deposit” means –
- (1) the unpaid balance of money or its equivalent received or held by a bank or savings association in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank or savings association, or a letter of credit or a traveler's check on which the bank or savings association is primarily liable: Provided, That, without limiting the generality of the term "money or its equivalent", any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable, or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such bank or savings association for collection,
 - (2) trust funds as defined in this Act received or held by such bank or savings association, whether held in the trust department or held or deposited in any other department of such bank or savings association,
 - (3) money received or held by a bank or savings association, or the credit given for money or its equivalent received or held by a bank or savings association, in the usual course of business for a special or specific purpose, regardless of the legal relationship thereby established, including without being limited to, escrow funds, funds held as security for an obligation due to the bank or savings association or others (including funds held as dealers reserves) or for securities loaned by the bank or savings association, funds deposited by a debtor to meet maturing obligations, funds deposited as advance payment on subscriptions to United States Government securities, funds held for distribution or purchase of securities, funds held to meet its acceptances or letters of credit, and withheld taxes: Provided, That there shall not be included funds which are received by the bank or savings association for immediate application to the reduction of an indebtedness to the receiving bank or savings association, or under condition that the receipt thereof immediately reduces or extinguishes such an indebtedness,
 - (4) outstanding draft (including advice or authorization to charge a bank's or a savings association's balance in another bank or savings association), cashier's check, money order, or other officer's check issued in the usual course of business for any purpose, including without being limited to those issued in payment for services, dividends, or purchases, and
 - (5) such other obligations of a bank or savings association as the Board of Directors [of the Federal Deposit Insurance Corporation], after consultation with the Comptroller of the Currency and the Board of Governors of the Federal Reserve System, shall find and prescribe by regulation to be deposit liabilities by general usage, except that the following shall not be a deposit for any of the purposes of this Act or be included as part of the total deposits or of an insured deposit:
 - (A) any obligation of a depository institution which is carried on the books and records of an office of such bank or savings association located outside of any State, unless –
 - (i) such obligation would be a deposit if it were carried on the books and records of the depository institution, and would be payable at, an office located in any State; and
 - (ii) the contract evidencing the obligation provides by express terms, and not by implication, for payment at an office of the depository institution located in any State; and

Deposits (cont.):

- (B) any international banking facility deposit, including an international banking facility time deposit, as such term is from time to time defined by the Board of Governors of the Federal Reserve System in [regulation D](#) or any successor regulation issued by the Board of Governors of the Federal Reserve System; and
 - (C) any liability of an insured depository institution that arises under an annuity contract, the income of which is tax deferred under [section 72 of title 26](#) [the Internal Revenue Code].
- (II) Transaction-nontransaction deposit distinction – The Monetary Control Act of 1980 and the current [Federal Reserve Regulation D, "Reserve Requirements of Depository Institutions,"](#) establish, for purposes of federal reserve requirements on deposit liabilities, a category of deposits designated as "transaction accounts." All deposits that are not transaction accounts are "nontransaction accounts."
- (1) Transaction accounts – With the exceptions noted below, a "transaction account," as defined in [Regulation D](#) and in these instructions, is a deposit or account from which the depositor or account holder is permitted to make transfers or withdrawals by negotiable or transferable instruments, payment orders of withdrawal, telephone transfers, or other similar devices for the purpose of making payments or transfers to third persons or others or from which the depositor may make third party payments at an automated teller machine (ATM), a remote service unit (RSU), or another electronic device, including by debit card.

Excluded from transaction accounts are savings deposits (both money market deposit accounts (MMDAs) and other savings deposits) as defined below in the nontransaction account category, even though such deposits permit some third-party transfers. However, an account that otherwise meets the definition of a savings deposit but that authorizes or permits the depositor to exceed the transfer limitations specified for that account shall be reported as a transaction account. (Please refer to the definition of savings deposits for further detail.)

NOTE: Under the Federal Reserve's current [Regulation D](#), no transaction account, regardless of its other characteristics, is classified either as a savings deposit or as a time deposit. Thus, those transaction accounts that are not demand deposits – NOW accounts, ATS (Automatic Transfer Service) accounts, and telephone and preauthorized transfer accounts – are excluded from [Regulation D](#) time and savings deposits. For all items in the Consolidated Reports of Condition and Income involving time or savings deposits, a strict distinction, based on [Regulation D](#) definitions, is to be maintained between transaction accounts and time and savings accounts.

Transaction accounts consist of the following types of deposits: (a) demand deposits; (b) NOW accounts; (c) ATS accounts; and (d) telephone and preauthorized transfer accounts, all as defined below. Interest that is paid by the crediting of transaction accounts is also included in transaction accounts.

- (a) Demand deposits are deposits that are payable immediately on demand, or that are issued with an original maturity or required notice period of less than seven days, or that represent funds for which the depository institution does not reserve the right to require at least seven days' written notice of an intended withdrawal. Demand deposits include any matured time deposits without automatic renewal provisions, unless the deposit agreement provides for the funds to be transferred at maturity to another type of account. Effective July 21, 2011, demand deposits may be interest-bearing or noninterest-bearing. Demand deposits do not include: (i) money market deposit accounts (MMDAs) or (ii) NOW accounts, as defined below in this entry.
- (b) NOW accounts are interest-bearing deposits (i) on which the depository institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account and (ii) that can be withdrawn or transferred to third parties by issuance of a negotiable or transferable instrument.

Deposits (cont.):

NOW accounts, as authorized by federal law, are limited to accounts held by:

- (i) Individuals or sole proprietorships;
- (ii) Organizations that are operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and that are not operated for profit. These include organizations, partnerships, corporations, or associations that are not organized for profit and are described in [section 501\(c\)\(3\) through \(13\) and \(19\)](#) and [section 528 of the Internal Revenue Code](#), such as church organizations; professional associations; trade associations; labor unions; fraternities, sororities and similar social organizations; and nonprofit recreational clubs; or
- (iii) Governmental units including the federal government and its agencies and instrumentalities; state governments; county and municipal governments and their political subdivisions; the District of Columbia; the Commonwealth of Puerto Rico, American Samoa, Guam, and any territory or possession of the United States and their political subdivisions.

Also included are the balances of all NOW accounts of certain other nonprofit organizations that may not fall within the above description but that had established NOW accounts with the reporting institution prior to September 1, 1981.

NOTE: There are no regulatory requirements with respect to minimum balances to be maintained in a NOW account or to the amount of interest that may be paid on a NOW account.

- (c) ATS accounts are deposits or accounts of individuals or sole proprietorships on which the depository institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account and from which, pursuant to written agreement arranged in advance between the reporting institution and the depositor, withdrawals may be made automatically through payment to the depository institution itself or through transfer of credit to a demand deposit or other account in order to cover checks or drafts drawn upon the institution or to maintain a specified balance in, or to make periodic transfers to, such other accounts.

Some institutions may have entered into agreements with their customers providing that in the event the customer should overdraw a demand deposit (checking) or NOW account, the institution will transfer from that customer's savings account an amount sufficient to cover the overdraft. The availability of the overdraft protection plan would not in and of itself require that such a savings account be regarded as a transaction account provided that the overall transfer and withdrawal restrictions of a savings deposit are not exceeded. Please refer to the definition of savings deposit for further detail.

- (d) Telephone or preauthorized transfer accounts consist of deposits or accounts, other than savings deposits, (1) in which the entire beneficial interest is held by a party eligible to hold a NOW account, (2) on which the reporting institution has reserved the right to require at least seven days' written notice prior to withdrawal or transfer of any funds in the account, and (3) under the terms of which, or by practice of the reporting institution, the depositor is permitted or authorized to make more than six withdrawals per month or

Deposits (cont.):

statement cycle (or similar period) of at least four weeks for purposes of transferring funds to another account of the depositor at the same institution (including a transaction account) or for making payment to a third party by means of preauthorized transfer, or telephonic (including data transmission) agreement, order or instruction. An account that permits or authorizes more than six such withdrawals in a "month" (a calendar month or any period approximating a month that is at least four weeks long, such as a statement cycle) is a transaction account whether or not more than six such withdrawals actually are made in the "month."

A "preauthorized transfer" includes any arrangement by the reporting institution to pay a third party from the account of a depositor (1) upon written or oral instruction (including an order received through an automated clearing house (ACH)), or (2) at a predetermined time or on a fixed schedule.

Telephone and preauthorized transfer accounts also include:

- (i) Deposits or accounts maintained in connection with an arrangement that permits the depositor to obtain credit directly or indirectly through the drawing of a negotiable or nonnegotiable check, draft, order or instruction or other similar device (including telephone or electronic order or instruction) on the issuing institution that can be used for the purpose of making payments or transfers to third parties or others, or to another deposit account of the depositor.
- (ii) The balance of deposits or accounts that otherwise meet the definition of time deposits, but from which payments may be made to third parties by means of a debit card, an automated teller machine, remote service unit or other electronic device, regardless of the number of payments made.

However, an account is not a transaction account merely by virtue of arrangements that permit the following types of transfers or withdrawals, regardless of the number:

- (i) Transfers for the purpose of repaying loans and associated expenses at the same depository institution (as originator or servicer).
 - (ii) Transfers of funds from this account to another account of the same depositor at the same depository institution when made by mail, messenger, automated teller machine, or in person.
 - (iii) Withdrawals for payment directly to the depositor when made by mail, messenger, automated teller machine, in person, or by telephone (via check mailed to the depositor).
- (2) Nontransaction accounts – All deposits that are not transaction accounts (as defined above) are nontransaction accounts. Nontransaction accounts include: (a) savings deposits ((i) money market deposit accounts (MMDAs) and (ii) other savings deposits) and (b) time deposits ((i) time certificates of deposit and (ii) time deposits, open account). [Regulation D](#) no longer distinguishes between money market deposit accounts (MMDAs) and other savings deposits. However, these two types of accounts are defined below for purposes of these reports, which call for separate data on each in Schedule RC-E, (Part I,) Memorandum items 2.a.(1) and (2).

NOTE: Under the [Federal Reserve's current Regulation D](#), no transaction accounts, regardless of other characteristics, are defined as savings or time deposits. Thus, savings deposits as defined here, under the heading nontransaction accounts, constitute the entire savings deposit category. Likewise, time deposits, also defined here under nontransaction accounts, constitute the entire time deposits category.

Deposits (cont.):

- (a) Savings deposits are deposits with respect to which the depositor is not required by the deposit contract but may at any time be required by the depository institution to give written notice of an intended withdrawal not less than seven days before withdrawal is made, and that is not payable on a specified date or at the expiration of a specified time after the date of deposit.

The term savings deposit also means a deposit or account, such as an account commonly known as a passbook savings account, a statement savings account, or a money market deposit account (MMDA), that otherwise meets the requirements of the preceding paragraph and from which, under the terms of the deposit contract or by practice of the depository institution, the depositor is permitted or authorized to make no more than six transfers and withdrawals, or a combination of such transfers and withdrawals, per calendar month or statement cycle (or similar period) of at least four weeks, to another account (including a transaction account) of the depositor at the same institution or to a third party by means of a preauthorized or automatic transfer, or telephonic (including data transmission) agreement, order, or instruction; or by check, draft, debit card, or similar order made by the depositor and payable to third parties. Transfers from savings deposits for purposes of covering overdrafts (overdraft protection plans) are included under the withdrawal limits specified for savings deposits.

There are no regulatory restrictions on the following types of transfers or withdrawals from a savings deposit account, regardless of the number:

- (1) Transfers for the purpose of repaying loans and associated expenses at the same depository institution (as originator or servicer).
- (2) Transfers of funds from this account to another account of the same depositor at the same institution when made by mail, messenger, automated teller machine, or in person.
- (3) Withdrawals for payment directly to the depositor when made by mail, messenger, automated teller machine, in person, or by telephone (via check mailed to the depositor).

Further, for a savings deposit account, no minimum balance is required by regulation, there is no regulatory limitation on the amount of interest that may be paid, and no minimum maturity is required (although depository institutions must reserve the right to require at least seven days' written notice prior to withdrawal as stipulated above for a savings deposit).

Any depository institution may place restrictions and requirements on savings deposits in addition to those stipulated above. In the case of such further restrictions, the account would still be reported as a savings deposit.

On the other hand, an account that otherwise meets the definition of a savings deposit but that authorizes or permits the depositor to exceed the six-transfer/withdrawal rule shall be reported as a transaction account, as follows:

- (1) If the depositor is ineligible to hold a NOW account, such an account is considered a demand deposit.
- (2) If the depositor is eligible to hold a NOW account, the account will be considered either a NOW account, a telephone or preauthorized transfer account, or an ATS account:
 - (a) If withdrawals or transfers by check, draft, or similar instrument are permitted or authorized, the account is considered a NOW account.

Deposits (cont.):

- (b) If withdrawals or transfers by check, draft, or similar instrument are not permitted or authorized, the account is considered either an ATS account or a telephone or preauthorized transfer account.

[Regulation D](#) no longer distinguishes between money market deposit accounts (MMDAs) and other savings deposits. However, these two types of accounts are defined as follows for purposes of these reports, which call for separate data on each.

- (1) Money market deposit accounts (MMDAs) are deposits or accounts that meet the above definition of a savings deposit and that permit up to (but no more than) six allowable transfers to be made by check, draft, debit card or similar order made by the depositor and payable to third parties.
- (2) Other savings deposits are deposits or accounts that meet the above definition of a savings deposit but that permit no transfers by check, draft, debit card, or similar order made by the depositor and payable to third parties. Other savings deposits are commonly known as passbook savings or statement savings accounts.

Examples illustrating distinctions between MMDAs and other savings deposits for purposes of these reports are provided at the end of this Glossary entry.

- (b) Time deposits are deposits that the depositor does not have a right, and is not permitted, to make withdrawals from within six days after the date of deposit unless the deposit is subject to an early withdrawal penalty of at least seven days' simple interest on amounts withdrawn within the first six days after deposit. A time deposit from which partial early withdrawals are permitted must impose additional early withdrawal penalties of at least seven days' simple interest on amounts withdrawn within six days after each partial withdrawal. If such additional early withdrawal penalties are not imposed, the account ceases to be a time deposit. The account may become a savings deposit if it meets the requirements for a savings deposit; otherwise it becomes a demand deposit.

NOTE: The above prescribed penalties are the minimum required by [Federal Reserve Regulation D](#). Institutions may choose to require penalties for early withdrawal in excess of the regulatory minimums.

Time deposits take two forms:

- (i) Time certificates of deposit (including rollover certificates of deposit) are deposits evidenced by a negotiable or nonnegotiable instrument, or a deposit in book entry form evidenced by a receipt or similar acknowledgement issued by the bank, that provides, on its face, that the amount of such deposit is payable to the bearer, to any specified person, or to the order of a specified person, as follows:
 - (1) on a certain date not less than seven days after the date of deposit,
 - (2) at the expiration of a specified period not less than seven days after the date of the deposit, or
 - (3) upon written notice to the bank which is to be given not less than seven days before the date of withdrawal.

Deposits (cont.):

- (ii) Time deposits, open account are deposits (other than time certificates of deposit) for which there is in force a written contract with the depositor that neither the whole nor any part of such deposit may be withdrawn prior to:
- (1) the date of maturity which shall be not less than seven days after the date of the deposit, or
 - (2) the expiration of a specified period of written notice of not less than seven days.

These deposits include those club accounts, such as Christmas club and vacation club accounts, that are made under written contracts that provide that no withdrawal shall be made until a certain number of periodic deposits has been made during a period of not less than three months, even though some of the deposits are made within six days of the end of such period.

Time deposits do not include the following categories of liabilities even if they have an original maturity of seven days or more:

- (1) Any deposit or account that otherwise meets the definition of a time deposit but that allows withdrawals within the first six days after deposit and that does not require an early withdrawal penalty of at least seven days' simple interest on amounts withdrawn within those first six days. Such deposits or accounts that meet the definition of a savings deposit shall be reported as savings deposits; otherwise they shall be reported as demand deposits.
- (2) The remaining balance of a time deposit if a partial early withdrawal is made and the remaining balance is not subject to additional early withdrawal penalties of at least seven days' simple interest on amounts withdrawn within six days after each partial withdrawal. Such time deposits that meet the definition of a savings deposit shall be reported as savings deposits; otherwise they shall be reported as demand deposits.

Reporting of Retail Sweep Arrangements Affecting Transaction and Nontransaction Accounts – In an effort to reduce their reserve requirements, some banks have established “retail sweep arrangements” or “retail sweep programs.” In a retail sweep arrangement, a depository institution transfers funds between a customer’s transaction account(s) and that customer’s nontransaction account(s) (usually savings deposit account(s)) by means of preauthorized or automatic transfers, typically in order to reduce transaction account reserve requirements while providing the customer with unlimited access to the funds.

There are three key criteria for retail sweep programs to comply with the [Federal Reserve Regulation D](#) definitions of “transaction account” and “savings deposit:”

- (1) A depository institution must establish by agreement with its transaction account customer two legally separate accounts: a transaction account (a NOW account or demand deposit account) and a savings deposit account, including those sometimes called a “money market deposit account” or “MMDA”;
- (2) The swept funds must actually be moved from the customer’s transaction account to the customer’s savings deposit account on the official books and records of the depository institution as of the close of the business on the day(s) on which the depository institution intends to report the funds in question as savings deposits and not transaction accounts, and vice versa. In addition to actually moving the customer’s funds between accounts and reflecting this movement at the account level:

Deposits (cont.):

- (a) If the depository institution's general ledger is sufficiently disaggregated to distinguish between transaction and savings deposit accounts, the aforementioned movement of funds between the customer's transaction account and savings deposit account must be reflected on the general ledger.
- (b) If the depository institution's general ledger is not sufficiently disaggregated, the distinction may be reflected in supplemental records or systems, but only if such supplemental records or systems constitute official books and records of the institution and are subject to the same prudent managerial oversight and controls as the general ledger.

A retail sweep program may not exist solely in records or on systems that do not constitute official books and records of the depository institution and that are not used for any purpose other than generating its [Report of Transaction Accounts, Other Deposits and Vault Cash \(FR 2900\)](#) for submission to the Federal Reserve; and

- (3) The maximum number of preauthorized or automatic funds transfers ("sweeps") out of a savings deposit account and into a transaction account in a retail sweep program is limited to not more than six per month. Transfers out of the transaction account and into the savings deposit account may be unlimited in number.

If any of the three criteria is not met, all swept funds must continue to be reported as transaction accounts, both for purposes of these reports and of [FR 2900](#) deposit reports. All three criteria must be met in order to report the nontransaction account component of a retail sweep program as a nonreservable savings deposit account.

Further, for purposes of the Consolidated Reports of Condition and Income, if all three of the criteria above are met, a bank must report the transaction account and nontransaction account components of a retail sweep program separately when it reports its quarter-end deposit information in Schedules RC, RC-E, and RC-O; its quarterly averages in Schedule RC-K; and its interest expense (if any) in Schedule RI. Thus, when reporting quarterly averages in Schedule RC-K, a bank should include the amounts held in the transaction account (if interest-bearing) and the nontransaction savings account components of retail sweep arrangements each day or each week in the appropriate separate items for average deposits. In addition, if the bank pays interest on accounts involved in retail sweep arrangements, the interest expense reported in Schedule RI should be allocated between the transaction account and the nontransaction (savings) account based on the balances in these accounts during the reporting period.

For additional information, refer to the Federal Reserve Board staff guidance relating to the requirements for a retail sweep program under [Regulation D](#) at <http://www.federalreserve.gov/boarddocs/legalint/FederalReserveAct/2007/20070501/20070501.pdf>.

(III) Interest-bearing-noninterest-bearing deposit distinction –

- (a) Interest-bearing deposit accounts consist of deposit accounts on which the issuing depository institution makes any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit. Such compensation may be in the form of cash, merchandise, or property or as a credit to an account. An institution's absorption of expenses incident to providing a normal banking function or its forbearance from charging a fee in connection with such a service is not considered a payment of interest.

Deposits (cont.):

Deposits with a zero percent interest rate that are issued on a discount basis are to be treated as interest-bearing. Deposit accounts on which the interest rate is periodically adjusted in response to changes in market interest rates and other factors should be reported as interest-bearing even if the rate has been reduced to zero, provided the interest rate on these accounts can be increased as market conditions change.

- (b) Noninterest-bearing deposit accounts consist of deposit accounts on which the issuing depository institution makes no payment to or for the account of any depositor as compensation for the use of funds constituting a deposit. An institution's absorption of expenses incident to providing a normal banking function or its forbearance from charging a fee in connection with such a service is not considered a payment of interest.

Noninterest-bearing deposit accounts include (i) matured time deposits that are not automatically renewable (unless the deposit agreement provides for the funds to be transferred at maturity to another type of account) and (ii) deposits with a zero percent stated interest rate that are issued at face value.

See also "Brokered Deposits" and "Hypothecated Deposits."

Examples Illustrating Distinctions Between
MONEY MARKET DEPOSIT ACCOUNTS (MMDAs) and OTHER SAVINGS DEPOSITS

Example 1

A savings deposit account permits no transfers of any type to other accounts or to third parties. Report this account as an other savings deposit.

Example 2

A savings deposit permits up to six, but no more than six, "preauthorized, automatic, or telephonic" transfers to other accounts or to third parties. None of the third-party payments may be made by check, draft, or similar order (including debit card).

Report this account as an other savings deposit.

Example 3

A savings deposit permits no more than six "preauthorized, automatic, or telephonic" transfers to other accounts or to third parties, any or all which may be by check, draft, debit card or similar order made by the depositor and payable to third parties.

Report this account as an MMDA.

Derivative Contracts: Banks commonly use derivative instruments for managing (positioning or hedging) their exposure to market risk (including interest rate risk and foreign exchange risk), cash flow risk, and other risks in their operations and for trading. The accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities are set forth in ASC Topic 815, Derivatives and Hedging, which banks must follow for purposes of these reports. ASC Topic 815 requires all derivatives to be recognized on the balance sheet as either assets or liabilities at their fair value. A summary of the principal provisions of ASC Topic 815 follows. For further information, see ASC Topic 815, which includes the implementation guidance issued by the FASB's Derivatives Implementation Group.

Definition of Derivative

ASC Topic 815 defines a "derivative instrument" as a financial instrument or other contract with all three of the following characteristics:

- (1) It has one or more underlyings (i.e., specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable) and one or more notional amounts (i.e., number of currency units, shares, bushels, pounds, or other units specified in the contract) or payment provisions or both. These terms determine the amount of the settlement or settlements, and in some cases, whether or not a settlement is required.
- (2) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have similar response to changes in market factors.
- (3) Its terms require or permit net settlement, it can be readily settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Certain contracts that may meet the definition of a derivative are specifically excluded from the scope of ASC Topic 815, including:

- "Regular-way" securities trades, which are trades that are completed within the time period generally established by regulations and conventions in the marketplace or by the exchange on which the trade is executed;
- Normal purchases and sales of an item other than a financial instrument or derivative instrument (e.g., a commodity) that will be delivered in quantities expected to be used or sold by the reporting entity over a reasonable period in the normal course of business;
- Traditional life insurance and property and casualty contracts; and
- Certain financial guarantee contracts.

ASC Topic 815 has special criteria for determining whether commitments to originate loans meet the definition of a derivative. Commitments to originate mortgage loans that will be held for sale are accounted for as derivatives. Commitments to originate mortgage loans that will be held for investment are not accounted for as derivatives. Also, all commitments to originate loans other than mortgage loans are not accounted for as derivatives. Commitments to purchase loans must be evaluated to determine whether the commitment meets the definition of a derivative under ASC Topic 815.

Types of Derivatives

The most common types of freestanding derivatives are forwards, futures, swaps, options, caps, floors, and collars.

Forward contracts are agreements that obligate two parties to purchase (long) and sell (short) a specific financial instrument, foreign currency, or commodity at a specified price with delivery and settlement at a specified future date.

Derivative Contracts (cont.):

Futures contracts are standardized forward contracts that are traded on organized exchanges. Exchanges in the U.S. are registered with and regulated by the Commodity Futures Trading Commission. The deliverable financial instruments underlying interest-rate future contracts are specified investment-grade financial instruments, such as U.S. Treasury securities or mortgage-backed securities. Foreign currency futures contracts involve specified deliverable amounts of a particular foreign currency. The deliverable products under commodity futures contracts are specified amounts and grades of commodities such as gold bullion. Equity futures contracts are derivatives that have a portion of their return linked to the price of a particular equity or to an index of equity prices, such as the Standard and Poor's 500.

Other forward contracts are traded over the counter and their terms are not standardized. Such contracts can only be terminated, other than by receipt of the underlying asset, by agreement of both buyer and seller. A forward rate agreement is a forward contract that specifies a reference interest rate and an agreed on interest rate (one to be paid and one to be received), an assumed principal amount (the notional amount), and a specific maturity and settlement date.

Swap contracts are forward-based contracts in which two parties agree to swap streams of payments over a specified period. The payments are based on an agreed upon notional principal amount. An interest rate swap generally involves no exchange of principal at inception or maturity. Rather, the notional amount is used to calculate the payment streams to be exchanged. However, foreign exchange swaps often involve the exchange of principal.]

Option contracts (standby contracts) are traded on exchanges and over the counter. Option contracts grant the right, but do not obligate, the purchaser (holder) to buy (call) or sell (put) a specific or standard commodity, financial, or equity instrument at a specified price during a specified period or at a specified date. A purchased option is a contract in which the buyer has paid compensation (such as a fee or premium) to acquire the right to sell or purchase an instrument at a stated price on a specified future date. A written option obligates the option seller to purchase or sell the instrument at the option of the buyer of the contract. Option contracts may relate to purchases or sales of securities, money market instruments, futures contracts, other financial instruments, or commodities.

Interest rate caps are option contracts in which the cap seller, in return for a premium, agrees to limit the cap holder's risk associated with an increase in interest rates. If rates go above a specified interest-rate level (the strike price or cap rate), the cap holder is entitled to receive cash payments equal to the excess of the market rate over the strike price multiplied by the notional principal amount. For example, an issuer of floating-rate debt may purchase a cap to protect against rising interest rates, while retaining the ability to benefit from a decline in rates.

Interest rate floors are option contracts in which the floor seller, in return for a premium, agrees to limit the risk associated with a decline in interest rates based on a notional amount. If rates fall below an agreed rate, the floor holder will receive cash payments from the floor writer equal to the difference between the market rate and an agreed rate, multiplied by the notional principal amount.

Interest rate collars are option contracts that combine a cap and a floor (one held and one written). Interest rate collars enable a user with a floating rate contract to lock into a predetermined interest-rate range often at a lower cost than a cap or a floor.

Embedded Derivatives

Contracts that do not in their entirety meet the definition of a derivative instrument, such as bonds, insurance policies, and leases, may contain "embedded" derivative instruments. Embedded derivatives are implicit or explicit terms within a contract that affect some or all of the cash flows or

Derivative Contracts (cont.):

the value of other exchanges required by the contract in a manner similar to a derivative instrument. The effect of embedding a derivative instrument in another type of contract (“the host contract”) is that some or all of the cash flows or other exchanges that otherwise would be required by the host contract, whether unconditional or contingent upon the occurrence of a specified event, will be modified based on one or more of the underlyings.

An embedded derivative instrument shall be separated from the host contract and accounted for as a derivative instrument, i.e., bifurcated, if and only if all three of the following conditions are met:

- (1) The economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract,
- (2) The contract (“the hybrid instrument”) that embodies the embedded derivative and the host contract is not remeasured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur, and
- (3) A separate instrument with the same terms as the embedded derivative instrument would be a considered a derivative.

An embedded derivative instrument in which the underlying is an interest rate or interest rate index that alters net interest payments that otherwise would be paid or received on an interest-bearing host contract is considered to be clearly and closely related to the host contract unless either of the following conditions exist:

- (1) The hybrid instrument can contractually be settled in such a way that the investor (holder) would not recover substantially all of its initial recorded investment,
or
- (2) The embedded derivative could at least double the investor’s initial rate of return on the host contract and could also result in a rate of return that is at least twice what otherwise would be the market return for a contract that has the same terms as the host contract and that involves a debtor with a similar credit quality.

Examples of hybrid instruments (not held for trading purposes) with embedded derivatives which meet the three conditions listed above and must be accounted for separately include debt instruments (including deposit liabilities) whose return or yield is indexed to: changes in an equity securities index (e.g., the Standard & Poor’s 500); changes in the price of a specific equity security; or changes in the price of gold, crude oil, or some other commodity. For purposes of these reports, when an embedded derivative must be accounted for separately from the host contract under ASC Topic 815, the carrying value of the host contract and the fair value of the embedded derivative may be combined and presented together on the balance sheet in the asset or liability category appropriate to the host contract.

Under ASC Subtopic 815-15, Derivatives and Hedging – Embedded Derivatives, a bank with a hybrid instrument for which bifurcation would otherwise be required is permitted to irrevocably elect to initially and subsequently measure the hybrid instrument in its entirety at fair value with changes in fair value recognized in earnings. In addition, ASC Subtopic 815-15 subjects all but the simplest forms of interest-only and principal-only strips and all forms of beneficial interests in securitized financial assets to the requirements of ASC Topic 815. Thus, a bank must evaluate such instruments to identify those that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. However, a beneficial interest that contains a concentration of credit risk in the form of subordination to another financial instrument and certain securitized interests in prepayable financial assets are not considered to contain embedded derivatives that must be accounted for separately from the host contract. For further information, see ASC Subtopic 815-15.

Derivative Contracts (cont.):

Except in limited circumstances, interest-only and principal-only strips and beneficial interests in securitized assets that were recognized prior to the effective date (or early adoption date) of ASC Subtopic 815-15 are not subject to evaluation for embedded derivatives under ASC Topic 815.

Recognition of Derivatives and Measurement of Derivatives and Hedged Items

A bank should recognize all of its derivative instruments on its balance sheet as either assets or liabilities at fair value. As defined in ASC Topic 820, Fair Value Measurement, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. For further information, see the Glossary entry for "Fair Value."

The accounting for changes in the fair value (that is, gains and losses) of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, on the reason for holding it. Either all or a proportion of a derivative may be designated as a hedging instrument. The proportion must be expressed as a percentage of the entire derivative. Gains and losses on derivative instruments are accounted for as follows:

- (1) No hedging designation – The gain or loss on a derivative instrument not designated as a hedging instrument, including all derivatives held for trading purposes, is recognized currently in earnings.
- (2) Fair value hedge – For a derivative designated as hedging the exposure to changes in the fair value of a recognized asset or liability or a firm commitment, which is referred to as a fair value hedge, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the risk being hedged should be recognized currently in earnings.
- (3) Cash flow hedge – For a derivative designated as hedging the exposure to variable cash flows of an existing recognized asset or liability or a forecasted transaction, which is referred to as a cash flow hedge, the effective portion of the gain or loss on the derivative should initially be reported outside of earnings as a component of other comprehensive income and subsequently reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument, if any, (i.e., the ineffective portion of the gain or loss and any component of the gain or loss excluded from the assessment of hedge effectiveness) should be recognized currently in earnings.
- (4) Foreign currency hedge – For a derivative designated as hedging the foreign currency exposure of a net investment in a foreign operation, the gain or loss is reported outside of earnings in other comprehensive income as part of the cumulative translation adjustment. For a derivative designated as a hedge of the foreign currency exposure of an unrecognized firm commitment or an available-for-sale security, the accounting for a fair value hedge should be applied. Similarly, for a derivative designated as a hedge of the foreign currency exposure of a foreign-currency denominated forecasted transaction, the accounting for a cash flow hedge should be applied.

To qualify for hedge accounting, the risk being hedged must represent an exposure to an institution's earnings. In general, if the hedged item is a financial asset or liability, the designated risk being hedged can be (1) all risks, i.e., the risk of changes in the overall fair value of the hedged item or the risk of overall changes in the hedged cash flows; (2) the risk of changes in the fair value or cash flows

Derivative Contracts (cont.):

of the hedged item attributable to changes in the benchmark interest rate;¹ (3) the risk of changes in the fair value or cash flows of the hedged item attributable to changes in foreign exchange rates; or (4) the risk of changes in the fair value or cash flows of the hedged item attributable to changes in the obligor's creditworthiness. For held-to-maturity securities, only credit risk, foreign exchange risk, or both may be hedged.

Designated hedging instruments and hedged items qualify for fair value or cash flow hedge accounting if all of the criteria specified in ASC Topic 815 are met. These criteria include:

- (1) At inception of the hedge, there is formal documentation of the hedging relationship and the institution's risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged, and how the hedging instrument's effectiveness will be assessed. There must be a reasonable basis for how the institution plans to assess the hedging instrument's effectiveness.
- (2) Both at inception of the hedge and on an ongoing basis, the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value or offsetting cash flows attributable to the hedged risk during the period that the hedge is designated or the term of the hedge. An assessment of effectiveness is required whenever financial statements or earnings are reported, and at least every three months. All assessments of effectiveness shall be consistent with the risk management strategy documented for that particular hedging relationship.

In a fair value hedge, an asset or a liability is eligible for designation as a hedged item if the hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment, the hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof), and certain other criteria specified in ASC Topic 815 are met. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk.

¹ The benchmark interest rate is a widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market. In theory, this should be a risk-free rate. In the U.S., interest rates on U.S. Treasury securities and the LIBOR swap rate are considered benchmark interest rates.

Derivative Contracts (cont.):

In a cash flow hedge, the individual cash flows related to a recognized asset or liability and the cash flows related to a forecasted transaction are both referred to as a forecasted transaction. Thus, a forecasted transaction is eligible for designation as a hedged transaction if the forecasted transaction is specifically identified as a single transaction or a group of individual transactions, the occurrence of the forecasted transaction is probable, and certain other criteria specified in ASC Topic 815 are met. If the hedged transaction is a group of individual transactions, those individual transactions must share the same risk exposure for which they are designated as being hedged.

An institution should discontinue prospectively its use of fair value or cash flow hedge accounting for an existing hedge if any of the qualifying criteria for hedge accounting is no longer met; the derivative expires or is sold, terminated, or exercised; or the institution removes the designation of the hedge. When this occurs for a cash flow hedge, the net gain or loss on the derivative should remain in "Accumulated other comprehensive income" and be reclassified into earnings in the periods during which the hedged forecasted transaction affects earnings. However, if it is probable that the forecasted transaction will not occur by the end of the originally specified time period (as documented at the inception of the hedging relationship) or within an additional two-month period of time thereafter (except as noted in ASC Topic 815), the derivative gain or loss reported in "Accumulated other comprehensive income" should be reclassified into earnings immediately.

For a fair value hedge, in general, if a periodic assessment of hedge effectiveness indicates noncompliance with the highly effective criterion that must be met in order to qualify for hedge accounting, an institution should not recognize adjustment of the carrying amount of the hedged item for the change in the item's fair value attributable to the hedged risk after the last date on which compliance with the effectiveness criterion was established.

With certain limited exceptions, a nonderivative instrument, such as a U.S. Treasury security, may not be designated as a hedging instrument.

Reporting Derivative Contracts in the Call Report

When an institution enters into a derivative contract, it should classify the derivative as either held for trading or held for purposes other than trading (end-user derivatives) based on the reasons for entering into the contract. All derivatives must be reported at fair value on the balance sheet (Schedule RC).

Trading derivatives with positive fair values should be reported as trading assets in Schedule RC, item 5. Trading derivatives with negative fair values should be reported as trading liabilities in Schedule RC, item 15. Changes in the fair value (that is, gains and losses) of trading derivatives should be recognized currently in earnings and included in Schedule RI, item 5.c, "Trading revenue."

Freestanding derivatives held for purposes other than trading (and embedded derivatives that are accounted for separately under ASC Topic 815, which the bank has chosen to present separately from the host contract on the balance sheet) that have positive fair values should be included in Schedule RC-F, item 6, "All other assets." If the total fair value of these derivatives is greater than \$100,000 and exceeds 25 percent of "All other assets," this amount should be disclosed in Schedule RC-F, item 6.c. Freestanding derivatives held for purposes other than trading (and embedded derivatives that are accounted for separately under ASC Topic 815, which the bank has chosen to present separately from the host contract on the balance sheet) that have negative fair values should be included in Schedule RC-G, item 4, "All other liabilities." If the total fair value of these derivatives is greater than \$100,000 and exceeds 25 percent of "All other liabilities," this amount should be disclosed in Schedule RC-G, item 4.d. Net gains (losses) on derivatives held for purposes other than trading that are not designated as hedging instruments in hedging relationships that qualify for hedge accounting in accordance with ASC Topic 815 should be recognized currently in earnings and reported consistently as either "Other noninterest income" or "Other noninterest expense" in Schedule RI, item 5.l or item 7.d, respectively.

Derivative Contracts (cont.):

Netting of derivative assets and liabilities is prohibited on the balance sheet except as permitted under ASC Subtopic 210-20, Balance Sheet – Offsetting. See the Glossary entry for "Offsetting."

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

Discounts: See "Premiums and Discounts."

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

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

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

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

Domestic Office: For purposes of these reports, a domestic office of the reporting bank is a branch or consolidated subsidiary (other than an Edge or Agreement subsidiary) located in the 50 states of the United States or the District of Columbia or a branch on a U.S. military facility wherever located. However, if the reporting bank is chartered and headquartered in Puerto Rico or a U.S. territory or possession, a branch or consolidated subsidiary located in the 50 states of the United States, the District of Columbia, Puerto Rico, or a U.S. territory or possession is a domestic office. The domestic offices of the reporting bank exclude all International Banking Facilities (IBFs); all offices of Edge and Agreement subsidiaries, including their U.S. offices; and all branches and other consolidated subsidiaries of the bank located in foreign countries.

Domicile: Domicile is used to determine the foreign (non-U.S. addressee) or domestic (U.S. addressee) status of a customer of the reporting bank for the purposes of these reports. Domicile is determined by the principal residence address of an individual or the principal business address of a corporation, partnership, or sole proprietorship. If other addresses are used for correspondence or other purposes, only the principal address, insofar as it is known to the reporting bank, should be used in determining whether a customer should be regarded as a U.S. or non-U.S. addressee.

For purposes of defining customers of the reporting bank, U.S. addressees include residents of the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. Non-U.S. addressees includes residents of any foreign country. The term non-U.S. addressee generally includes foreign-based subsidiaries of other U.S. banks.

For customer identification purposes, the IBFs of other U.S. depository institutions are U.S. addressees. (This is in contrast to the treatment of the IBFs of the reporting bank, which are treated as foreign offices of the reporting bank.)

Due Bills: A due bill is an obligation that results when a bank sells an asset and receives payment, but does not deliver the security or other asset. A due bill can also result from a promise to deliver an asset in exchange for value received. In both cases, the receipt of the payment creates an obligation regardless of whether the due bill is issued in written form. Outstanding due bill obligations shall be reported as borrowings in Schedule RC, item 16, "Other borrowed money," by the issuing bank. Conversely, when the reporting bank is the holder of a due bill, the outstanding due bill obligation of the seller shall be reported as a loan to that party.

Edge and Agreement Corporation: An Edge corporation is a federally-chartered corporation organized under [Section 25A of the Federal Reserve Act](#) and subject to [Federal Reserve Regulation K](#). Edge corporations are allowed to engage only in international banking or other financial transactions related to international business.

An Agreement corporation is a state-chartered corporation that has agreed to operate as if it were organized under [Section 25 of the Federal Reserve Act](#) and has agreed to be subject to [Federal Reserve Regulation K](#). Agreement corporations are restricted, in general, to international banking operations. Banks must apply to the Federal Reserve for permission to acquire stock in an Agreement corporation.

A reporting bank's Edge or Agreement subsidiary, i.e., the bank's majority-owned Edge or Agreement corporation, is treated for purposes of these reports as a "foreign" office of the reporting bank.

Equity-Indexed Certificates of Deposit: Under ASC Topic 815, Derivatives and Hedging, a certificate of deposit that pays "interest" based on changes in an equity securities index is a hybrid instrument with an embedded derivative that must be accounted for separately from the host contract, i.e., the certificate of deposit. For further information, see the Glossary entry for "Derivative Contracts." Examples of equity-indexed certificates of deposit include the "Index Powered® CD" and the "Dow Jones Industrials Indexed Certificate of Deposit."

At the maturity date of a typical equity-indexed certificate of deposit, the holder of the certificate of deposit receives the original amount invested in the deposit plus some or all of the appreciation, if any, in an index of stock prices over the term of the certificate of deposit. Thus, the equity-indexed certificate of deposit contains an embedded equity call option. To manage the market risk of its equity-indexed certificates of deposit, a bank that issues these deposits normally enters into one or more separate freestanding equity derivative contracts with an overall term that matches the term of the certificates of deposit. At maturity, these separate derivatives are expected to provide the bank with a cash payment in an amount equal to the amount of appreciation, if any, in the same stock price index that is embedded in the certificates of deposit, thereby providing the bank with the funds to pay the

Equity-Indexed Certificates of Deposit (cont.):

"interest" on the equity-indexed certificates of deposit. During the term of the separate freestanding equity derivative contracts, the bank will periodically make either fixed or variable payments to the counterparty on these contracts.

When a bank issues an equity-indexed certificate of deposit, it must either account for the written equity call option embedded in the deposit separately from the certificate of deposit host contract or irrevocably elect to account for the hybrid instrument (the equity-indexed certificate of deposit) in its entirety at fair value.

- If the bank accounts for the written equity call option separately from the certificate of deposit, the fair value of this embedded derivative on the date the certificate of deposit is issued must be deducted from the amount the purchaser invested in the deposit, creating a discount on the certificate of deposit that must be amortized to interest expense over the term of the deposit using the effective interest method. This interest expense should be reported in the income statement in the appropriate subitem of Schedule RI, item 2.a, "Interest on deposits." The equity call option must be "marked to market" at least quarterly with any changes in the fair value of the option recognized in earnings. On the balance sheet, the carrying value of the certificate of deposit host contract and the fair value of the embedded equity derivative may be combined and reported together as a deposit liability on the balance sheet (Schedule RC) and in the deposit schedule (Schedule RC-E).
- If the bank elects to account for the equity-indexed certificate of deposit in its entirety at fair value, no discount is to be recorded on the certificate of deposit. Rather, the equity-indexed certificate of deposit must be "marked to market" at least quarterly, with changes in the instrument's fair value reported in the income statement consistently in either item 5.I, "Other noninterest income," or item 7.d, "Other noninterest expense", excluding interest expense incurred that is reported in the appropriate subitem of Schedule RI, item 2.a, "Interest on deposits."

As for the separate freestanding derivative contracts the bank enters into to manage its market risk, these derivatives must be carried on the balance sheet as assets or liabilities at fair value and "marked to market" at least quarterly with changes in their fair value recognized in earnings. The fair value of the freestanding derivatives should not be netted against the fair value of the embedded equity derivatives for balance sheet purposes because these two derivatives have different counterparties. The periodic payments to the counterparty on these freestanding derivatives must be accrued with the expense reported in earnings along with the change in the derivative's fair value. In the income statement (Schedule RI), the changes in the fair value of the embedded and freestanding derivatives, including the effect of the accruals for the payments to the counterparty on the freestanding derivatives, should be netted and reported consistently in either item 5.I, "Other noninterest income," or item 7.d, "Other noninterest expense."

Unless the bank that issues the equity-indexed certificate of deposit elects to account for the certificate of deposit in its entirety at fair value, the notional amount of the embedded equity call option must be reported in Schedule RC-L, item 12.d.(1), column C, and item 14, column C, and its fair value (which will always be negative or zero, but not positive) must be reported in Schedule RC-L, item 15.b.(2), column C. The notional amount of the freestanding equity derivative must be reported in the appropriate subitem of Schedule RC-L, item 12, column C (e.g., item 12.e, column C, if it is an equity swap), and in Schedule RC-L, item 14, column C. The fair value of the freestanding equity derivative must be included in the appropriate subitem of Schedule RC-L, item 15.b, column C. The equity derivative embedded in the equity-indexed certificate of deposit is a written option, which is not covered by the agencies' risk-based capital standards. However, the freestanding equity derivative is covered by these standards.

For deposit insurance assessment purposes, if the carrying value of the certificate of deposit host contract and the fair value of the embedded equity derivative are combined and reported together as a deposit liability on the balance sheet, the difference between these combined amounts and the face amount of the certificate of deposit should be treated as an unamortized premium or discount, as

Equity-Indexed Certificates of Deposit (cont.):

appropriate, for purposes of reporting total deposit liabilities in Schedule RC-O, item 1. If these two amounts are not combined and only the carrying value of the certificate of deposit host contract is reported as a deposit liability on the balance sheet, the difference between the carrying value and the face amount of the certificate of deposit should be treated as an unamortized discount in Schedule RC-O, item 1. If the bank elects to account for the equity-indexed certificate of deposit in its entirety at fair value, the difference between the fair value and the face amount of the certificate of deposit should be treated as an unamortized premium or discount, as appropriate, in Schedule RC-O, item 1.

A bank that purchases an equity-indexed certificate of deposit for investment purposes must either account for the embedded purchased equity call option separately from the certificate of deposit host contract or irrevocably elect to account for the hybrid instrument (the equity-indexed certificate of deposit) in its entirety at fair value.

- If the bank accounts for the purchased equity call option separately from the certificate of deposit, the fair value of this embedded derivative on the date of purchase must be deducted from the purchase price of the certificate, creating a discount on the deposit that must be accreted into income over the term of the deposit using the effective interest method. This accretion should be reported in the income statement in Schedule RI, item 1.c. The embedded equity derivative must be "marked to market" at least quarterly with any changes in its fair value recognized in earnings. These fair value changes should be reported consistently in Schedule RI in either item 5.I, "Other noninterest income," or item 7.d, "Other noninterest expense." The carrying value of the certificate of deposit host contract and the fair value of the embedded equity derivative may be combined and reported together as interest-bearing balances due from other depository institutions on the balance sheet in Schedule RC, item 1.b.
- If the bank elects to account for the equity-indexed certificate of deposit in its entirety at fair value, no discount is to be recorded on the certificate of deposit. Rather, the equity-indexed certificate of deposit must be "marked to market" at least quarterly, with changes in the instrument's fair value reported in the income statement consistently in either item 5.I, "Other noninterest income," or item 7.d, "Other noninterest expense," excluding interest income that is reported in Schedule RI, item 1.c.

Unless the bank that purchases the equity-indexed certificate of deposit elects to account for the certificate of deposit in its entirety at fair value, the notional amount of the embedded derivative must be reported in Schedule RC-L, item 12.d.(2), column C, and item 14, column C, and its fair value (which will always be positive or zero, but not negative) must be reported in Schedule RC-L, item 15.b.(1), column C. The embedded equity derivative in the equity-indexed certificate of deposit is a purchased option, which is subject to the agencies' risk-based capital standards unless the fair value election has been made.

Equity Method of Accounting: The equity method of accounting shall be used to account for:

- (1) Investments in subsidiaries that have not been consolidated; associated companies; and corporate joint ventures, unincorporated joint ventures, and general partnerships over which the bank exercises significant influence; and
- (2) Noncontrolling investments in:
 - (a) Limited partnerships; and
 - (b) Limited liability companies that maintain "specific ownership accounts" for each investor and are within the scope of ASC Subtopic 323-30, Investments-Equity Method and Joint Ventures – Partnerships, Joint Ventures, and Limited Liability Entities.

unless the investment in the limited partnership or limited liability company is so minor that the limited partner or investor may have virtually no influence over the operating and financial policies

Equity Method of Accounting (cont.):

of the partnership or company. Consistent with guidance in ASC Subtopic 323-30, Investments-Equity Method and Joint Ventures – Partnerships, Joint Ventures, and Limited Liability Entities, noncontrolling investments of more than 3 to 5 percent are considered to be more than minor.

The entities in which these investments have been made are collectively referred to as “investees.”

Under the equity method, the carrying value of a bank’s investment in an investee is originally recorded at cost but is adjusted periodically to record as income the bank’s proportionate share of the investee’s earnings or losses and decreased by the amount of cash dividends or similar distributions received from the investee. For purposes of these reports, the date through which the carrying value of the bank’s investment in an investee has been adjusted should, to the extent practicable, match the report date of the Consolidated Report of Condition, but in no case differ by more than 93 days from the report.

See also “Subsidiaries.”

Excess Balance Account: An excess balance account (EBA) is a limited-purpose account at a Federal Reserve Bank established for maintaining the excess balances of one or more depository institutions (participants) that are eligible to earn interest on balances held at the Federal Reserve Banks. An EBA is managed by another depository institution that has its own account at a Federal Reserve Bank (such as a participant’s pass-through correspondent) and acts as an agent on behalf of the participants. Balances in an EBA represent a liability of a Federal Reserve Bank directly to the EBA participants and not to the agent. The Federal Reserve Banks pay interest on the average balance in the EBA over a 7-day maintenance period and the agent disburses that interest to each participant in accordance with the instructions of the participant. Only a participant’s excess balances may be placed in an EBA; the account balance cannot be used to satisfy the participant’s reserve balance requirement.

The reporting of an EBA by participants and agents differs from the required reporting of a pass-through reserve relationship, which is described in the Glossary entry for “Pass-through Reserve Balances.”

A participant’s balance in an EBA is to be treated as a claim on a Federal Reserve Bank (not as a claim on the agent) and, as such, should be reported on the balance sheet in Schedule RC, item 1.b, “Interest-bearing balances” due from depository institutions, and, for a participant with foreign offices or with \$300 million or more in total assets, in Schedule RC-A, item 4, “Balances due from Federal Reserve Banks.” For risk-based capital purposes, the participant’s balance in an EBA is accorded a zero percent risk weight and should be reported in Schedule RC-R, Part II, item 1, “Cash and balances due from depository institutions,” column C. A participant should not include its balance in an EBA in Schedule RC, item 3.a, “Federal funds sold.”

The balances in an EBA should not be reflected as an asset or a liability on the balance sheet of the depository institution that acts as the agent for the EBA. Thus, the agent should not include the balances in the EBA in Schedule RC, item 1.b, “Interest-bearing balances” due from depository institutions; Schedule RC, item 13.a.(2), “Interest-bearing” deposits (in domestic offices); Schedule RC-A, item 4, “Balances due from Federal Reserve Banks”; or Schedule RC-R, Part II, item 1, “Cash and balances due from depository institutions.”

Extinguishments of Liabilities: The accounting and reporting standards for extinguishments of liabilities are set forth in ASC Subtopic 405-20, Liabilities – Extinguishments of Liabilities. Under ASC Subtopic 405-20, a bank should remove a previously recognized liability from its balance sheet if and only if the liability has been extinguished. A liability has been extinguished if either of the following conditions is met:

- (1) The bank pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivering cash, other financial assets, goods, or services or the bank's reacquiring its outstanding debt.
- (2) The bank is legally released from being the primary obligor under the liability, either judicially or by the creditor.

Banks should aggregate their gains and losses from the extinguishment of liabilities (debt), including losses resulting from the payment of prepayment penalties on borrowings such as Federal Home Loan Bank advances, and consistently report the net amount in item 7.d, "Other noninterest expense," of the income statement (Schedule RI). Only if a bank's debt extinguishments normally result in net gains over time should the bank consistently report its net gains (losses) in Schedule RI, item 5.I, "Other noninterest income."

In addition, under ASC Subtopic 470-50, Debt – Modifications and Extinguishments, the accounting for the gain or loss on the modification or exchange of debt depends on whether the original and the new debt instruments are substantially different. If they are substantially different, the transaction is treated as an extinguishment of debt and the gain or loss on the modification or exchange is reported immediately in earnings as discussed in the preceding paragraph. If the original and new debt instruments are not substantially different, the gain or loss on the modification or replacement of the debt is deferred and recognized over time as an adjustment to the interest expense on the new borrowing. ASC Subtopic 470-50 provides guidance on how to determine whether the original and the new debt instruments are substantially different.

Fails: When a bank has sold an asset and, on settlement date, does not deliver the security or other asset and does not receive payment, a sales fail exists. When a bank has purchased a security or other asset and, on settlement date, does not receive the asset and does not pay for it, a purchase fail exists. Fails do not affect the way securities are reported in the Consolidated Reports of Condition and Income.

Fair Value: ASC Topic 820, Fair Value Measurement, defines fair value and establishes a framework for measuring fair value. ASC Topic 820 should be applied when other accounting topics require or permit fair value measurements. For further information, refer to ASC Topic 820.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the asset's or liability's principal (or most advantageous) market at the measurement date. This value is often referred to as an "exit" price.

An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced liquidation or distressed sale.

ASC Topic 820 establishes a three level fair value hierarchy that prioritizes inputs used to measure fair value based on observability. The highest priority is given to Level 1 (observable, unadjusted) and the lowest priority to Level 3 (unobservable). The broad principles for the hierarchy follow.

Level 1 fair value measurement inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that a bank has the ability to access at the measurement date. In addition, a Level 1 fair value measurement of a liability can also include the quoted price for an identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required.

Fair Value (cont.):

Level 2 fair value measurement inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Depending on the specific factors related to an asset or a liability, certain adjustments to Level 2 inputs may be necessary to determine the fair value of the asset or liability. If those adjustments are significant to the asset or liability's fair value in its entirety, the adjustments may render the fair value measurement to a Level 3 measurement.

Level 3 fair value measurement inputs are unobservable inputs for the asset or liability. Although these inputs may not be readily observable in the market, the fair value measurement objective is, nonetheless, to develop an exit price for the asset or liability from the perspective of a market participant. Therefore, Level 3 fair value measurement inputs should reflect the bank's own assumptions about the assumptions that a market participant would use in pricing an asset or liability and should be based on the best information available in the circumstances.

Refer to ASC Topic 820 for additional fair value measurement guidance, including considerations related to holding large positions (blocks), the existence of multiple active markets, and the use of practical expedients.

Measurement of Fair Values in Stressed Market Conditions – The measurement of various assets and liabilities on the balance sheet – including trading assets and liabilities, available-for-sale securities, loans held for sale, assets and liabilities accounted for under the fair value option, and foreclosed assets – involves the use of fair values. During periods of market stress, the fair values of some financial instruments and nonfinancial assets may be difficult to determine. Institutions are reminded that, under such conditions, fair value measurements should be determined consistent with the objective of fair value set forth in ASC Topic 820.

ASC Topic 820 provides guidance on determining fair value when the volume and level of activity for an asset or liability have significantly decreased when compared with normal market activity for the asset or liability (or similar assets or liabilities). According to ASC Topic 820, if there has been such a significant decrease, transactions or quoted prices may not be determinative of fair value because, for example, there may be increased instances of transactions that are not orderly. In those circumstances, further analysis of transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value in accordance with ASC Topic 820.

Federal Funds Transactions: For purposes of the Consolidated Reports of Condition and Income, federal funds transactions involve the reporting bank's lending (federal funds sold) or borrowing (federal funds purchased) in domestic offices of immediately available funds under agreements or contracts that have an original maturity of one business day or roll over under a continuing contract. However, funds lent or borrowed in the form of securities resale or repurchase agreements, due bills, borrowings from the Discount and Credit Department of a Federal Reserve Bank, deposits with and advances from a Federal Home Loan Bank, and overnight loans for commercial and industrial purposes are excluded from federal funds. Transactions that are to be reported as federal funds transactions may be secured or unsecured or may involve an agreement to resell loans or other instruments that are not securities.

Immediately available funds are funds that the purchasing bank can either use or dispose of on the same business day that the transaction giving rise to the receipt or disposal of the funds is executed.

The borrowing and lending of immediately available funds has an original maturity of one business day if the funds borrowed on one business day are to be repaid or the transaction reversed on the next business day, that is, if immediately available funds borrowed today are to be repaid tomorrow (in tomorrow's immediately available funds). Such transactions include those made on a Friday to mature

Federal Funds Transactions (cont.):

or be reversed the following Monday and those made on the last business day prior to a holiday (for either or both of the parties to the transaction) to mature or be reversed on the first business day following the holiday.

A continuing contract is a contract or agreement that remains in effect for more than one business day, but has no specified maturity and does not require advance notice of either party to terminate. Such contracts may also be known as rollovers or as open-ended agreements.

Federal funds may take the form of the following two types of transactions in domestic offices provided that the transactions meet the above criteria (i.e., immediately available funds with an original maturity of one business day or under a continuing contract):

- (1) Unsecured loans (federal funds sold) or borrowings (federal funds purchased). (In some market usage, the term "fed funds" or "pure fed funds" is confined to unsecured loans of immediately available balances.)
- (2) Purchases (sales) of financial assets (other than securities) under agreements to resell (repurchase) that have original maturities of one business day (or are under continuing contracts) and are in immediately available funds.

Any borrowing or lending of immediately available funds in domestic offices that has an original maturity of more than one business day, other than securities repurchase or resale agreements, is to be treated as a borrowing or as a loan, not as federal funds. Such transactions are sometimes referred to as "term federal funds."

Federally-Sponsored Lending Agency: A federally-sponsored lending agency is an agency or corporation that has been chartered, authorized, or organized as a result of federal legislation for the purpose of providing credit services to a designated sector of the economy. These agencies include Banks for Cooperatives, Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, Federal Intermediate Credit Banks, Federal Land Banks, the Federal National Mortgage Association, and the Student Loan Marketing Association.

Fees, Loan: See "Loan Fees."

Foreclosed Assets: The accounting and reporting standards for the receipt and holding of foreclosed assets are set forth in ASC Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors, and ASC Topic 360, Property, Plant, and Equipment. Subsequent to the issuance of FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (the predecessor of ASC Topic 360), AICPA Statement of Position (SOP) No. 92-3, "Accounting for Foreclosed Assets," was rescinded. Certain provisions of SOP 92-3 are not present in Statement No. 144, but the application of these provisions represents prevalent practice in the banking industry and is consistent with safe and sound banking practices and the accounting objectives set forth in Section 37(a) of the Federal Deposit Insurance Act. These provisions of SOP 92-3 have been incorporated into this Glossary entry, which institutions must follow for purposes of preparing their Consolidated Reports of Condition and Income.

An institution that receives from a borrower in full satisfaction of a loan either receivables from a third party, an equity interest in the borrower, or another type of asset (except a long-lived asset that will be sold) shall initially measure the asset received at its fair value at the time of the restructuring. When an institution receives a long-lived asset, such as real estate, from a borrower in full satisfaction of a loan, the long-lived asset is rebuttably presumed to be held for sale and the institution shall initially measure this asset at its fair value less cost to sell. The fair value (less cost to sell, if applicable) of the asset received in full satisfaction of the loan becomes the "cost" of the asset. The amount, if any, by which the recorded investment in the loan (or the amortized cost basis of the loan, if the institution has

Foreclosed Assets (cont.):

adopted ASC Topic 326, Financial Instruments–Credit Losses)¹ exceeds the fair value (less cost to sell, if applicable) of the asset is a loss which must be charged to the allowance for loan and lease losses (or allowance for credit losses, if the institution has adopted ASC Topic 326) at the time of restructuring, foreclosure, or repossession. In those cases where property is received in full satisfaction of an asset other than a loan (e.g., a debt security), the loss should be reported on the income statement in a manner consistent with the balance sheet classification of the asset satisfied.

If an asset is sold shortly after it is received in a restructuring, foreclosure, or repossession, it would generally be appropriate to substitute the value received in the sale (net of the cost to sell for a long-lived asset, such as real estate, that has been sold) for the fair value (less cost to sell for a long-lived asset, such as real estate, that will be sold) that had been estimated at the time of restructuring, foreclosure, or repossession. Any adjustments should be made to the loss charged against the allowance.

An asset received in partial satisfaction of a loan should be initially measured as described above and the recorded investment in, or amortized cost basis of, the loan, as applicable, should be reduced by the fair value (less cost to sell, if applicable) of the asset at the time of restructuring, foreclosure, or repossession.

The measurement and accounting subsequent to acquisition for real estate received in full or partial satisfaction of a loan, including through foreclosure or repossession, is discussed below in this Glossary entry. For other types of assets that an institution receives in full or partial satisfaction of a loan, the institution generally should subsequently measure and account for such assets in accordance with other applicable generally accepted accounting principles and regulatory reporting instructions for such assets.

For purposes of these reports, foreclosed assets include loans (other than residential real estate property collateralizing a consumer mortgage loan) where an institution, as creditor, has received physical possession of a borrower's assets, regardless of whether formal foreclosure proceedings take place. An institution, as creditor, is considered to have received physical possession (resulting from an in-substance repossession or foreclosure) of residential real estate property collateralizing a consumer mortgage loan only upon the occurrence of either of the following:

- (1) The institution obtains legal title to the residential real estate property upon completion of a foreclosure even if the borrower has redemption rights that provide the borrower with a legal right for a period of time after a foreclosure to reclaim the real estate property by paying certain amounts specified by law, or
- (2) The borrower conveys all interest in the residential real estate property to the bank to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The deed in lieu of foreclosure or similar legal agreement is completed when agreed-upon terms and conditions have been satisfied by both the borrower and the creditor.

In situations where physical possession is received, the secured loan should be recategorized on the balance sheet in the asset category appropriate to the underlying collateral (e.g., as other real estate owned for real estate collateral) and accounted for as described above, except for foreclosures on certain fully and partially government-guaranteed mortgage loans, which are to be reported in Schedule RC-F, item 6, "All other assets," as discussed below in this Glossary entry.

¹ The recorded investment in the loan is the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest. For institutions that have adopted ASC Topic 326, the term "amortized cost basis" is used in place of "recorded investment." See the Glossary entry for "Amortized Cost Basis."

Foreclosed Assets (cont.):

The amount of any senior debt (principal and accrued interest) to which foreclosed real estate is subject at the time of foreclosure must be reported as a liability in Schedule RC-M, item 5.b, "Other borrowings."

After foreclosure, each foreclosed real estate asset (including any real estate for which the institution receives physical possession) must be carried at the lower of (1) the fair value of the asset minus the estimated costs to sell the asset or (2) the cost of the asset (as defined in the preceding paragraphs). This determination must be made on an asset-by-asset basis. If the fair value of a foreclosed real estate asset minus the estimated costs to sell the asset is less than the asset's cost, the deficiency must be recognized as a valuation allowance against the asset which is created through a charge to expense. The valuation allowance should thereafter be increased or decreased (but not below zero) through charges or credits to expense for changes in the asset's fair value or estimated selling costs.

If a foreclosed real estate asset is held for more than a short period of time, any declines in value after foreclosure and any gain or loss from the sale or disposition of the asset shall not be reported as a loan or lease loss or recovery and shall not be debited or credited to the allowance for loan and lease losses (or allowance for credit losses, if the institution has adopted ASC Topic 326). Such additional declines in value and the gain or loss from the sale or disposition shall be reported net on the income statement in Schedule RI, item 5.j, "Net gains (losses) on sales of other real estate owned."

Reporting Certain Government-Guaranteed Mortgage Loans upon Foreclosure – ASC Subtopic 310-40 clarifies the conditions under which a creditor must derecognize a government-guaranteed mortgage loan and recognize a separate "other receivable" upon foreclosure (that is, when a creditor receives physical possession of real estate property collateralizing a mortgage loan). When these conditions are met, other real estate owned should not be recognized by an institution.

An institution should derecognize a mortgage loan and record a separate other receivable upon foreclosure of the real estate collateral if all of the following conditions are met:

- The loan has a government guarantee that is not separable from the loan before foreclosure.
- At the time of foreclosure, the institution has the intent to convey the property to the guarantor and make a claim on the guarantee and it has the ability to recover under that claim.
- At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed (that is, the real estate property has been appraised for purposes of the claim and thus the institution is not exposed to changes in the fair value of the property).

This guidance is applicable to fully and partially government-guaranteed mortgage loans provided the three conditions identified above have been met. In such situations, upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. This other receivable should be reported in Schedule RC-F, item 6, "All other assets." Any interest income earned on the other receivable should be reported in Schedule RI, item 1.g, "Other interest income."

Dispositions of Foreclosed Real Estate – Until the effective date of ASU 2014-09 "Revenue from Contracts with Customers," which includes amendments to ASC Subtopic 610-20, Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets, the primary accounting guidance for sales of foreclosed real estate is ASC Subtopic 360-20, Property, Plant, and Equipment – Real Estate Sales. When it takes effect, ASC Subtopic 610-20 supersedes ASC Subtopic 360-20 for real estate sales not accompanied by a leaseback and becomes the primary accounting guidance for sales of foreclosed real estate.

This Glossary entry presents a summary of the methods included in ASC Subtopic 360-20 for institutions that have not yet adopted ASC 610-20. For institutions that have adopted ASC Subtopic 610-20, this Glossary entry also presents a summary of the provisions of ASC Subtopic 610-20, which requires the application of specified portions of ASC Topic 606, Revenue from Contracts with

Foreclosed Assets (cont.):

Customers, to an institution's sale of repossessed nonfinancial assets such as foreclosed real estate (also referred to as other real estate owned or OREO).

Effective Date of ASU 2014-09, including ASC Subtopic 610-20 (and ASC Topic 606) – For institutions that are public business entities, these standards are effective for fiscal years beginning after December 15, 2017, including interim reporting periods within those fiscal years. For institutions that are not public business entities (i.e., that are private companies), the standards are effective for fiscal years beginning after December 15, 2018, and interim reporting periods within fiscal years beginning after December 15, 2019. For further information, see the Glossary entries for “Public Business Entity” and “Private Company.” Early application of these standards is permitted for all institutions for fiscal years beginning after December 15, 2016, and interim reporting periods as prescribed in the standards. An institution that early adopts these standards must apply them (including all of ASC Topic 606 on revenue recognition) in their entirety. If an institution chooses to early adopt these standards for financial reporting purposes, the institution should implement them in its Call Report for the same quarter-end report date.

Accounting under ASC Subtopic 360-20 – This subtopic, which applies to all transactions in which the seller provides financing to the buyer of the real estate, establishes the following methods to account for dispositions of real estate. If a profit is involved in the sale of real estate, each method sets forth the manner in which the profit is to be recognized. Regardless of which method is used, however, any losses on the disposition of real estate should be recognized immediately.

- (1) Full Accrual Method – Under the full accrual method, the disposition is recorded as a sale. Any profit resulting from the sale is recognized in full and the asset resulting from the seller's financing of the transaction is reported as a loan. This method may be used when the following conditions have been met:
- (a) A sale has been consummated;
 - (b) The buyer's initial investment (down payment) and continuing investment (periodic payments) are adequate to demonstrate a commitment to pay for the property;
 - (c) The receivable is not subject to future subordination; and
 - (d) The usual risks and rewards of ownership have been transferred.

Guidelines for the minimum down payment that must be made in order for a transaction to qualify for the full accrual method are set forth in ASC Subtopic 360-20. These vary from five percent to 25 percent of the property's sales value. These guideline percentages vary by type of property and are primarily based on the inherent risk assumed for the type and characteristics of the property. To meet the continuing investment criteria, the contractual loan payments must be sufficient to repay the loan over the customary loan term for the type of property involved. Such periods may range up to 30 years for loans on single family residential property.

- (2) Installment Method – Dispositions of foreclosed real estate that do not qualify for the full accrual method may qualify for the installment method. This method recognizes a sale and the corresponding loan. Any profits on the sale are only recognized as the institution receives payments from the purchaser/borrower. Interest income is recognized on an accrual basis, when appropriate.

The installment method is used when the buyer's down payment is not adequate to allow use of the full accrual method but recovery of the cost of the property is reasonably assured if the buyer defaults. Assurance of recovery requires careful judgment on a case-by-case basis. Factors which should be considered include: the size of the down payment, loan-to-value ratios, projected cash flows from the property, recourse provisions, and guarantees.

Foreclosed Assets (cont.):

Since default on the loan usually results in the seller's reacquisition of the real estate, reasonable assurance of cost recovery may often be achieved with a relatively small down payment. This is especially true in situations involving loans with recourse to borrowers who have verifiable net worth, liquid assets, and income levels. Reasonable assurance of cost recovery may also be achieved when the purchaser/borrower pledges additional collateral.

- (3) Cost Recovery Method – Dispositions of foreclosed real estate that do not qualify for either the full accrual or installment methods are sometimes accounted for using the cost recovery method. This method recognizes a sale and the corresponding loan, but all income recognition is deferred. Principal payments are applied as a reduction of the loan balance and interest increases the unrecognized gross profit. No profit or interest income is recognized until either (1) the aggregate payments by the borrower exceed the recorded investment in, or the amortized cost basis of, the loan, as applicable, or (2) a change to another accounting method is appropriate (e.g., installment method). Consequently, the loan is maintained in nonaccrual status while this method is being used.
- (4) Reduced-Profit Method – This method is used in certain situations where the institution receives an adequate down payment, but the loan amortization schedule does not meet the requirements for use of the full accrual method. The method recognizes a sale and the corresponding loan. However, like the installment method, any profit is apportioned over the life of the loan as payments are received. The method of apportionment differs from the installment method in that profit recognition is based on the present value of the lowest level of periodic payments required under the loan agreement.

Since sales with adequate down payments are generally not structured with inadequate loan amortization requirements, this method is seldom used in practice.

- (5) Deposit Method – The deposit method is used in situations where a sale of the foreclosed real estate has not been consummated. It may also be used for dispositions that could be accounted for under the cost recovery method. Under this method a sale is not recorded and the asset continues to be reported as foreclosed real estate. Further, no profit or interest income is recognized. Payments received from the borrower are reported as a liability in Schedule RC-G, item 4, "All other liabilities," until sufficient payments or other events have occurred which allow the use of one of the other methods.

Accounting under ASC Subtopic 610-20 (and ASC Topic 606) – The amendments to ASC Subtopic 610-20, when effective as a result of ASU 2014-09 (as discussed above), eliminate the prescriptive criteria and methods for sale accounting and gain recognition for dispositions of OREO set forth in ASC Subtopic 360-20. Under ASC Subtopic 610-20, if the buyer of the OREO is a legal entity, an institution should first assess whether it has a controlling financial interest in the legal entity buying the OREO by applying the guidance in ASC Topic 810, Consolidation. If an institution determines that it has a controlling financial interest in the buying legal entity, it should not derecognize the OREO and should apply the guidance in ASC Subtopic 810-10. When an institution does not have a controlling financial interest in the buying legal entity or the OREO buyer is not a legal entity, which is expected to be the case for most sales of OREO, the institution will recognize the entire gain or loss, if any, and derecognize the OREO at the time of sale if the transaction meets certain requirements of ASC Topic 606. Otherwise, the institution generally will continue reporting the OREO as an asset, with any cash payments or other consideration received from the individual or entity acquiring the OREO (i.e., any down payment and any subsequent payments of principal or interest) reported as a liability in Schedule RC-G, item 4, "All other liabilities," until it becomes appropriate to recognize the revenue and the sale of the OREO in accordance with ASC Subtopic 610-20 and ASC Topic 606.¹

¹ Although ASC Topic 606 describes the consideration received (including any cash payments) using such terms as "liability," "deposit," and "deposit liability," for regulatory reporting purposes these amounts should be reported in Schedule RC-G, item 4, and not as a deposit in Schedule RC, item 13.

Foreclosed Assets (cont.):

When applying ASC Subtopic 610-20 and Topic 606, an institution will need to exercise judgment in determining whether a contract (within the meaning of Topic 606) exists for the sale or transfer of OREO, whether the institution has performed its obligations identified in the contract, and what the transaction price is for calculation of the amount of gain or loss. These standards apply to all sales or transfers of real estate by institutions, but greater judgment will generally be required for seller-financed sales of OREO.

Under ASC Subtopic 610-20, when an institution does not have a controlling financial interest in the buying legal entity or the OREO buyer is not a legal entity, the institution's first step in assessing whether it can derecognize an OREO asset and recognize revenue upon the sale or transfer of the OREO is to determine whether a contract exists under the provisions of Topic 606. In the context of an OREO sale or transfer, in order for an institution's transaction with the party acquiring the property to be a contract under ASC Topic 606, it must meet all the following criteria:

- (a) The parties to the contract have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to perform their respective obligations;
- (b) The institution can identify each party's rights regarding the OREO to be transferred;
- (c) The institution can identify the payment terms for the OREO to be transferred;
- (d) The contract has commercial substance (that is, the risk, timing, or amount of the institution's future cash flows is expected to change as a result of the contract); and
- (e) It is probable that the institution will collect substantially all of the consideration to which it will be entitled in exchange for OREO that will be transferred to the buyer, i.e. the transaction price. In evaluating whether collectability of an amount of consideration is probable, an institution shall consider only the buyer's ability and intention to pay that amount of consideration when it is due.

These five criteria require careful analysis for seller-financed sales of OREO. In particular, criteria (a) and (e) may require significant judgment. When determining whether the buyer is committed to perform its obligations under criterion (a) and collectability under criterion (e), a selling institution should consider all facts and circumstances related to the buyer's ability and intent to pay the transaction price, which may include:

- Amount of cash paid as a down payment;
- Existence of recourse provisions;
- Credit standing of the buyer;
- Age and location of the property;
- Cash flow from the property;
- Payments by the buyer to third parties;
- Other amounts paid to the selling institution, including current or future contingent payments;
- Transfer of noncustomary consideration (i.e., consideration other than cash and a note receivable);
- Other types of financing involved with the property or transaction;
- Financing terms of the loan (reasonable and customary terms, amortization, any graduated payments, any balloon payment);
- Underwriting inconsistent with the institution's underwriting policies for loans not involving OREO sales; and
- Future subordination of the selling institution's receivable.

Although ASC Subtopic 610-20 does not include the prescriptive minimum down payment requirements in ASC Subtopic 360-20, the amount and character of a buyer's equity (typically the down payment) and recourse provisions remain important factors when evaluating criteria (a) and (e). Specifically, the buyer's initial equity in the property immediately after the sale is an important consideration in determining whether a buyer is committed to perform its obligations under criterion (a). Furthermore, the buyer's initial equity is a factor to consider under criterion (e) when evaluating the collectability of consideration that the institution is entitled to receive from the buyer.

Foreclosed Assets (cont.):

In applying the revenue recognition principles in ASC Topic 606, all relevant factors are to be weighed collectively in evaluating whether the five contract criteria have been met as the first step in determining the appropriate accounting for a seller-financed OREO transaction. However, the agencies consider the down payment and financing terms to be of particular importance when making this determination. A transaction with an insignificant down payment and nonrecourse financing generally would not meet the definition of a contract (within the meaning of Topic 606) unless there is considerable support from other factors. The need for support from other factors recedes in importance for a transaction with a substantial down payment and recourse financing to a buyer with adequate capacity to repay.

If the five contract criteria in ASC Topic 606 have not been met, the institution generally may not derecognize the OREO asset or recognize revenue (gain or loss) as an accounting sale has not occurred. The institution should continue to assess the transaction to determine whether the contract criteria have been met in a later period. Until that time, any consideration the institution has received from the buyer should generally be recorded as a deposit liability. In addition, if the transaction price is less than the carrying amount of the OREO, the institution should consider whether this indicates a decline in fair value of the OREO that should be recognized as a valuation allowance, or an increase in an existing valuation allowance, and through a charge to expense as discussed above in this Glossary entry.

If an institution determines the contract criteria in ASC Topic 606 have been met, it must then determine whether it has satisfied its performance obligations as identified in the contract by transferring control of the asset to the buyer. Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. As it relates to an institution's sale of OREO, ASC Topic 606 includes the following indicators of the transfer of control:

- (a) The institution has a present right to payment for the asset;
- (b) The buyer has legal title to the asset;
- (c) The institution has transferred physical possession of the asset;
- (d) The buyer has the significant risks and rewards of ownership of the asset; and
- (e) The buyer has accepted the asset.

For seller-financed sales of OREO, the transfer of control generally occurs on the closing date of the sale when the institution obtains the right to receive payment for the property and transfers legal title to the buyer. However, an institution must consider all relevant facts and circumstances to determine whether control of the OREO has transferred, which may include the selling institution's:

- Involvement with the property following the transaction;
- Obligation to repurchase the property in the future;
- Obligation to provide support for the property following the sale transaction; and
- Retention of an equity interest in the property.

In particular, if an institution has the obligation or right to repurchase the OREO, the buyer does not obtain control of the OREO because the buyer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though it may have physical possession. In this situation, an institution should account for the contract as either (1) a lease in accordance with ASC Topic 840, Leases, or ASC Topic 842, Leases, as applicable, or (2) a financing arrangement in accordance with ASC Topic 606. In addition, situations may exist where the selling institution has legal title to the OREO, while the borrower whose property was foreclosed upon under the original loan still has redemption rights to reclaim the property in the future. If such redemption rights exist, the selling institution may not be able to transfer control to the buyer of the OREO and recognize revenue until the redemption period expires.

Foreclosed Assets (cont.):

When a contract exists and an institution has transferred control of the property, the institution should derecognize the OREO asset and recognize a gain or loss for the difference between the transaction price and the carrying amount of the OREO asset. Generally, the transaction price in a sale of OREO will be the contract amount in the purchase/sale agreement, including for a seller-financed sale financed at market terms. However, the transaction price may differ from the amount stated in the contract due to the existence of a significant financing component. Under the new standard, a significant financing component exists if the timing of the buyer's payments explicitly or implicitly provides the selling institution or the buyer with a significant benefit of financing the transfer of the OREO. A seller-financed transaction of OREO at off-market terms generally indicates the existence of a significant financing component. If a significant financing component exists, the contract amount should be adjusted for the time value of money to reflect what the cash selling price of the OREO would have been at the time of its transfer to the buyer. The discount rate used in adjusting for the time value of money should be a market rate of interest considering the credit characteristics of the buyer and the terms of the financing.

Foreign Banks: See "Banks, U.S. and Foreign."

Foreign Currency Transactions and Translation: Foreign currency transactions are transactions occurring in the ordinary course of business (e.g., purchases, sales, borrowings, and lendings) denominated in a currency other than the office's functional currency (as described below).

Foreign currency translation, on the other hand, is the process of translating financial statements from the foreign office's functional currency into the reporting currency. Such translation normally is performed only at reporting dates.

A functional currency is the currency of the primary economic environment in which an office operates. For most banks, the functional currency will be the U.S. dollar. However, if a bank has foreign offices, one or more foreign offices may have a functional currency other than the U.S. dollar.

Accounting for foreign currency transactions – A change in exchange rates between the functional currency and the currency in which a transaction is denominated will increase or decrease the amount of the functional currency expected to be received or paid. These increases or decreases in the expected functional currency cash flow are foreign currency transaction gains and losses and are to be included in the determination of the income of the period in which the transaction takes place, or if the transaction has not yet settled, the period in which the rate change takes place.

Except for foreign currency derivatives and transactions described in the following section, banks should consistently report net gains (losses) from foreign currency transactions other than trading transactions in Schedule RI, item 5.l, "Other noninterest income," or item 7.d, "Other noninterest expense." Net gains (losses) from foreign currency trading transactions should be reported in Schedule RI, item 5.c, "Trading revenue."

Foreign currency transaction gains or losses to be excluded from the determination of net income – Gains and losses on the following foreign currency transactions shall not be included in "Noninterest income" or "Noninterest expense," but shall be reported in the same manner as translation adjustments (as described below):

- (1) Foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign office.
- (2) Intercompany foreign currency transactions that are of a long-term investment nature (i.e., settlement is not planned or anticipated in the foreseeable future), when the parties to the transaction are consolidated, combined, or accounted for by the equity method in the bank's Consolidated Reports of Condition and Income.

Foreign Currency Transactions and Translation (cont.):

In addition, the entire change in the fair value of foreign-currency-denominated available-for-sale debt securities should not be included in "Realized gains (losses) on available-for-sale debt securities" (Schedule RI, item 6.b), but should be reported in Schedule RI-A, item 10, "Other comprehensive income." These fair value changes should be accumulated in the "Net unrealized holding gains (losses) on available-for-sale securities" component of "Accumulated other comprehensive income" in Schedule RC, item 26.b. However, if a decline in fair value of a foreign-currency-denominated available-for-sale debt 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 (Schedule RI, item 6.b).

See the Glossary entry for "Derivative Contracts" for information on the accounting and reporting for foreign currency derivatives.

Accounting for foreign currency translation (applicable only to banks with foreign offices) – The Consolidated Reports of Condition and Income must be reported in U.S. dollars. Balances of foreign subsidiaries or branches of the reporting bank denominated in a functional currency other than U.S. dollars shall be converted to U.S. dollar equivalents and consolidated into the reporting bank's Consolidated Reports of Condition and Income. The translation adjustments for each reporting period, determined utilizing the current rate method, should be reported in Schedule RI-A, item 10, "Other comprehensive income." Amounts accumulated in the "Cumulative foreign currency translation adjustments" component of "Accumulated other comprehensive income" in Schedule RC, item 26.b, will not be included in the bank's results of operations until such time as the foreign office is disposed of, when they will be used as an element to determine the gain or loss on disposition.

For further guidance, refer to ASC Topic 830, Foreign Currency Matters.

Foreign Debt Exchange Transactions: Foreign debt exchange transactions generally fall into three categories: (1) loan swaps, (2) debt/equity swaps, and (3) debt-for-development swaps. These transactions are to be reported in the Consolidated Reports of Condition and Income in accordance with generally accepted accounting principles as summarized below. The accounting pronouncements mentioned below should be consulted for more detailed reporting guidance in these areas.

Generally accepted accounting principles require that these transactions be reported at their fair value. There is a significant amount of precedent in the accounting for exchange transactions to consider both the fair value of the consideration given up as well as the fair value of the assets received in arriving at the most informed valuation, especially if the value of the consideration given up is not readily determinable or may not be a good indicator of the value received. It is the responsibility of management to make the valuation considering all of the circumstances. Such valuations are subject to examiner review.

Among the factors to consider in determining fair values for foreign debt exchange transactions are:

- (1) Similar transactions for cash;
- (2) Estimated cash flows from the debt or equity instruments or other assets received;
- (3) Market values, if any, of similar instruments; and
- (4) Currency restrictions, if any, affecting payments on or sales of the debt or equity instruments, local currency, or other assets received, including where appropriate those affecting the repatriation of capital.

Losses arise from swap transactions when the fair value determined for the transaction is less than the recorded investment in the sovereign debt and other consideration paid, if any. Such losses should

Foreign Debt Exchange Transactions (cont.)

generally be charged to the allowance for loan and lease losses or the allowance for credit losses, as applicable (or allocated transfer risk reserve, if appropriate), and must include any discounts from official exchange rates that are imposed by sovereign obligors as transaction fees. All other fees and transaction costs involved in such transactions must be charged to expense as incurred.

Loss recoveries or even gains might be indicated in a swap transaction as a result of the valuation process. However, due to the subjective nature of the valuation process, such loss recoveries or gains ordinarily should not be recorded until the debt or equity instruments, local currency, or other assets received in the exchange transaction are realized in unrestricted cash or cash equivalents.

Loan swaps – Foreign loan swaps, or debt/debt swaps, involve the exchange of one foreign loan for another. This type of transaction represents an exchange of monetary assets that must be reported at current fair value. Normally, when monetary assets are exchanged, with or without additional cash payments, and the parties have no remaining obligations to each other, the earnings process is complete.

Debt/equity swaps – The reporting treatment for this type of transaction is presented in ASC Subtopic 942-310, Financial Services-Depository and Lending – Receivables.

A foreign debt/equity swap represents an exchange of monetary for nonmonetary assets that must be measured at fair value. This type of swap is typically accomplished when holders of U.S. dollar-denominated sovereign debt agree to convert that debt into approved local equity investments. The holders are generally credited with local currency at the official exchange rate. A discount from the official exchange rate is often imposed as a transaction fee. The local currency is generally not available to the holders for any purposes other than approved equity investments. Restrictions may be placed on dividends on the equity investments and capital usually cannot be repatriated for several years.

In arriving at the fair value of the transaction, both the secondary market price of the debt given up and the fair value of the equity investment or assets received should be considered.

Debt-for-development swaps – In this type of exchange, sovereign debt held by a bank is generally purchased by a nonprofit organization or contributed to the nonprofit organization. When the sovereign debt is purchased by or donated to a nonprofit organization, the organization may enter into an agreement with the debtor country to cancel the debt in return for the country's commitment to provide local currency or other assets for use in connection with specific projects or programs in that country. Alternatively, a bank may exchange the sovereign debt with the country and receive local currency. In this alternative, the local currency will be donated or sold to the nonprofit organization for use in connection with specific projects or programs in that country.

These transactions, including amounts charged to expense as donations, must be reported at their fair values in accordance with generally accepted accounting principles applicable to foreign debt exchange transactions. This includes appropriate consideration of the market value of the instruments involved in the transaction and the fair value of any assets received, taking into account any restrictions that would limit the use of the assets. In debt-for-development swaps where a bank receives local currency in exchange for the sovereign loan it held and the local currency has no restrictions on its use and is freely convertible, it is generally appropriate for fair value to be determined by valuing the local currency received at its fair market exchange value.

Foreign Governments and Official Institutions: Foreign governments and official institutions are central, state, provincial, and local governments in foreign countries and their ministries, departments, and agencies. These include treasuries, ministries of finance, central banks, development banks, exchange control offices, stabilization funds, diplomatic establishments, fiscal agents, and nationalized banks and other banking institutions that are owned by central governments and that have as an

Foreign Governments and Official Institutions (cont.):

important part of their function activities similar to those of a treasury, central bank, exchange control office, or stabilization fund. For purposes of these reports, other government-owned enterprises are not included.

Also included as foreign official institutions are international, regional, and treaty organizations, such as the International Monetary Fund, the International Bank for Reconstruction and Development (World Bank), the Bank for International Settlements, the Inter-American Development Bank, and the United Nations.

Foreign Office: For purposes of these reports, a foreign office of the reporting bank is a branch or consolidated subsidiary located in a foreign country; an Edge or Agreement subsidiary, including both its U.S. and its foreign offices; or an IBF. In addition, if the reporting bank is chartered and headquartered in the 50 states of the United States and the District of Columbia, a branch or consolidated subsidiary located in Puerto Rico or a U.S. territory or possession is a foreign office. Branches on U.S. military facilities wherever located are treated as domestic offices, not foreign offices.

Forward Contracts: See "Derivative Contracts."

Functional Currency: See "Foreign Currency Transactions and Translation."

Futures Contracts: See "Derivative Contracts."

Goodwill: According to ASC Topic 805, Business Combinations, goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. The private company accounting alternative for identifiable intangible assets acquired in a business combination is discussed in a subsection of this Glossary entry. In addition, see "Acquisition method" in the Glossary entry for "Business Combinations" for guidance on the recognition and initial measurement of goodwill acquired in a business combination.

Subsequent Measurement of Goodwill – Goodwill should not be amortized, but must be tested for impairment at the reporting unit level at least annually, unless an institution meets the definition of a private company, as defined in U.S. GAAP, and elects the goodwill amortization accounting alternative described below. Any impairment losses recognized on goodwill during the year-to-date reporting period should be reported in Schedule RI, item 7.c.(1), "Goodwill impairment losses," except those impairment losses associated with discontinued operations, which should be reported on a net-of-tax basis in Schedule RI, item 11. Goodwill, net of any impairment losses, should be reported on the balance sheet in Schedule RC, item 10, and in Schedule RC-M, item 2.b.

Private Company Accounting Alternative for Goodwill – ASC Subtopic 350-20, Intangibles-Goodwill and Other – Goodwill, generally permits a private company, as defined in U.S. GAAP, to elect an accounting alternative for goodwill under which goodwill is amortized on a straight-line basis over a period of ten years (or less than ten years if more appropriate) and a simplified impairment model is applied to goodwill. In addition, if a private company chooses to adopt the goodwill accounting alternative, the private company is required make an accounting policy election to test goodwill for impairment at either the entity level or the reporting unit level. Goodwill must be tested for impairment when a triggering event occurs that indicates that the fair value of an entity or a reporting unit, as appropriate under the private company's accounting policy election, may be below its carrying amount. U.S. GAAP for a public business entity does not permit goodwill to be amortized, instead requiring goodwill to be tested for impairment at the reporting unit level annually and between annual tests in certain circumstances. For information on the distinction between a private company and a public business entity, see the Glossary entry for "Public Business Entity."

Goodwill (cont.):

A bank or savings association that meets the definition of a private company is permitted, but not required to adopt the goodwill amortization accounting alternative. If a private institution issues U.S. GAAP financial statements and chooses to adopt the private company alternative, it should apply the goodwill accounting alternative in its Call Report in a manner consistent with its reporting of goodwill in its financial statements.

Goodwill amortization expense should be reported in item 7.c.(1) of the Call Report income statement (Schedule RI) unless the amortization is associated with a discontinued operation, in which case the goodwill amortization should be included within the results of discontinued operations and reported in Schedule RI, item 11.

Goodwill Impairment Testing – ASC Subtopic 350-20 provides guidance for testing and reporting goodwill impairment losses, a summary of which follows. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Because the fair value of goodwill can be measured only as a residual and cannot be measured directly, ASC Subtopic 350-20 includes a methodology for estimating the implied fair value of goodwill for impairment measurement purposes.

Whether or not the reporting institution is a subsidiary of a holding company or other company, the institution's goodwill must be tested for impairment using the institution's reporting units (unless the institution is a private company that has elected the goodwill accounting alternative and has made an accounting policy election to test goodwill for impairment at the entity level). Goodwill should be assigned to reporting units in accordance with ASC Subtopic 350-20. The institution itself may be a reporting unit.

Goodwill of a reporting unit must be tested for impairment annually and between annual tests upon the occurrence of a triggering event, i.e., if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. However, if an institution is a private company that has elected the goodwill accounting alternative, goodwill must be tested for impairment only upon the occurrence of a triggering event. Examples of such events or circumstances include a significant adverse change in the business climate, unanticipated competition, a loss of key personnel, and a more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of. In addition, goodwill must be tested for impairment after a portion of goodwill has been allocated to a business to be disposed of.

When testing the goodwill of a reporting unit¹ for impairment, an institution has the option of first assessing qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test described in ASC Subtopic 350-20. If determined to be necessary, the two-step impairment test shall be used to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any). However, an institution may choose to bypass the qualitative assessment option for any reporting unit in any period and proceed directly to performing the two-step quantitative goodwill impairment test described below.

Qualitative Assessment – If an institution performs a qualitative assessment and, after considering all relevant events and circumstances, determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount (including goodwill), then the institution does not need to perform the two-step quantitative goodwill impairment test. In other words, if it is more likely than not that the fair value of a reporting unit is greater than its carrying amount; an institution would not have to quantitatively test the unit's goodwill for impairment.

¹ For purposes of the discussions of goodwill impairment testing, the qualitative assessment, and the quantitative impairment test, if an institution is a private company that has elected the goodwill accounting alternative and also has elected to test goodwill for impairment at the entity level, references to the reporting unit should be read as references to the entity.

Goodwill (cont.):

However, if the institution instead concludes that the opposite is true (that is, it is more likely than not that the fair value of a reporting unit is less than its carrying amount), then it is required to perform the two-step quantitative goodwill impairment test described below.

ASC Subtopic 350-20 includes examples of events and circumstances that an institution should consider in evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Because the examples are not all-inclusive, other relevant events and circumstances also must be considered.

Quantitative Impairment Test –

- **Step 1:** The first step of the goodwill impairment test compares the fair value of a reporting unit¹ with its carrying amount, including goodwill. If the carrying amount of a reporting unit is greater than zero² and its fair value exceeds its carrying amount, the reporting unit's goodwill is considered not impaired and the second step of the impairment test is unnecessary. However, if the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test must be performed to measure the amount of impairment loss, if any.
- **Step 2:** The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill³ with the carrying amount of that goodwill. If the implied fair value of the reporting unit's goodwill exceeds the carrying amount of that goodwill, the goodwill is considered not impaired. In contrast, if the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss must be recognized in earnings in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of the reporting unit's goodwill.

After an impairment loss is recognized on a reporting unit's goodwill, the adjusted carrying amount of that goodwill (i.e., the carrying amount of the goodwill before recognizing the impairment loss less the amount of the impairment loss) shall be its new accounting basis. Subsequent reversal of a previously recognized goodwill impairment loss is prohibited once the measurement of that loss is completed.

Disposal of a Reporting Unit or a Business – When a reporting unit is to be disposed of in its entirety, goodwill of that reporting unit must be included in the carrying amount of the reporting unit when determining the gain or loss on disposal. When a portion of a reporting unit (or a portion of the entity if the institution is a private company that has elected the goodwill accounting alternative and also has elected to test goodwill for impairment at the entity level) that constitutes a business is to be disposed of, goodwill associated with that business must be included in the carrying amount of the business in determining the gain or loss on disposal. Otherwise, an institution may not remove goodwill from its balance sheet, for example, by "selling" or "dividending" this asset to its parent holding company or another affiliate.

Accounting by Private Companies for Identifiable Intangible Assets Acquired in a Business Combination – ASC Subtopic 805-20, Business Combinations – Identifiable Assets and Liabilities, and Any Noncontrolling Interest, provides an accounting alternative that permits a private company, as defined in U.S. GAAP, to simplify the accounting for certain intangible assets. This accounting

¹ The fair value of a reporting unit is the price that would be received to sell the unit as a whole in an orderly transaction between market participants at the measurement date.

² An institution should refer to ASC Subtopic 350-20 for guidance on applying the quantitative impairment test if the carrying amount of a reporting unit is zero or negative.

³ The implied fair value of goodwill should be determined in the same manner as the amount of goodwill recognized in a business combination is determined. That is, an institution must assign the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination.

Goodwill (cont.):

alternative applies when a private company is required to recognize or otherwise consider the fair value of intangible assets as a result of certain transactions, including when applying the acquisition method to a business combination under ASC Topic 805. A private company that elects the accounting alternative for identifiable intangible assets should no longer recognize separately from goodwill:

- Customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of a business, and
- Noncompetition agreements.

However, because mortgage servicing rights and core deposit intangibles are regarded as capable of being sold or licensed independently, a private company that elects this accounting alternative must recognize these intangible assets separately from goodwill, initially measure them at fair value, and subsequently measure them in accordance with ASC Topic 350.

A private company that elects the accounting alternative for identifiable intangible assets in ASC Subtopic 805-20 also must adopt the private company goodwill accounting alternative in ASC Subtopic 350-20, which is described above in this Glossary entry. However, a private company that elects the goodwill accounting alternative in ASC Subtopic 350-20 is not required to adopt the accounting alternative for identifiable intangible assets.

A private company's decision to adopt the accounting alternative for identifiable intangible assets must be made upon the occurrence of the first business combination (or other transaction within the scope of the alternative) in fiscal years beginning after December 15, 2015. The effective date of the private company's decision to adopt the accounting alternative for identifiable intangible assets depends on the timing of that first transaction as described in the applicable transition guidance in ASC Subtopic 805-20.¹ Customer-related intangible assets and noncompetition agreements that exist as of the beginning of the period of adoption should continue to be accounted for separately from goodwill, i.e., such existing intangible assets should not be combined with goodwill.

If an institution that is a private company issues U.S. GAAP financial statements and adopts the accounting alternative for identifiable intangible assets, it should apply this accounting alternative in its Call Report in a manner consistent with its reporting of intangible assets in its financial statements.

Hypothecated Deposit: A hypothecated deposit is the aggregation of periodic payments on an installment contract received by a reporting institution in a state in which, under law, such payments are not immediately used to reduce the unpaid balance of the installment note, but are accumulated until the sum of the payments equals the entire amount of principal and interest on the contract, at which time the loan is considered paid in full. For purposes of these reports, hypothecated deposits are to be netted against the related loans.

Deposits that simply serve as collateral for loans are not considered hypothecated deposits for purposes of these reports.

See also "Deposits."

IBF: See "International Banking Facility (IBF)."

¹ If the first transaction occurs in the private company's first fiscal year beginning after December 15, 2015, the adoption of the accounting alternative will be effective for that fiscal year's annual financial reporting period and all interim and annual periods thereafter. If the first transaction occurs in a fiscal year beginning after December 15, 2016, the adoption of the accounting alternative will be effective in the interim period that includes the date of the transaction and subsequent interim and annual periods thereafter. Early application of the intangibles accounting alternative is permitted for any annual or interim period for which a private company's financial statements have not yet been made available for issuance.

Income Taxes: All banks, regardless of size, are required to report income taxes (federal, state and local, and foreign) in the Consolidated Reports of Condition and Income on an accrual basis. Note that, in almost all cases, applicable income taxes as reported on the Consolidated Report of Income will differ from amounts reported to taxing authorities. The applicable income tax expense or benefit that is reflected in the Consolidated Report of Income should include both taxes currently paid or payable (or receivable) and deferred income taxes. The following discussion of income taxes is based on ASC Topic 740, Income Taxes.

Applicable income taxes in the year-end Consolidated Report of Income shall be the sum of the following:

- (1) Taxes currently paid or payable (or receivable) for the year determined from the bank's federal, state, and local income tax returns for that year. Since the bank's tax returns will not normally be prepared until after the year-end Consolidated Reports of Condition and Income have been completed, the bank must estimate the amount of the current income tax liability (or receivable) that will ultimately be reported on its tax returns. Estimation of this liability (or receivable) may involve consultation with the bank's tax advisers, a review of the previous year's tax returns, the identification of significant expected differences between items of income and expense reflected on the Consolidated Report of Income and on the tax returns, and the identification of expected tax credits.)

and

- (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 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 Consolidated Report of Income. An amendment to the bank's year-end and subsequent Consolidated 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 Consolidated Report of Income for report dates other than year-end is discussed below under "interim period applicable income taxes."

When determining the current and deferred income tax assets and liabilities to be reported in any period, a bank's income tax calculation contains an inherent degree of uncertainty surrounding the realizability of the tax positions included in the calculation. The term "tax position" refers to a position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. For each tax position taken or expected to be taken in a tax return, a bank must evaluate whether the tax position is more likely than not, i.e., more than a 50 percent probability, to be sustained upon examination by the appropriate taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, a bank should presume that the taxing authority examining the position will have full knowledge of all relevant information. A bank's assessment of the technical merits of a tax position should reflect consideration of all relevant authoritative sources, e.g., tax legislation and statutes, legislative intent, regulations, rulings, and case law, and reflect the bank's determination of the applicability of these sources to the facts and circumstances of the tax position. A bank must evaluate each tax position without consideration of the possibility of an offset or aggregation with other positions. No tax benefit can be recorded for a tax position that fails to meet the more-likely-than-not recognition threshold.

Income Taxes (cont.):

Each tax position that meets the more-likely-than-not recognition threshold should be measured to determine the amount of benefit to recognize in the Consolidated Reports of Condition and Income. The tax position is measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. When measuring the tax benefit, a bank must consider the amounts and probabilities of the outcomes that could be realized upon ultimate settlement using the facts, circumstances, and information available at the reporting date. A bank may not use the valuation allowance associated with any deferred tax asset as a substitute for measuring this tax benefit or as an offset to this amount.

If a bank's assessment of the merits of a tax position subsequently changes, the bank should adjust the amount of tax benefit it has recognized and accrue interest and penalties for any underpayment of taxes in accordance with the tax laws of each applicable jurisdiction. In this regard, a tax position that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent quarterly reporting period in which the threshold is met. A previously recognized tax position that no longer meets the more-likely-than-not recognition threshold should be derecognized in the first subsequent quarterly reporting period in which the threshold is no longer met.

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 Consolidated 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 Consolidated 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 Consolidated 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 that 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 50 percent¹ of cash dividends received on the corporate stock of domestic U.S. corporations owned less than 20 percent.

¹ The percentage is 70 percent for tax years beginning before January 1, 2018.

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.

Net operating loss carrybacks and carryforwards and tax credit carryforwards – When a bank's deductions exceed its income for income tax purposes, it has sustained a net operating loss. To the extent permitted under a taxing authority's laws and regulations, a net 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 Consolidated Report of Income will reflect a credit rather than an expense. For tax years beginning before January 1, 2018, a bank may carry back operating losses for two years for federal income tax purposes. However, in general, for tax years beginning on or after January 1, 2018, a bank may no longer carry back operating losses to recover taxes paid in prior tax years.

Generally, a net operating loss that occurs when loss carrybacks are not available becomes a net operating loss carryforward. For tax years beginning before January 1, 2018, a bank may carry operating losses forward 20 years for federal income tax purposes. For tax years beginning on or after January 1, 2018, net operating losses can be carried forward indefinitely for federal income tax purposes; however, for net operating losses arising in such tax years, the amount of loss that can be carried forward and deducted in a particular year is limited to 80 percent of a bank's taxable income in that year.

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 net 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. For tax years beginning on or after January 1, 2018, the federal corporate tax rate is a flat 21 percent rate. This flat rate replaced the graduated federal corporate tax rate structure that applied in prior tax years. If a bank is subject to graduated tax rates and 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.c)."

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.c)." The following discussion of the valuation allowance relates to the allowance, if any, included in the

Income Taxes (cont.):

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-R, Part I, item 8; items 15, 15.a, and 15.b, as applicable; and, for advanced approaches institutions, item 16.

Banks must consider all available evidence, both positive and negative, in assessing the need for a valuation allowance. The future realization of deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character in either the carryback or carryforward period. Four sources of taxable income may be available to realize the deferred tax assets:

- (1) Taxable income in carryback years (which can be offset to recover taxes previously paid),
- (2) Reversing taxable temporary differences,
- (3) Future taxable income (exclusive of reversing temporary differences and carryforwards.
- (4) Tax-planning strategies.

In general, positive evidence refers to the existence of one or more of the four sources of taxable income. To the extent evidence about one or more sources of income is sufficient to support a conclusion that a valuation allowance is not necessary (i.e., the bank can conclude that the deferred tax asset is more likely than not to be realized), other sources need not be considered. However, if a valuation allowance is needed, each source of income must be evaluated to determine the appropriate amount of the allowance needed.

Evidence used in determining the valuation allowance should be subject to objective verification. The weight given to evidence when both positive and negative evidence exist should be consistent with the extent to which it can be verified. Sources (1) and (2) listed above are more susceptible to objective verification and, therefore, may provide sufficient evidence regardless of future events.

The consideration of future taxable income (exclusive of reversing temporary differences and carryforwards) as a source for the realization of deferred tax assets will require subjective estimates and judgments about future events which may be less objectively verifiable.

Examples of negative evidence include:

- Cumulative losses in recent years.
- A history of operating loss or tax credit carryforwards expiring unused.
- Losses expected in early future years by a presently profitable bank.
- Unsettled circumstances that, if unfavorably resolved, would adversely affect future profit levels.
- A brief carryback or carryforward that would limit the ability to realize the deferred tax asset.

Examples of positive evidence include:

- A strong earnings history exclusive of the loss that created the future deductible amount (tax loss carryforward or deductible temporary difference) coupled with evidence indicating that the loss is an aberration rather than a continuing condition.
- Existing contracts that will generate significant income.
- An excess of appreciated asset value over the tax basis of an entity's net assets in an amount sufficient to realize the deferred tax asset.

Income Taxes (cont.):

When realization of a bank's deferred tax assets is dependent upon future taxable income, the reliability of a bank's projections is very important. The bank's record in achieving projected results under an actual operating plan will be a strong measure of this reliability. Other factors a bank should consider in evaluating evidence about its future profitability include but are not limited to current and expected economic conditions, concentrations of credit risk within specific industries and geographical areas, historical levels and trends in past due and nonaccrual assets, historical levels and trends in loan loss reserves, and the bank's interest rate sensitivity.

When strong negative evidence, such as the existence of cumulative losses, exists, it is extremely difficult for a bank to determine that no valuation allowance is needed. Positive evidence of significant quality and quantity would be required to counteract such negative evidence.

For purposes of determining the valuation allowance, a tax-planning strategy is a prudent and feasible action that would result in realization of deferred tax assets and that management ordinarily might not take, but would do so to prevent an operating loss or tax credit carryforward from expiring unused. For example, a bank could accelerate taxable income to utilize carryforwards by selling or securitizing loan portfolios, selling appreciated securities, or restructuring nonperforming assets. Actions that management would take in the normal course of business are not considered tax-planning strategies.

Significant expenses to implement the tax-planning strategy and any significant losses that would result from implementing the strategy shall be considered in determining any benefit to be realized from the tax-planning strategy. Also, banks should consider all possible consequences of any tax-planning strategies. For example, loans pledged as collateral would not be available for sale.

The determination of whether a valuation allowance is needed for deferred tax assets should be made for total deferred tax assets, not for deferred tax assets net of deferred tax liabilities. In addition, the evaluation should be made on a jurisdiction-by-jurisdiction basis. Separate analyses should be performed for amounts related to each taxing authority (e.g., federal, state, and local).

Deferred tax assets (net of the valuation allowance) and deferred tax liabilities related to a particular tax jurisdiction (e.g., federal, state, and local) may be offset against each other for reporting purposes. A resulting debit balance shall be included in "Other assets" and reported in Schedule RC-F, item 2. A resulting credit balance shall be included in "Other liabilities" and reported in Schedule RC-G, item 2. (A bank may report a net deferred tax debit, or asset, for one tax jurisdiction (e.g., federal taxes) and also report a net deferred tax credit, or liability, for another tax jurisdiction (e.g., state taxes).

Interim period applicable income taxes – When preparing its year-to-date Consolidated Report of Income as of the end of March, June, and September ("interim periods"), a bank generally should determine its best estimate of its effective annual tax rate for the full year, including both current and deferred portions and considering all tax jurisdictions (e.g., federal, state and local). To arrive at its estimated effective annual tax rate, a bank should divide its estimated total applicable income taxes (current and deferred) for the year by its estimated pretax income for the year (excluding discontinued operations). This rate would then be applied to the year-to-date pretax income to determine the year-to-date applicable income taxes at the interim date.

Intraperiod allocation of income taxes – When the Consolidated Report of Income for a period includes the results of "Discontinued operations" that are reportable in Schedule RI, item 11, the total amount of the applicable income taxes for the year to date shall be allocated in Schedule RI between item 9, "Applicable income taxes (on item 8.c)," and item 11, "Discontinued operations, net of applicable income taxes."

The applicable income taxes on operating income (item 9) shall be the amount that the total applicable income taxes on pretax income, including both current and deferred taxes (calculated as described above), would have been for the period had the results of "Discontinued operations" been zero.

Income Taxes (cont.):

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

Tax calculations by tax jurisdiction – Separate calculations of income taxes, both current and deferred amounts, are required for each tax jurisdiction. However, if 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 Consolidated 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 that files a consolidated tax return should record current tax expense for the amount that 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 stockholders (including a parent holding company)" in Schedule RI-A, Changes in Bank Equity Capital.

In addition, bank subsidiaries should first compute their taxes on a separate entity basis without considering the alternative minimum tax (AMT).¹ 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 stockholders (including a parent holding company)" in Schedule RI-A, Changes in Bank Equity Capital.

¹ The 2017 federal tax law known as the Tax Cuts and Jobs Act eliminates the corporate AMT for tax years beginning on or after January 1, 2018. The law also provides for the use of existing AMT credits to offset a bank's regular tax liability for tax years beginning in 2018, 2019, and 2020, with any remaining AMT credit carryforwards fully refundable in the tax year beginning in 2021.

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. 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, item 11, "Other transactions with stockholders (including a parent holding company)," and in Schedule RI-E, item 5.

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 9. 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.

Purchase business combinations -- 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 ASC Topic 740). 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 that 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, 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.

Income Taxes (cont.):

Alternative Minimum Tax¹ – 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 particular items in Schedule RI-A of the Consolidated Report of Income such as "Restatements due to corrections of material accounting errors and changes in accounting principles," and, on the FFIEC 031 only, "Foreign currency translation adjustments" that are included in "Other comprehensive income." These transactions or other items may 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 Consolidated 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 ASC Topic 740.

Intangible Assets: See "Business Combinations" and the instructions to Consolidated Report of Condition Schedule RC-M, item 2.

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 ASC Subtopic 350-40, Intangibles-Goodwill and Other – Internal-Use Software. A summary of this accounting guidance follows. For further information, see ASC Subtopic 350-40.

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.

ASC Subtopic 350-40 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.

¹ See the footnote on the alternative minimum tax in the section of this Glossary entry on "Income taxes of a bank subsidiary of a holding company," above.

Internal-Use Computer Software (cont.):

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;
- (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 ASC Topic 360, Property, Plant, and Equipment.

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 ASC Subtopic 985-20, Software – Costs of Software to Be Sold, Leased or 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 Regulation D](#). 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.

International Banking Facility (IBF) (cont.):

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.

Permissible IBF liabilities include (as specified in [Federal Reserve Regulation D](#)) liabilities to non-U.S. nonbank residents only if such liabilities have a minimum maturity or notice period of at least two business days. IBF liabilities also may include overnight liabilities to:

- (1) non-U.S. offices of other depository institutions and of Edge or Agreement corporations;
- (2) non-U.S. offices of foreign banks;
- (3) foreign governments and official institutions;
- (4) other IBFs; and
- (5) the establishing entity.

IBF liabilities may be issued in the form of deposits, borrowings, placements, and other similar instruments. However, IBFs are prohibited from issuing negotiable certificates of deposit, bankers acceptances, or other negotiable or bearer instruments.

Treatment of the reporting bank's IBFs in the Consolidated Reports of Condition and Income – IBFs established by the reporting bank (i.e., by the bank or by its Edge or Agreement subsidiaries) are to be consolidated in the Consolidated Reports of Condition and Income. In the consolidated balance sheet (Schedule RC) and income statement (Schedule RI), transactions between the IBFs of the reporting bank and between these IBFs and other offices of the bank are to be eliminated. (See the discussion of consolidation in the General Instructions section of this book.)

For purposes of these reports, the reporting bank's IBFs are to be treated as foreign offices of the bank. Thus, a bank with an IBF, even if it has no other foreign offices, must submit the Consolidated Reports of Condition and Income applicable to banks with foreign offices (FFIEC 031). Similarly, the reporting bank's IBFs are to be treated as foreign offices where, in the supporting schedules, a distinction is made between foreign and domestic offices of the reporting bank.

Assets of the reporting bank's IBFs should be reported in the asset categories of the report by type of instrument and customer, as appropriate. For example, IBFs are to report their holdings of securities in Schedule RC, item 2, and in the appropriate items of Schedule RC-B; their holdings of loans that the IBF has the intent and ability to hold for the foreseeable future or until maturity or payoff (including loans of immediately available funds that have an original maturity of one business day or roll over under a continuing contract that are not securities resale agreements) in Schedule RC, item 4.b, and in the appropriate items of Schedule RC-C, Part I; and securities purchased under agreements to resell in Schedule RC, item 3.b.

For purposes of these reports, all liabilities of the reporting bank's IBFs to outside parties are classified under four headings:

- (1) Securities sold under agreements to repurchase, which are to be reported in Schedule RC, item 14.b;
- (2) Borrowings of immediately available funds that have an original maturity of one business day or roll over under a continuing contract that are not securities repurchase agreements, which are to be reported in Schedule RC-M, item 5.b;

International Banking Facility (IBF) (cont.):

- (3) Accrued liabilities, which are to be reported in Schedule RC, item 20; and
- (4) All other liabilities, including deposits, placements, and borrowings, which are to be treated as deposit liabilities in foreign offices and reported in Schedule RC, item 13.b, and by customer detail in Schedule RC-E, Part II, if applicable.

In addition to being included in the appropriate items of the balance sheet, the total assets and total liabilities of the reporting bank's IBFs are to be reported separately in Schedule RC-I, Assets and Liabilities of IBFs, by banks with IBFs and other "foreign" offices. For a bank whose only foreign offices are IBFs, the total assets and liabilities of the reporting bank's IBFs are not reported separately in Schedule RC-I, but are derived from Schedule RC-H, Selected Balance Sheet Items for Domestic Offices.

Treatment of transactions with IBFs of other depository institutions – Transactions between the reporting bank and IBFs outside the scope of the reporting bank's Consolidated Reports of Condition and Income are to be reported as transactions with depository institutions in the U.S., as appropriate. (Note, however, that only foreign offices of the reporting bank and the reporting bank's IBFs are permitted to have transactions with other IBFs.)

Interoffice Accounts: See "Suspense Accounts."

Investments in Common Stock of Unconsolidated Subsidiaries: See "Equity Method of Accounting" and "Subsidiaries."

Joint Venture: See "Subsidiaries."

Lease Accounting: A lease is an agreement that transfers the right to use land, buildings, or equipment for a specified period of time. This financing device is essentially an extension of credit evidenced by an obligation between a lessee and a lessor.

Since the creation of the ASC by the FASB, standards for lease accounting have been set forth in ASC Topic 840, Leases. In February 2016, the FASB issued ASU No. 2016-02, "Leases," which added ASC Topic 842, Leases. The FASB has since issued various codification improvements for leases in ASU 2018-10, "Codification Improvements to Topic 842, Leases"; ASU 2018-11, "Leases (Topic 842): Targeted Improvements"; ASU 2018-20, "Leases (Topic 842): Narrow-Scope Improvements for Lessors"; and ASU 2019-01, "Leases (Topic 842): Codification Improvements"; hereafter referred to collectively as the "Standard" or ASC Topic 842. Upon an institution's adoption of the Standard, based on the effective dates below, ASC Topic 842 supersedes ASC Topic 840, Leases. Accordingly, institutions that are required to adopt or have elected to early adopt ASC Topic 842 should follow the guidance in that section of this Glossary entry.

For institutions that are public business entities as defined in U.S. GAAP, ASC Topic 842 is effective for fiscal years beginning after December 15, 2018, including interim reporting periods within those fiscal years. Thus, for institutions that are public business entities, ASC Topic 842 is currently in effect. (For further information, see the Glossary entry for "Public Business Entity.") For institutions that are not public business entities, the FASB issued ASU 2020-05, "Effective Dates for Certain Entities," on June 3, 2020, to defer the effective date of ASC Topic 842 by one year. As amended by ASU 2020-05, ASC Topic 842 will take effect for entities that are not public business entities for fiscal years beginning after December 15, 2021, and interim reporting periods within fiscal years beginning after December 15, 2022. Early application of the Standard is permitted for all institutions. An institution that early adopts the Standard must apply it in its entirety to all lease-related transactions. If an institution chooses to early adopt the Standard for financial reporting purposes, the institution should implement the new Standard in its Call Report for the same quarter-end report date.

Lease Accounting (cont.):

ASC Topic 842 does not fundamentally change the lessor accounting in ASC Topic 840; however, ASC Topic 842 aligns terminology between lessee and lessor accounting and brings key aspects of lessor accounting into alignment with the FASB's new revenue recognition guidance in ASC Topic 606, Revenue from Contracts with Customers. As a result, the classification difference between direct financing leases and sales-type leases for lessors in ASC Topic 840 moves from a risk-and-rewards principle to a transfer-of-control principle. There is no longer a distinction in the treatment of real estate and non-real estate leases by lessors in ASC Topic 842.

The most significant change that ASC Topic 842 makes, upon its adoption by an institution, is to lessee accounting. Under the predecessor accounting standard (ASC Topic 840), lessees recognize lease assets and lease liabilities on the balance sheet for capital leases, but do not recognize operating leases on the balance sheet. ASC Topic 842 instead requires institutions that lease premises and other fixed assets as lessees to recognize a right-of-use (ROU) asset and a lease liability on its balance sheet for most operating leases. When preparing to implement ASC Topic 842, institutions will need to analyze their existing lease contracts to determine the cumulative-effect adjustment and other balance sheet entries to record as of the effective date of the adoption of ASC Topic 842.

Accounting for Leases under ASC Topic 840

This section of this Glossary entry applies to institutions that have not adopted ASC Topic 842. For institutions that have adopted ASC Topic 842, Leases, this section is no longer applicable. Refer to the "Accounting for Leases under ASC Topic 842" section below.

Accounting and Reporting by an Institution as Lessee – Any lease entered into by a lessee institution that meets certain criteria (defined in the following paragraph) shall be accounted for as a property acquisition financed with a debt obligation. The property shall be amortized according to the institution's normal depreciation policy (except, if appropriate, the amortization period shall be the lease term) unless the lease involves land only. The interest expense portion of each lease payment shall be calculated to result in a constant rate of interest on the balance of the debt obligation. In the Consolidated Report of Condition, the property "asset" is to be reported in Schedule RC, item 6, "Premises and fixed assets," and the liability for capitalized leases in Schedule RC-M, items 5.b, "Other borrowings," and 10.b, "Amount of 'Other borrowings' that are secured." In the Consolidated Report of Income, the interest expense portion of the capital lease payments is to be reported in Schedule RI, item 2.c, "Interest on trading liabilities and other borrowed money," and the amortization expense on the asset is to be reported in Schedule RI, item 7.b, "Expenses of premises and fixed assets."

If any one of the following criteria is met, a lease must be accounted for as a capital lease:

- (1) Ownership of the property is transferred to the lessee at the end of the lease term; or
- (2) The lease contains a bargain purchase option; or
- (3) The lease term represents at least 75 percent of the estimated economic life of the leased property; or
- (4) The present value of the minimum lease payments at the beginning of the lease term is 90 percent or more of the fair value of the leased property to the lessor at the inception of the lease less any related investment tax credit retained by and expected to be realized by the lessor.

If none of the above criteria is met, the lease should be accounted for as an operating lease. Normally, rental payments should be charged to expense over the term of the operating lease as they become payable.

NOTE: If a lease involves land only, the lease must be capitalized if either of the first two criteria above is met. Where a lease that involves land and building meets either of these two criteria, the land

Lease Accounting (cont.):

and building must be separately capitalized by the lessee. The accounting for a lease involving land and building that meets neither of the first two criteria should conform to the standards prescribed by ASC Topic 840.

Accounting for Sales with Leasebacks – Sale-leaseback transactions involve the sale of property by the owner and a lease of the property back to the seller. If an institution sells premises or fixed assets and leases back the property, the lease shall be treated as a capital lease if it meets any one of the four criteria above for capitalization. Otherwise, the lease shall be accounted for as an operating lease.

As a general rule, the institution shall defer any gain resulting from the sale. For capital leases, this deferred gain is amortized in proportion to the depreciation taken on the leased asset. For operating leases, the deferred gain is amortized in proportion to the rental payments the institution will make over the lease term. The unamortized deferred gain is to be reported in Schedule RC-G, item 4, "All other liabilities." (Exceptions to the general rule on deferral that permit full or partial recognition of a gain at the time of the sale may occur if the leaseback covers less than substantially all of the property that was sold or if the total gain exceeds the minimum lease payments.)

If the fair value of the property at the time of the sale is less than the book value of the property, the difference between these two amounts shall be recognized as a loss immediately. In this case, if the sales price is less than the fair value of the property, the additional loss shall be deferred since it is in substance a prepayment of rent. Similarly, if the fair value of the property sold is greater than its book value, any loss on the sale shall also be deferred. Deferred losses shall be amortized in the same manner as deferred gains as described above.

For further information, see ASC Subtopic 840-40, Leases – Sale-Leaseback Transactions.

Accounting and Reporting by an Institution as Lessor – Unless a long-term creditor is also involved in the transaction, a lease entered into by a lessor institution that meets one of the four criteria above for a capital lease plus two additional criteria (as defined below) shall be treated as a direct financing lease. The unearned income (minimum lease payments plus estimated residual value plus initial direct costs less the cost of the leased property) shall be amortized to income over the lease term in a manner which produces a constant rate of return on the net investment (minimum lease payments plus estimated residual value plus initial direct costs less unearned income). Other methods of income recognition may be used if the results are not materially different.

The following two additional criteria must be met for a lease to be classified as a direct financing lease:

- (1) Collectability of the minimum lease payments is reasonably predictable.
- (2) No important uncertainties surround the amount of unreimbursable costs yet to be incurred by the lessor under the lease.

When a lessor institution enters into a lease that has all the characteristics of a direct financing lease but where a long-term creditor provides nonrecourse financing to the lessor, the transaction shall be accounted for as a leveraged lease. The lessor's net investment in a leveraged lease shall be recorded in a manner similar to that for a direct financing lease but net of the principal and interest on the nonrecourse debt. Based on a projected cash flow analysis for the lease term, unearned and deferred income shall be amortized to income at a constant rate only in those years of the lease term in which the net investment is positive. In the years in which the net investment is not positive, no income is to be recognized on the leveraged lease.

If a lease is neither a direct financing lease nor a leveraged lease, the lessor institution shall account for it as an operating lease. The leased property shall be reported as "Other assets" and depreciated in accordance with the institution's normal policy. Rental payments are generally credited to income over the term of an operating lease as they become receivable.

Lease Accounting (cont.):Accounting for Leases under ASC Topic 842

This section of this Glossary entry applies to institutions that have adopted ASC Topic 842. Institutions that have not adopted ASC Topic 842 should continue to refer to the “Accounting for Leases under ASC Topic 840” section above.

Lease Term – The Standard defines lease term as the noncancellable period for which a lessee has the right to use an underlying asset, together with all of the following:

- (1) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option;
- (2) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option; and
- (3) Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.

Reasonable certainty is based on an assessment of factors at the commencement date of the lease that would create an economic incentive for the lessee either to exercise or not exercise an option to extend, terminate, or purchase. The commencement date of the lease is the date on which the lessor makes the underlying asset available for use by the lessee. Examples of factors that could create economic incentives that should be considered include (1) a lease renewal option priced below market rates and (2) significant leasehold improvements that would be impaired, business interruption costs, and relocation costs if the lease term were not extended. For additional information on the lease term, reasonable certainty, and commencement date, refer to ASC Topic 842.

Accounting and Reporting by an Institution as Lessee – ASC Topic 842 distinguishes between an operating lease and a finance lease (formerly classified as a capital lease under ASC Topic 840). The Standard requires all lessees to report an ROU asset and a lease liability on the balance sheet for most operating and finance leases. The ROU asset reflects the lessee’s control over the leased item’s economic benefits during the lease term.

While most leases will be reported on a lessee’s balance sheet, the Standard permits a lessee to make an accounting policy election to exempt leases from balance sheet recognition as long as the lease, as of its commencement date, has a lease term, as defined above, of 12 months or less and does not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise. This accounting policy election for short-term leases must be made by class of underlying asset.

In the Consolidated Report of Condition, ROU assets for operating leases and finance leases should be reported in Schedule RC, item 6, “Premises and fixed assets.” Lease liabilities for finance leases should be reported in Schedule RC-M, items 5.b, “Other borrowings,” and 10.b, “Amount of ‘Other borrowings’ that are secured.” Lease liabilities for operating leases should be reported in Schedule RC-G, item 4, “All other liabilities.”

In the Consolidated Report of Income, the interest expense on lease liabilities for finance leases (measured using the effective interest method) should be reported in Schedule RI, item 2.c, “Interest on trading liabilities and other borrowed money.” The amortization expense (typically straight-line) on the ROU asset for a finance lease should be reported in Schedule RI, item 7.b, “Expenses of premises and fixed assets.” The ROU asset for a finance lease generally should be amortized on a straight-line basis from the commencement date of the lease to the earlier of the end of the useful life of the ROU asset or the end of the lease term.

Lease Accounting (cont.):

In the Consolidated Report of Income, operating lease expenses are to be reported in Schedule RI, item 7.b, "Expenses of premises and fixed assets," as a single lease cost calculated so that this cost (i.e., the interest on the lease liability and the amortization of the ROU asset) is allocated over the lease term, generally on a straight-line basis.

Lease Classification - Lessee – A lessee classifies a lease as a finance lease¹ when the terms of the lease effectively transfer control of the underlying asset and the substance of the transaction is reflective of a sale. This occurs when any of the following five criteria are met:

- (1) The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- (2) The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
- (3) The lease term is for the major part of the remaining economic life of the underlying asset. However, if the commencement date of the lease falls at or near the end of the economic life of the underlying asset, this criterion shall not be used for the purpose of classifying the lease.
- (4) The present value of the sum of the lease payments, as defined in ASC Topic 842, and any residual value guaranteed by the lessee that is not already reflected in the lease payments equals or exceeds substantially all of the fair value of the underlying asset.
- (5) The underlying asset is such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

If none of the finance lease criteria are met and the lease is not a short-term lease for which the institution has elected the short-term lease policy election, the lease is classified as an operating lease.

Lease Measurement – Lessee – The determination of whether a contract is or contains a lease is performed at its inception (the date the contract is agreed upon) and is reassessed only if the terms and conditions of the contract are changed. The classification and measurement of a lease are determined at the commencement date of the lease.

At the commencement date, the ROU asset consists of:

- (1) The amount of the initial measurement of the lease liability;
- (2) Any lease payments made to the lessor at or before the commencement date, minus any lease incentives received; and
- (3) Any initial direct costs incurred by the lessee.

At the commencement date, the lease liability equals the present value of the lease payments not yet paid, discounted using the discount rate for the lease.² The lease payments consist of:

- (1) Fixed lease payments, less any lease incentives payable to the lessee;

¹ ASC Topic 842 requires that land be considered a separate lease component in a contract involving land and other assets, unless the effect of separately accounting for the land portion of the contract is insignificant.

² As defined in ASC Topic 842, the discount rate for the lease for a lessee is the rate implicit in the lease (see the footnote in the "Lease Measurement – Lessor – Sales-Type and Direct Financing Leases" section below) unless that rate cannot be readily determined, in which case the lessee is required to use its incremental borrowing rate. The lessee's incremental borrowing rate is the rate of interest that the lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment.

Lease Accounting (cont.):

- (2) Variable lease payments tied to an index or a rate, measured using the index or rate at lease commencement;
- (3) The exercise price of an option to purchase the leased asset, if that option is reasonably certain of being exercised;
- (4) Payments for penalties to terminate the lease, if it is reasonably certain that such penalties will be incurred;
- (5) Fees owed by the lessee to the owners of a special-purposes entity for structuring the transaction; and
- (6) Amounts probable of being owed by the lessee under residual value guarantees.

Regulatory Capital Treatment of Leases for a Lessee – To the extent an ROU asset arises due to a lessee's lease of a tangible asset (e.g., building or equipment), the lessee institution should treat the ROU asset as a tangible asset not subject to deduction from regulatory capital. ROU assets must be risk weighted at 100 percent in accordance with the agencies' regulatory capital rules and included in the lessee institution's calculation of total risk-weighted assets, except for an institution subject to the community bank leverage ratio (CBLR) framework. In addition, the lessee institution should include its ROU assets in its total assets for leverage ratio calculation purposes.

Accounting and Reporting by an Institution as Lessor – ASC Topic 842 does not significantly change the lessor's accounting under ASC Topic 840. ASC Topic 842 clarifies that, for sales-type and direct financing leases, the lessor assesses its net investment in the lease (described below under "Lease Measurement – Lessor") for impairment under ASC Topic 310, Receivables, or ASC Subtopic 326-20, Financial Instruments – Credit Losses – Measured at Amortized Cost, as applicable.¹ Operating lease assets remain on the lessor's balance sheet and shall be assessed for impairment under ASC Topic 360, Property, Plant, and Equipment.

In the Consolidated Report of Condition, the lessor should report the net investment in the lease in Schedule RC-C, Part I, item 10, "Lease financing receivables." In the Consolidated Report of Income, the income on the lease should be reported in Schedule RI, item 1.b, "Income from lease financing receivables."

For operating leases, the lessor shall depreciate the leased property in accordance with the institution's normal policy and reports the property (net of depreciation) in Schedule RC-F, item 6, "All other assets." Rental income is reported in Schedule RI, item 5.1, "Other noninterest income," over the term of an operating lease.

Lease Classification – Lessor – Accounting by an institution as a lessor results in classifying a lease as a sales-type, direct financing, or operating lease based on an assessment of the criteria described in the following paragraphs at the commencement date of the lease.

A lessor classifies a lease as a sales-type lease if any one of the five criteria described above under "Lease Classification – Lessee" is met, subject to the clarification of criterion (4) described below. Otherwise, the lessor is required to assess whether the lease is a direct financing lease or an operating lease.

¹ The guidance in ASC Subtopic 326-20, which introduces the current expected credit losses methodology (CECL), should be applied to the net investment in the lease once this Subtopic is adopted.

Lease Accounting (cont.):

A lease that does not meet any of the five criteria for a sales-type lease, but meets the following two criteria, shall be classified as a direct financing lease.

- (1) The present value of the sum of the lease payments and any residual value guaranteed by the lessee that is not already reflected in the lease payments and/or any other third party unrelated to the lessor equals or exceeds substantially all of the fair value of the underlying asset; and
- (2) It is probable that the lessor will collect the lease payments plus any amount necessary to satisfy a residual value guarantee.

If a lease does not meet the criteria for a sales-type or a direct financing lease, the lessor institution shall account for the lease as an operating lease.

For purposes of assessing criterion (4) above under “Lease Classification – Lessee” for a sales-type lease and criterion (1) above for a direct financing lease, the codification improvements in ASU 2019-01 clarified that, for a lessor that is not a manufacturer or a dealer (e.g., a financial institution), the fair value of the underlying asset at lease commencement is ordinarily its cost, reflecting any volume or trade discounts that may apply, instead of fair value as defined in ASC Topic 820, Fair Value Measurement. However, if significant time lapses between the acquisition of the underlying asset and lease commencement, a lessor institution is required to apply the definition of fair value in ASC Topic 820.

Lease Measurement – Lessor – Sales-Type and Direct Financing Leases – At the commencement date of the lease, the net investment in a sales-type or a direct financing lease is measured at the present value of the following amounts, discounted using the rate implicit in the lease:¹

- (1) The lease payments not yet received by the lessor;
- (2) The amount the lessor expects to derive from the underlying asset following the end of the lease term that is guaranteed by the lessee or any other third party unrelated to the lessor; and
- (3) The amount the lessor expects to derive from the underlying asset following the end of the lease term that is not guaranteed by the lessee or any other third party unrelated to the lessor (i.e., the unguaranteed residual asset).

In a direct financing lease, selling profit, if any, and initial direct costs are deferred at the commencement date and included in the net investment in the lease, but any selling loss arising from the lease must be recognized. When no selling profit or loss is recognized in a sales-type lease, initial direct costs are deferred at the commencement date and recognized over the lease term as part of the net investment in the lease.

In addition, at the lease commencement date, the lessor should derecognize the carrying amount of the underlying asset (if previously recognized) unless the lease is a sales-type lease and collectibility of the lease payments is not probable as discussed below.

Collectibility – Lessor – Sales-Type and Direct Financing Leases – In recording either a sales-type lease or a direct financing lease, the collectibility of amounts due under the lease, including any amount necessary to satisfy a residual value guarantee, must be probable at the lease commencement

¹ As defined in ASC Topic 842, the rate implicit in the lease is the rate of interest that, at a given date, causes the aggregate present value of (a) the lease payments and (b) the amount that a lessor expects to derive from the underlying asset following the end of the lease term to equal the sum of (1) the fair value of the underlying asset minus any related investment tax credit retained and expected to be realized by the lessor and (2) any deferred initial direct costs of the lessor.

Lease Accounting (cont.):

date. If collectibility is not probable, a lease that would otherwise be classified as a direct financing lease should be accounted for as an operating lease. For a sales-type lease, if collectibility of amounts due under the lease is not probable at the lease commencement date, the institution, as lessor, should neither derecognize the underlying asset nor recognize the net investment in the lease. Instead, the institution, as lessor, should recognize lease payments received as a liability until the earliest of the following:

- (1) The collectibility of amounts due under the lease becomes probable; or
- (2) The contract has been terminated and the lease payments received are nonrefundable; or
- (3) The institution, as lessor, has repossessed the leased asset, it has no further obligation under the lease to the lessee, and the lease payments received are nonrefundable.

In a sales-type lease, any selling profit or loss arising from the lease is recognized in full and initial direct costs generally are expensed by the lessor at the commencement date unless there is no selling profit or loss to be recognized or collectibility of amounts due under the lease is not probable.

Operating Lease - Lessor – In an operating lease, the leased asset remains on the lessor's balance sheet and continues to be depreciated over its estimated useful life. The lessor defers initial direct costs at the commencement date of the lease. The lease payments and initial direct costs generally are recognized in income and expense, respectively, over the lease term on a straight-line basis, or on another systematic and rational basis if it is more representative of the pattern in which benefit is expected to be derived from (i.e., income is earned from) the use of the underlying asset. Other methods of income recognition may be used if the results are not materially different. The lessor is required to use the guidance in ASC Topic 842 to assess the probability of collection of the lease payments from a lessee at, as well as after, the lease commencement date. A lessor may elect to supplement the guidance in ASC Topic 842 with the portfolio allowance approach in ASC Subtopic 450-20, Contingencies – Loss Contingencies.

Leveraged Leases – Leveraged leases no longer exist under ASC Topic 842. The Standard grandfathers the ASC Topic 840 accounting treatment for leveraged leases existing on the date of adoption of ASC Topic 842. However, lessors are required to follow the criteria in ASC Topic 842 when classifying and accounting for any grandfathered leveraged leases modified after the date of adoption of the Standard.

Sale and Leaseback Transactions – In a sale and leaseback transaction, the seller-lessee sells an asset it owns to the buyer-lessor and leases back all or a portion of the same asset for all or a portion of the asset's remaining economic life. For the transfer of an asset in a sale and leaseback transaction to qualify for sale treatment, ASC Topic 842 requires certain criteria within ASC Topic 606 to be met. In general, under ASC Topic 606, an institution is required to determine whether a contract exists (within the meaning of ASC Topic 606) and whether the seller-lessee has satisfied its performance obligations by transferring control of the asset to the buyer-lessor.

These criteria also require, among other things, that a contract with a related party have commercial substance (that is, the risk, timing, or amount of the seller-lessee's future cash flows is expected to change as a result of the contract). Related party contracts that lack commercial substance will not qualify for sale treatment in sale and leaseback transactions.

An option for the seller-lessee to repurchase the asset would preclude accounting for the transfer of the asset as a sale unless both of the following criteria are met:

- (1) The exercise price of the option is the fair value of the asset at the time the option is exercised; and
- (2) There are alternative assets, substantially the same as the transferred asset, readily available in the marketplace.

Lease Accounting (cont.):

However, if the contract for the asset transfer contains a repurchase option and the leased asset is real estate, control of the asset has not been transferred to the buyer-lessor and therefore the transaction is not expected to meet the criteria necessary under ASC Topic 606 to recognize a sale. Additionally, if the leaseback is a finance lease for the seller-lessee, control has not been transferred, and thus there is no sale.

The classification of a lease can also impact whether a sale has occurred for accounting purposes. In the event a leaseback is classified as a finance lease by the seller-lessee, or a sales-type lease by the buyer-lessor, then a sale has not occurred since a finance lease is essentially the purchase of an asset and a sales-type lease is essentially a sale of an asset. As such, the transaction would be considered a failed sale and leaseback transaction.

If the transaction qualifies as a sale in accordance with ASC Topic 606 and the transaction would not be considered a failed sale and leaseback, any gain or loss on the sale is recognized immediately. If the transaction would not meet the criteria for a sale under ASC Topic 606, or when the leaseback would not be classified as an operating lease by the seller-lessee (i.e., would be a failed sale and leaseback), the transaction would be accounted for as a financing arrangement by the seller-lessee and a lending transaction by the buyer-lessor. The seller-lessee would not derecognize the transferred asset and would continue to depreciate the asset as if it were the legal owner. Any sales proceeds received by the seller-lessee would be reported as a liability.

Letter of Credit: A letter of credit is a document issued by a bank on behalf of its customer (the account party) authorizing a third party (the beneficiary), or in special cases the account party, to draw drafts on the bank up to a stipulated amount and with specified terms and conditions. The letter of credit is a conditional commitment (except when prepaid by the account party) on the part of the bank to provide payment on drafts drawn in accordance with the terms of the document.

As a matter of sound practice, letters of credit should:

- (1) Be conspicuously labeled as a letter of credit;
- (2) Contain a specified expiration date or be for a definite term;
- (3) Be limited in amount;
- (4) Call upon the issuing bank to pay only upon the presentation of a draft or other documents as specified in the letter of credit and not require the issuing bank to make determinations of fact or law at issue between the account party and the beneficiary; and
- (5) Be issued only subject to an agreement between the account party and the issuing bank that establishes the unqualified obligation of the account party to reimburse the issuing bank for all payments made under the letter of credit.

There are four basic types of letters of credit:

- (1) A commercial letter of credit is issued specifically to facilitate trade or commerce. Under the terms of a commercial letter of credit, as a general rule, drafts will be drawn when the underlying transaction is consummated as intended.
- (2) A letter of credit sold for cash is a letter of credit for which the bank has received funds from the account party at the time of issuance. This type of letter of credit is not to be reported as an outstanding letter of credit but as a demand deposit. These letters are considered to have been sold for cash even though the bank may have advanced funds to the account party for the purchase of such letters of credit on a secured or unsecured basis.

Letter of Credit (cont.):

- (3) A travelers' letter of credit is issued to facilitate travel. This letter of credit is addressed by the bank to its correspondents authorizing the correspondents to honor drafts drawn by the person named in the letter of credit in accordance with specified terms. These letters are generally sold for cash.
- (4) A standby letter of credit is a letter of credit or similar arrangement that:
 - (a) Represents an obligation on the part of the issuing bank to a designated third party (the beneficiary) contingent upon the failure of the issuing bank's customer (the account party) to perform under the terms of the underlying contract with the beneficiary, or
 - (b) Obligates the bank to guarantee or stand as surety for the benefit of a third party to the extent permitted by law or regulation.

The underlying contract may entail either financial or nonfinancial undertakings of the account party with the beneficiary. The underlying contract may involve such things as the customer's payment of commercial paper, delivery of merchandise, completion of a construction contract, release of maritime liens, or repayment of the account party's obligations to the beneficiary. Under the terms of a standby letter, as a general rule, drafts will be drawn only when the underlying event fails to occur as intended.

Limited-Life Preferred Stock: See "Preferred Stock."

Loan: For purposes of these reports, a loan is generally an extension of credit resulting from direct negotiations between a lender and a borrower. The reporting bank may originate a loan by directly negotiating with a borrower or it may purchase a loan or a portion of a loan originated by another lender that directly negotiated with a borrower. The reporting bank may also sell a loan or a portion of a loan, regardless of the method by which it acquired the loan.

Loans may take the form of promissory notes, acknowledgments of advance, due bills, invoices, overdrafts, acceptances, and similar written or oral obligations.

Among the extensions of credit reportable as loans in Schedule RC-C, which covers both loans held for sale and loans held for investment, are:

- (1) Acceptances of other banks purchased in the open market, not held for trading;
- (2) Acceptances executed by or for the account of the reporting bank and subsequently acquired by it through purchase or discount;
- (3) Customers' liability to the reporting bank on drafts paid under letters of credit for which the bank has not been reimbursed;
- (4) "Advances" and commodity or bill-of-lading drafts payable upon arrival of goods against which drawn, for which the reporting bank has given deposit credit to customers;
- (5) Paper pledged by the bank whether for collateral to secure bills payable (e.g., margin collateral to secure bills rediscounted) or for any other purpose;
- (6) Sales of so-called "term federal funds" (i.e., sales of immediately available funds with a maturity of more than one business day), other than those involving security resale agreements;
- (7) Factored accounts receivable;
- (8) Loans arising out of the purchase of assets (other than securities) under resale agreements with a maturity of more than one business day if the agreement requires the bank to resell the identical asset purchased; and

Loan (cont.):

- (9) Participations (acquired or held) in a single loan or in a pool of loans or receivables (see the discussion of loan participations in the Glossary entry for "Transfers of Financial Assets").

Loan assets held for trading are to be reported in Schedule RC, item 5, "Trading assets."

See also "Loan Secured by Real Estate," "Overdraft," and "Transfers of Financial Assets."

Loan Fees: The accounting standards for nonrefundable fees and costs associated with lending, committing to lend, and purchasing a loan or group of loans are set forth in ASC Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs, a summary of which follows. The statement applies to all types of loans as well as to debt securities (but not to loans or debt securities carried at fair value if the changes in fair value are included in earnings) and to all types of lenders. For further information, see ASC Subtopic 310-20.

A bank may acquire a loan by originating the loan (lending) or by acquiring a loan from a party other than the borrower (purchasing). Lending, committing to lend, refinancing or restructuring loans, arranging standby letters of credit, syndicating loans, and leasing activities are all considered "lending activities." Nonrefundable loan fees paid by the borrower to the lender may have many different names, such as origination fees, points, placement fees, commitment fees, application fees, management fees, restructuring fees, and syndication fees, but in this Glossary entry, they are referred to as loan origination fees, commitment fees, or syndication fees.

ASC Subtopic 310-20 applies to both a lender and a purchaser, and should be applied to individual loan contracts. Aggregation of similar loans for purposes of recognizing net fees or costs and purchase premiums or discounts is permitted under certain circumstances specified in ASC Subtopic 310-20 or if the result does not differ materially from the amount that would have been recognized on an individual loan-by-loan basis. In general, ASC Subtopic 310-20 specifies that:

- (1) Loan origination fees should be deferred and recognized over the life of the related loan as an adjustment of yield (interest income). Once a bank adopts ASC Subtopic 310-20, recognizing a portion of loan fees as revenue to offset all or part of origination costs in the reporting period in which a loan is originated is no longer acceptable.
- (2) Certain direct loan origination costs specified in ASC Subtopic 310-20 should be deferred and recognized over the life of the related loan as a reduction of the loan's yield. Loan origination fees and related direct loan origination costs for a given loan should be offset and only the net amount deferred and amortized.
- (3) Direct loan origination costs should be offset against related commitment fees and the net amounts deferred except for: (a) commitment fees (net of costs) where the likelihood of exercise of the commitment is remote, which generally should be recognized as service fee income on a straight line basis over the loan commitment period, and (b) retrospectively determined fees, which are recognized as service fee income on the date as of which the amount of the fee is determined. All other commitment fees (net of costs) shall be deferred over the entire commitment period and recognized as an adjustment of yield over the related loan's life or, if the commitment expires unexercised, recognized in income upon expiration of the commitment.
- (4) Loan syndication fees should be recognized by the bank managing a loan syndication (the syndicator) when the syndication is complete unless a portion of the syndication loan is retained. If the yield on the portion of the loan retained by the syndicator is less than the average yield to the other syndication participants after considering the fees passed through by the syndicator, the syndicator should defer a portion of the syndication fee to produce a yield on the portion of the loan retained that is not less than the average yield on the loans held by the other syndication participants.

Loan Fees (cont.):

- (5) Loan fees, certain direct loan origination costs, and purchase premiums and discounts on loans shall be recognized as an adjustment of yield generally by the interest method based on the contractual term of the loan. However, if the bank holds a large number of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated, the bank may consider estimates of future principal prepayments in the calculation of the constant effective yield necessary to apply the interest method. Once a bank adopts ASC Subtopic 310-20, the practice of recognizing fees over the estimated average life of a group of loans is no longer acceptable.
- (6) A refinanced or restructured loan, other than a troubled debt restructuring, should be accounted for as a new loan if the terms of the new loan are at least as favorable to the lender as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring a loan. Any unamortized net fees or costs and any prepayment penalties from the original loan should be recognized in interest income when the new loan is granted. If the refinancing or restructuring does not meet these conditions or if only minor modifications are made to the original loan contract, the unamortized net fees or costs from the original loan and any prepayment penalties should be carried forward as a part of the net investment in the new loan (or the amortized cost basis of the new loan if the institution has adopted ASC Topic 326, Financial Instruments—Credit Losses).

The net investment in, or the amortized cost basis of, the new loan, as applicable, should include the remaining net investment in the original loan, any additional amounts loaned, any fees received, and direct loan origination costs associated with the transaction. In a troubled debt restructuring involving a modification of terms, fees received should be applied as a reduction of the recorded investment in, or the amortized cost basis of, the loan, as applicable; all related costs, including direct loan origination costs, should be charged to expense as incurred. (See the Glossary entry for "Troubled Debt restructurings" for further discussion.)

- (7) Deferred net fees or costs shall not be amortized during periods in which interest income on a loan is not being recognized because of concerns about realization of loan principal or interest.

Direct loan origination costs of a completed loan are defined to include only (a) incremental direct costs of loan origination incurred in transactions with independent third parties for that particular loan and (b) certain costs directly related to specified activities performed by the lender for that particular loan.¹ Incremental direct costs are costs to originate a loan that (a) result directly from and are essential to the lending transaction and (b) would not have been incurred by the lender had that lending transaction not occurred. The specified activities performed by the lender are evaluating the prospective borrower's financial condition; evaluating and recording guarantees, collateral, and other security arrangements; negotiating loan terms; preparing and processing loan documents; and closing the transaction. The costs directly related to those activities include only that portion of the employees' total compensation and payroll-related fringe benefits directly related to time spent performing those activities for that particular loan and other costs related to those activities that would not have been incurred but for that particular loan.

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

¹ For purposes of these reports, a bank which deems its costs for these lending activities not to be material and which need not maintain records on a loan-by-loan basis for other purposes may expense such costs as incurred.

Loan Fees (cont.):

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

Loan Impairment: This Glossary entry applies to institutions that have not adopted ASC Topic 326, Financial Instruments—Credit Losses. Institutions that have adopted ASC Topic 326 should refer to the Glossary entry for "Allowance for Credit Losses."

The accounting standard for impaired loans is ASC Topic 310, Receivables. For further information, refer to ASC Topic 310.

Each institution is responsible for maintaining an allowance for loan and lease losses (allowance) at a level that is appropriate to cover estimated credit losses in its entire portfolio of loans and leases held for investment, i.e., loans and leases that the bank has the intent and ability to hold for the foreseeable future or until maturity or payoff. ASC Topic 310 sets forth measurement methods for estimating the portion of the overall allowance for loan and lease losses attributable to individually impaired loans. For the remainder of the portfolio, an appropriate allowance must be maintained in accordance with ASC Subtopic 450-20, Contingencies – Loss Contingencies. For comprehensive guidance on the maintenance of an appropriate allowance, banks should refer to the [Interagency Policy Statement on the Allowance for Loan and Lease Losses](#) dated December 13, 2006, and the Glossary entry for "Allowance for Loan and Lease Losses." National banks should also refer to the Office of the Comptroller of the Currency's [Handbook for National Bank Examiners discussing the allowance for loan and lease losses](#).

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

For purposes of the Consolidated Reports of Condition and Income, the impairment of an impaired collateral dependent loan must be measured using the fair value of collateral method. In general, any portion of the recorded investment in an impaired collateral dependent loan (including recorded

Loan Impairment (cont.):

accrued interest, net deferred loan fees or costs, and unamortized premium or discount) in excess of the fair value of the collateral (less estimated costs to sell, if applicable) that can be identified as uncollectible should be promptly charged off against the allowance for loan and lease losses.

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

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

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

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

A loan satisfying the criteria above, except a loan to a state or political subdivision in the U.S., is to be reported as a loan secured by real estate in Schedule RC-C, Part I, item 1, and related items in the Consolidated Reports of Condition and Income, (1) regardless of whether the loan is secured by a first or a junior lien; (2) regardless of whether the loan was originated by the reporting bank or purchased from others and, if originated by the reporting bank, regardless of the department within the bank or bank subsidiary that made the loan; (3) regardless of how the loan is categorized in the bank's records; (4) and regardless of the purpose of the financing. Only in a transaction where a lien or liens on real property (with an estimated collateral value greater than 50 percent of the loan's principal amount at origination) have been taken as collateral solely through an abundance of caution and where the loan terms as a consequence have not been made more favorable than they would have been in the

Loan Secured by Real Estate (cont.):

absence of the lien or liens, would the loan not be considered a loan secured by real estate for purposes of the Consolidated Reports of Condition and Income. In addition, when a loan is partially secured by a lien or liens on real property, but the estimated value of the real estate collateral at origination (after deducting any more senior liens held by others) is 50 percent or less of the principal amount of the loan at origination, the loan should not be categorized as a loan secured by real estate. Instead, the loan should be reported in one of the other loan categories used in these reports based on the purpose of the loan.

The following are examples of the application of the preceding guidance:

- (1) A bank loans \$700,000 to a dental group to construct and equip a building that will be used as its dental office. The loan will be secured by both the real estate and the dental equipment. At origination, the estimated values of the building, upon completion, and the equipment are \$400,000 and \$350,000, respectively. The loan should be reported as a loan secured by real estate in Schedule RC-C, Part I, item 1.a.(2), "Other construction loans and all land development and other land loans." In contrast, if the estimated values of the building and equipment at origination were \$340,000 and \$410,000, respectively, the loan should not be reported as a loan secured by real estate. Instead, the loan should be reported in Schedule RC-C, Part I, item 4, "Commercial and industrial loans."
- (2) A bank grants a \$25,000 line of credit and a \$125,000 term loan to a commercial borrower for working capital purposes on the same date. The loans will be cross-collateralized by equipment with an estimated value of \$40,000 and a third lien on the borrower's residence, which has an estimated value of \$140,000 and first and second liens with unpaid balances payable to other lenders totaling \$126,000. The two loans should be considered together to determine whether they are secured by real estate. Because the estimated equity in the real estate collateral available to the bank is \$14,000, the two cross-collateralized loans for \$150,000 should not be reported as loans secured by real estate. Instead, the loans should be reported in Schedule RC-C, Part I, item 4, "Commercial and industrial loans."
- (3) A bank grants a \$50,000 working capital loan and takes a first lien on a vacant commercial building lot as collateral. The estimated value of the lot is \$30,000. The loan should be reported as a loan secured by real estate in Schedule RC-C, Part I, item 1.a.(2), "Other construction loans and all land development and other land loans," unless the lien has been taken as collateral solely through an abundance of caution and where the loan terms as a consequence have not been made more favorable than they would have been in the absence of the lien.
- (4) A bank grants a \$10,000 home equity line of credit secured by a junior lien on a 1-4 family residential property. The bank also has a loan to the same borrower that is secured by a first lien on the same 1-4 family residential property and has an unpaid principal balance of \$71,000. There are no intervening liens and the line of credit will be used for household, family, and other personal expenditures. The estimated value of the residential property at the origination of the home equity line of credit is \$75,000. Consistent with the risk-based capital treatment of these loans, the two loans should be considered together to determine whether the home equity line of credit should be reported as a loan secured by real estate. Because the value of the collateral is greater than 50 percent of the first lien balance plus the amount of the home equity line of credit, loans extended under the line of credit should be reported as loans secured by real estate in Schedule RC-C, Part I, item 1.c.(1), "Revolving, open-end loans secured by 1-4 family residential properties and extended under lines of credit." In contrast, if a creditor other than the bank holds the first lien on the borrower's property, the estimated value of the collateral to the bank for the home equity line of credit would have been \$4,000 (\$75,000 less the \$71,000 first lien held by the other creditor), which is 50 percent or less of the amount of the line of credit at origination. In this case, the bank should not report loans extended under the line of credit as loans secured by real estate in Schedule RC-C, Part I, item 1. Rather, the loans should be reported as "Loans to individuals for household, family, and other personal expenditures" in Schedule RC-C, Part I, item 6.b, "Other revolving credit plans."

Loss Contingencies: A loss contingency is an existing condition, situation, or set of circumstances that involves uncertainty as to possible loss that will be resolved when one or more future events occur or fail to occur. An estimated loss (or expense) from a loss contingency (for example, pending or threatened litigation) must be accrued by a charge to income if it is probable that an asset has been impaired or a liability incurred as of the report date and the amount of the loss can be reasonably estimated.

A contingency that might result in a gain, for example, the filing of an insurance claim, shall not be recognized as income prior to realization.

For further information, see ASC Subtopic 450-20, Contingencies – Loss Contingencies.

Majority-Owned Subsidiary: See "Subsidiaries."

Mandatory Convertible Debt: Mandatory convertible debt is a subordinated note or debenture with a maturity of 12 years or less that obligates the holder to take the common or perpetual preferred stock of the issuer in lieu of cash for repayment of principal by a date at or before the maturity date of the debt instrument (so-called "equity contract notes").

Mergers: See "Business Combinations."

Money Market Deposit Account (MMDA): See "Deposits."

Nonaccrual Status: This entry covers, for purposes of these reports, the criteria for placing assets in nonaccrual status (presented in the general rule below) and related exceptions, the reversal of previously accrued but uncollected interest, the treatment of cash payments received on nonaccrual assets and the criteria for cash basis income recognition, the restoration of a nonaccrual asset to accrual status, and the treatment of multiple extensions of credit to one borrower.

General rule – Banks shall not accrue interest, amortize deferred net loan fees or costs, or accrete discount on any asset (1) which is maintained on a cash basis because of deterioration in the financial condition of the borrower, (2) for which payment in full of principal or interest is not expected, or (3) upon which principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection.

An asset is "well secured" if it is secured (1) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt (including accrued interest) in full, or (2) by the guarantee of a financially responsible party. An asset is "in the process of collection" if collection of the asset is proceeding in due course either (1) through legal action, including judgment enforcement procedures, or, (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future.

For purposes of applying the third test for nonaccrual status listed above, the date on which an asset reaches nonaccrual status is determined by its contractual terms. If the principal or interest on an asset becomes due and unpaid for 90 days or more on a date that falls between report dates, the asset should be placed in nonaccrual status as of the date it becomes 90 days past due and it should remain in nonaccrual status until it meets the criteria for restoration to accrual status described below.

Any state statute, regulation, or rule that imposes more stringent standards for nonaccrual of interest takes precedence over this instruction.

Nonaccrual Status (cont.):

Exceptions to the general rule – In the following situations, an asset need not be placed in nonaccrual status:

- (1) The criteria for accrual of income under the interest method specified in ASC Subtopic 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality, are met for a purchased credit-impaired loan, pool of loans, or debt security accounted for in accordance with that Subtopic, regardless of whether the loan, the loans in the pool, or debt security had been maintained in nonaccrual status by its seller. (For purchased credit-impaired loans with common risk characteristics that are aggregated and accounted for as a pool, the determination of nonaccrual or accrual status should be made at the pool level, not at the individual loan level.) For further information, see the Glossary entry for "Purchased Credit-Impaired Loans and Debt Securities." For institutions that have adopted ASC Topic 326, Financial Instruments–Credit Losses, as discussed in the "Definitions" section of the instructions for Schedule RC-N, this exception is no longer available.
- (2) The asset upon which principal or interest is due and unpaid for 90 days or more is a consumer loan (as defined for Schedule RC-C, Part I, item 6, "Loans to individuals for household, family, and other personal expenditures") or a loan secured by a 1-to-4 family residential property (as defined for Schedule RC-C, Part I, item 1.c, Loans "Secured by 1-4 family residential properties"). Nevertheless, such loans should be subject to other alternative methods of evaluation to assure that the bank's net income is not materially overstated. However, to the extent that the bank has elected to carry such a loan in nonaccrual status on its books, the loan must be reported as nonaccrual in Schedule RC-N.

Treatment of previously accrued interest – The reversal of previously accrued but uncollected interest applicable to any asset placed in nonaccrual status should be handled in accordance with generally accepted accounting principles. Acceptable accounting treatment includes a reversal of all previously accrued but uncollected interest applicable to assets placed in a nonaccrual status against appropriate income and balance sheet accounts.

For example, for institutions that have not adopted ASC Topic 326, one acceptable method of accounting for such uncollected interest on a loan placed in nonaccrual status is (1) to reverse all of the unpaid interest by crediting the "accrued interest receivable" account on the balance sheet, (2) to reverse the uncollected interest that has been accrued during the calendar year-to-date by debiting the appropriate "interest and fee income on loans" account on the income statement, and (3) to reverse any uncollected interest that had been accrued during previous calendar years by debiting the "allowance for loan and lease losses" account on the balance sheet. The use of this method presumes that bank management's additions to the allowance through charges to the "provision for loan and lease losses" on the income statement have been based on an evaluation of the collectability of the loan and lease portfolios and the "accrued interest receivable" account.

Institutions that have adopted ASC Topic 326 should refer to the Glossary entry for "Accrued Interest Receivable" for information on the treatment of previously accrued interest.

Treatment of cash payments and criteria for the cash basis recognition of income – When doubt exists as to the collectability of the remaining recorded investment in a nonaccrual asset (or the amortized cost basis of a nonaccrual asset, if the institution has adopted ASC Topic 326), any payments received must be applied to reduce the recorded investment in, or the amortized cost basis of, the asset, as applicable, to the extent necessary to eliminate such doubt. Placing an asset in nonaccrual status does not, in and of itself, require a charge-off, in whole or in part, of the asset's recorded investment or amortized cost basis, as applicable. However, any identified losses must be charged off.

While an asset is in nonaccrual status, some or all of the cash interest payments received may be treated as interest income on a cash basis as long as the remaining recorded investment in, or the

Nonaccrual Status (cont.):

amortized cost basis of, the asset, as applicable, (i.e., after charge-off of identified losses, if any) is deemed to be fully collectible.³ A bank's determination as to the ultimate collectibility of the asset's remaining recorded investment, or amortized cost basis, as applicable, must be supported by a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's historical repayment performance and other relevant factors.

When recognition of interest income on a cash basis is appropriate, it should be handled in accordance with generally accepted accounting principles. One acceptable accounting practice involves allocating contractual interest payments among interest income, reduction of the recorded investment in, or the amortized cost basis of, the asset, as applicable, and recovery of prior charge-offs. If this method is used, the amount of income that is recognized would be equal to that which would have been accrued on the asset's remaining recorded investment at the contractual rate. A bank may also choose to account for the contractual interest in its entirety either as income, reduction of the recorded investment in, or the amortized cost basis of, the asset, as applicable, or recovery of prior charge-offs, depending on the condition of the asset, consistent with its accounting policies for other financial reporting purposes.

Restoration to accrual status – As a general rule, a nonaccrual asset may be restored to accrual status when (1) none of its principal and interest is due and unpaid, and the bank expects repayment of the remaining contractual principal and interest, or (2) when it otherwise becomes well secured and in the process of collection. If any interest payments received while the asset was in nonaccrual status were applied to reduce the recorded investment in, or the amortized cost basis of, the asset, as applicable, as discussed in the preceding section of this entry, the application of these payments to the asset's recorded investment or amortized cost basis, as applicable, should not be reversed (and interest income should not be credited) when the asset is returned to accrual status.

For purposes of meeting the first test, the bank must have received repayment of the past due principal and interest unless, as discussed below, (1) the asset has been formally restructured and qualifies for accrual status, (2) the asset is a purchased credit-impaired loan, pool of loans, or debt security accounted for in accordance with ASC Subtopic 310-30 and it meets the criteria for accrual of income under the interest method specified therein, or (3) the borrower has resumed paying the full amount of the scheduled contractual interest and principal payments on a loan that is past due and in nonaccrual status, even though the loan has not been brought fully current, and the following two criteria are met. These criteria are, first, that all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within a reasonable period and, second, that there is a sustained period of repayment performance (generally a minimum of six months) by the borrower in accordance with the contractual terms involving payments of cash or cash equivalents. A loan that meets these two criteria may be restored to accrual status, but must continue to be disclosed as past due in Schedule RC-N until it has been brought fully current or until it later must be placed in nonaccrual status. For institutions that have adopted ASC Topic 326, the second exception above, which applies to purchased credit-impaired assets, is no longer available.

A loan or other debt instrument that has been formally restructured in a troubled debt restructuring so as to be reasonably assured of repayment (of principal and interest) and of performance according to its modified terms need not be maintained in nonaccrual status, provided the restructuring and any charge-off taken on the asset are supported by a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. Otherwise, the

³ An asset in nonaccrual status that is subject to the cost recovery method required by ASC Subtopic 325-40, Investments-Other – Beneficial Interests in Securitized Financial Assets, should follow that method for reporting purposes. In addition, when a purchased credit-impaired loan, pool of loans, or debt security that is accounted for in accordance with ASC Subtopic 310-30 (or when a purchased credit-deteriorated asset that is accounted for in accordance with ASC Subtopic 326-20, if the institution has adopted ASC Topic 326) has been placed on nonaccrual status, the cost recovery method should be used, when appropriate.

Nonaccrual Status (cont.):

restructured asset must remain in nonaccrual status. The evaluation must include consideration of the borrower's sustained historical repayment performance for a reasonable period prior to the date on which the loan or other debt instrument is returned to accrual status. A sustained period of repayment performance generally would be a minimum of six months and would involve payments of cash or cash equivalents. (In returning the asset to accrual status, sustained historical repayment performance for a reasonable 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 troubled debt 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 that 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. For a troubled debt restructuring of a collateral-dependent loan involving a multiple note structure, the amount of the "A" note should be determined using the fair value of the collateral. 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 Consolidated Report of Condition when a "right of setoff" exists. Under ASC Subtopic 210-20, Balance Sheet – Offsetting, 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.

Offsetting (cont.):

- (2) The reporting party has the right to set off the amount owed with the amount owed by the other party.
- (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 ASC Subtopic 210-20, 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 Consolidated 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 ASC Subtopic 210-20. 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, ASC Subtopic 210-20, Balance Sheet – Offsetting, 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 ASC Subtopic 210-20 must be applied consistently.

According to the AICPA Audit and Accounting Guide for Depository and Lending Institutions, ASC Subtopic 210-20 does not apply to securities borrowing or lending transactions. Therefore, for purposes of the Consolidated Report of Condition, banks should not offset securities borrowing and lending transactions in the balance sheet unless all the conditions set forth in ASC Subtopic 210-20 are met.

See also "Reciprocal Balances."

One-Day Transaction: See "Federal Funds Transactions."

Option: See "Derivative Contracts."

Organization Costs: See "Start-Up Activities."

Other Real Estate Owned: See "Foreclosed Assets" and the instructions to Schedule RC-M, item 3.

Other-Than-Temporary Impairment: See "Securities Activities." Institutions that have adopted ASC Topic 326, Financial Instruments—Credit Losses, and have identified impairment in the investment portfolio should no longer record any other-than-temporary impairment, as discussed in the Glossary entry for "Securities Activities."

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 should be reported in Schedule RC-C, Part I, item 2, "Loans to depository institutions and acceptances of other banks," and item 8, "Obligations (other than securities and leases) of states and political subdivisions in the U.S.," respectively. In addition, on the FFIEC 031, when the depositor is a foreign government or foreign official institution, an unplanned overdraft in the account of such a depositor should be reported in Schedule RC-C, Part I, item 7, "Loans to foreign governments and official institutions."

An overdraft also occurs when a borrower's loan secured by real estate has an escrow account for the payment of taxes and/or insurance and the institution pays taxes or insurance on behalf of the borrower when the escrow account does not have sufficient funds to cover the full amount of the payment. Because escrow funds are deposits for purposes of these reports, an overdrawn escrow account should be reported as a "loan" in Schedule RC-C, Part I, in the same loan category in Schedule RC-C, Part I, as the related loan.

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 institution's overdrafts on deposit accounts it holds with other depository institutions (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 institution 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](#), both member and nonmember depository institutions may hold the balances they maintain to satisfy reserve balance requirements (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-through Reserve Balances (cont.):

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 Consolidated Report of Condition, Schedule RC, item 1.a, "Noninterest-bearing balances and currency and coin," or item 1.b, "Interest-bearing balances," as appropriate. For respondent banks with foreign offices or with \$300 million or more in total 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 Consolidated Report of Condition, Schedule RC, item 13.a, "Deposits in domestic offices," and on in Schedule RC-E, Deposit Liabilities, (Part I), item 4.¹ The balances due from the Federal Reserve are to be reflected on the balance sheet in Schedule RC, item 1.b, "Interest-bearing balances," and, for correspondent banks with foreign offices or with \$300 million or more in total assets, in Schedule RC-A, item 4.

The reporting of pass-through reserve balances by correspondent and respondent banks differs from the required reporting of excess balance accounts by participants and agents, which is described in the Glossary entry for "Excess Balance Accounts."

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.

Preauthorized Transfer Account: See "Deposits."

Preferred Stock: Preferred stock is a form of ownership interest in a bank or other company which entitles its holders to some preference or priority over the owners of common stock, usually with respect to dividends or asset distributions in a liquidation.

Limited-life preferred stock is preferred stock that has a stated maturity date or that can be redeemed at the option of the holder. It excludes those issues of preferred stock that automatically convert into perpetual preferred stock or common stock at a stated date.

Perpetual preferred stock is preferred stock that does not have a stated maturity date or that cannot be redeemed at the option of the holder. It includes those issues of preferred stock that automatically convert into common stock at a stated date.

¹ When an Edge or Agreement Corporation acts as a correspondent, its balances due to respondents are to be reflected on the FFIEC 031 report form in Schedule RC, item 13.b, "Deposits in foreign offices," and in Schedule RC-E, Part II, item 2, if applicable.

Premiums and Discounts: A premium arises when an institution purchases a security, loan, or other asset at a price in excess of its par or face value, typically because the current level of interest rates for such assets is less than its contract or stated rate of interest. The difference between the purchase price and par or face value represents the premium, which all institutions are required to amortize.

A discount arises when an institution purchases a debt security, loan, or other asset at a price below its par or face value, typically because the current level of interest rates for such assets is greater than its contract or stated rate of interest. A discount is also present on instruments that do not have a stated rate of interest such as U.S. Treasury bills and commercial paper. The difference between par or face value and the purchase price represents the discount that all institutions are required to accrete.

Except as discussed in the next two paragraphs, premiums and discounts are accounted for as adjustments to the yield on an asset over its remaining life. A premium must be amortized and a discount must be accreted from the date of purchase to maturity, and not to the call or put date. The preferable method for amortizing premiums and accreting discounts involves the use of the interest method for accruing income on the asset. The objective of the interest method is to produce a constant effective yield or rate of return on the carrying value of the asset (par or face value plus unamortized premium or less unaccrued discount) at the beginning of each amortization period over the asset's remaining life. The difference between the periodic interest income that is accrued on the asset and interest at the stated rate is the periodic amortization or accretion. However, a straight-line method of amortization or accretion is acceptable only if the results are not materially different from the interest method.

If an institution holds a large number of similar debt securities, loans, or other assets for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated, the institution may consider estimates of future principal prepayments in the calculation of the constant effective yield necessary to apply the interest method.

For callable debt securities that have explicit, non-contingent call features and are callable at fixed prices and on preset dates, [Accounting Standards Update No. 2017-08](#) (ASU 2017-08) amends ASC Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs, to shorten the amortization period for any premiums on such debt securities. Under the ASU, after it has been adopted, the excess of the amortized cost basis of such a callable debt security over the amount repayable by the issuer at the earliest call date (i.e., the premium) must be amortized to the earliest call date (unless the institution applies the guidance that allows estimates of future principal prepayments to be considered in the effective yield calculation). If the call option is not exercised at its earliest call date, the institution must reset the effective yield using the payment terms of the debt security.¹

A premium or discount may also arise when the reporting institution, acting either as a lender or a borrower, is involved in an exchange of a note for assets other than cash and the interest rate is either below the market rate or not stated, or the face amount of the note is materially different from the fair value of the noncash assets exchanged. The noncash assets and the related note shall be recorded at either the fair value of the noncash assets or the market value of the note, whichever is more clearly determinable. The market value of the note would be its present value as determined by discounting all future payments on the note using an appropriate interest rate, i.e., a rate comparable to that on new loans of similar risk. The difference between the face amount and the recorded value of the note is a premium or discount. This discount or premium shall be accounted for as an adjustment of the interest income or expense over the life of the note using the interest method described above. For further information, see ASC Subtopic 835-30, Interest – Imputation of Interest.

¹ An institution must continue to amortize premiums over the contractual life of callable debt securities until the effective date of [ASU 2017-08](#) applicable to the institution unless early application of the ASU has been adopted. For information on the ASU's effective dates and transition, refer to ASU 2017-08.

Private Company: A private company is a business entity that is not a public business entity. For further information, see the Glossary entry for “Public Business Entity.”

Public Business Entity: Accounting Standards Update No. 2013-12, “Definition of a Public Business Entity,” added this term to the Master Glossary in the Accounting Standards Codification. The definition states that a business entity, such as bank or savings association, that meets any one of five specified criteria is a public business entity for reporting purposes under U.S. GAAP. This also applies for Call Report purposes. In contrast, a private company is a business entity that is not a public business entity. An institution that is a public business entity is not permitted to apply private company accounting alternatives when preparing its Call Report.

As defined in the ASC Master Glossary, a business entity is a public business entity if it meets any one of the following criteria:

- It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC (such as one of the federal banking agencies).
- It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- It has issued debt or equity securities that are traded, listed, or quoted on an exchange or an over-the-counter market, which includes an interdealer quotation or trading system for securities not listed on an exchange (for example, OTC Markets Group, Inc., including the OTC Pink Markets, or the OTC Bulletin Board).
- It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

The Master Glossary also explains that if an entity meets the definition of a public business entity solely because its financial statements or financial information is included in another entity’s filing with the SEC, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC, but not for other reporting purposes or for Call Report purposes.

If a bank or savings association does not meet any one of the first four criteria, it would need to consider whether it meets both of the conditions included in the fifth criterion to determine whether it would be a public business entity. With respect to the first condition under the fifth criterion, a stock institution must determine whether it has a class of securities not subject to contractual restrictions on transfer, which the FASB has stated means that the securities are not subject to management preapproval on resale. A contractual management preapproval requirement that lacks substance would raise questions about whether the stock institution meets this first condition.

If an institution is a wholly owned subsidiary of a holding company, an implicit contractual restriction on transfer is presumed to exist on the institution’s common stock; therefore, if the institution has issued no other debt or equity securities, the institution would not meet the first condition of the fifth criterion. A mutual institution that has issued no debt securities also does not meet the first condition of the fifth criterion. In all other scenarios (e.g., a closely-held bank or a Subchapter S bank that is not a wholly owned subsidiary of a holding company), an institution should assess whether contractual restrictions on transfer exist on its securities based on its individual facts and circumstances.

Public Business Entity (cont.):

With respect to the second condition under the fifth criterion, an insured depository institution with \$500 million or more in total assets as of the beginning of its fiscal year is required by [Section 36 of the Federal Deposit Insurance Act](#) and [Part 363 of the FDIC's regulations](#), "Annual Independent Audits and Reporting Requirements," to prepare and make publicly available audited annual U.S. GAAP financial statements. In certain circumstances, an insured depository institution with \$500 million or more in total assets that is a subsidiary of a holding company may choose to satisfy this annual financial statement requirement at a holding company level rather than at the institution level. An insured depository institution of this size that satisfies the financial statement requirement of [Section 36](#) and [Part 363](#) at either the institution level or the holding company level would meet the fifth criterion's second condition.

Purchase Acquisition: See "Business Combinations."

Purchased Credit-Deteriorated Assets: This Glossary entry applies to institutions that have adopted ASC Topic 326, Financial Instruments—Credit Losses. Institutions that have not adopted ASC Topic 326 should continue to refer to the Glossary entry for "Purchased Credit-Impaired Loans and Debt Securities."

Purchased credit-deteriorated (PCD) assets are acquired financial assets that, at acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by an acquirer's assessment.

In accordance with ASC Topic 326, institutions are required to estimate and record an allowance for credit losses (ACL) for PCD assets at the time of purchase. This acquisition date ACL is added to the purchase price of the financial assets rather than recording these losses through provisions for credit losses. This establishes the initial amortized cost basis of the PCD assets. An institution may use either a discounted or an undiscounted cash flow method at acquisition to determine this ACL. Subsequent ACL measurements for acquired financial assets with more-than-insignificant credit deterioration since origination are to be measured under ASC Topic 326 as with (1) originated financial assets and (2) purchased financial assets that do not have a more-than-insignificant deterioration in credit quality at acquisition.

Institutions that measure expected credit losses for PCD assets on a pool basis shall continue to evaluate whether financial assets in the pool continue to share similar risk characteristics with the other financial assets in the pool. If there have been changes in credit risk, borrower circumstances, recognition of a charge-off, or cash collections of interest applied to principal while the asset is in nonaccrual status, an institution may determine that either the financial asset has similar risk characteristics with another pool or the credit loss measurement should be performed on an individual financial asset basis because the financial asset does not share risk characteristics with other financial assets. Institutions that measure the ACL on a collective basis shall allocate the ACL and any noncredit discount or premium to the individual PCD assets unless the institution elected the transition option to account for existing purchased credit-impaired financial asset pools as PCD pools upon adoption of ASC Topic 326.

Any difference between the unpaid principal balance of the PCD asset and the amortized cost basis of the asset as of the acquisition date is the noncredit discount or premium. Provided the asset remains on accrual status, the noncredit discount or premium recorded at acquisition is accreted into interest income over the remaining life of the PCD asset on a level-yield basis.

For further information on the reporting of interest income on PCD assets, institutions should reference the Glossary entry for "Nonaccrual Status" and ASC Subtopic 310-10, Receivables – Overall.

Deferred Tax Asset Considerations – An institution's provisions for credit losses that increase the amount of the ACL also increase the amount of the deductible temporary difference associated with the

Purchased Credit-Deteriorated Assets (cont.):

ACL and the related deferred tax asset because the provisions are expensed for financial reporting purposes. These increases in the ACL typically are not deducted in the same period for income tax purposes. Tax deductions for credit losses typically occur in the period when financial assets are actually charged off. However, an addition to the ACL as of the acquisition date of a PCD asset (i.e., the “gross-up”) does not create such a deductible temporary difference or a deferred tax asset. An institution’s deferred tax assets should be calculated at the report date by applying the “applicable tax rate” based on the institution’s total deductible temporary differences. See the Glossary entry for “Income Taxes” for information on how to determine the tax effect of such a temporary difference and the need for any deferred tax asset valuation allowance.

See also the Glossary entries for “Allowance for Credit Losses” and “Nonaccrual Status.”

Purchased Credit-Impaired Loans and Debt Securities: This Glossary entry applies to institutions that have not adopted ASC Topic 326, Financial Instruments—Credit Losses. Institutions that have adopted ASC Topic 326 should refer to the Glossary entry for “Purchased Credit-Deteriorated Assets.”

Purchased credit-impaired loans and debt securities are loans and debt securities that an institution has purchased or otherwise acquired by completion of a transfer, including those acquired in a purchase business combination, where there is evidence of deterioration of credit quality since the origination of the loan or debt security and it is probable, at the acquisition date, that the institution will be unable to collect all contractually required payments receivable. Such loans and debt securities must be accounted for in accordance with ASC Subtopic 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality. ASC Subtopic 310-30 does not apply to loans that an institution has originated.

Under ASC Subtopic 310-30, a purchased credit-impaired loan or debt security is initially recorded at its purchase price (in a purchase business combination, the present value of amounts to be received). ASC Subtopic 310-30 limits the yield that may be accreted on the loan or debt security (the accretable yield) to the excess of the institution's estimate of the undiscounted principal, interest, and other cash flows expected at acquisition to be collected on the asset over the institution's initial investment in the asset. The excess of the contractually required payments receivable on the loan or debt security over the cash flows expected to be collected, which is referred to as the nonaccretable difference, must not be recognized as an adjustment of yield, loss accrual, or valuation allowance. Neither the accretable yield nor the nonaccretable difference may be shown on the balance sheet (Schedule RC). After acquisition, increases in the cash flows expected to be collected generally should be recognized prospectively as an adjustment of the asset's yield over its remaining life. Decreases in cash flows expected to be collected should be recognized as an impairment.

For purposes of applying the guidance in ASC Subtopic 310-30 to loans not accounted for as debt securities, an institution may aggregate loans acquired in the same fiscal quarter that have common risk characteristics and thereby use a composite interest rate and expectation of cash flows expected to be collected for the pool. To be eligible for aggregation, each loan first should be determined individually to meet the scope criteria in the first sentence of this Glossary entry. After determining that certain acquired loans individually meet these scope criteria, the institution may evaluate whether such loans have common risk characteristics, thus permitting the aggregation of such loans into one or more pools. The aggregation must be based on common risk characteristics that include similar credit risk or risk ratings, and one or more predominant risk characteristics, such as financial asset type, collateral type, size, interest rate, date of origination, term, and geographic location. Upon establishment of a pool of purchased credit-impaired loans, the pool becomes the unit of account.

Once a pool of purchased credit-impaired loans is assembled, the integrity of the pool must be maintained. An institution should remove an individual loan from a pool of purchased credit-impaired loans only if the institution sells, forecloses, or otherwise receives assets in satisfaction of the loan or if

Purchased Credit-Impaired Loans and Debt Securities (cont.):

the loan is written off. When an individual loan is removed from a pool of purchased credit-impaired loans under these circumstances, the loan shall be removed at its carrying amount. Carrying amount is defined as the loan's current contractually required payments receivable less its remaining nonaccretable difference, accretable yield, and any post-acquisition loan loss allowance. An institution that accounts for a pool of purchased credit-impaired loans with common risk characteristics as one unit of account may or may not document and maintain data on the nonaccretable difference and accretable yield on a loan-by-loan basis. Accordingly, for purposes of determining the carrying amount of an individual loan in the pool, an institution may apply a systematic and rational approach to allocating the nonaccretable difference and accretable yield for the pool to an individual loan in the pool. One acceptable approach is a pro rata allocation of the pool's total remaining nonaccretable difference and accretable yield to an individual loan in proportion to the loan's current contractually required payments receivable compared to the pool's total contractually required payments receivable.

A refinancing or restructuring of a loan within a pool of purchased credit-impaired loans should not result in the removal of the loan from the pool. In addition, a modification of the terms of a loan within a pool of purchased credit-impaired loans is not considered a troubled debt restructuring under the scope exceptions in ASC Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors. However, a modification of the terms of a purchased credit-impaired loan accounted for individually must be evaluated to determine whether the modification represents a troubled debt restructuring that should be accounted for in accordance with ASC 310-40. For further information, see the Glossary entry for "Troubled Debt Restructurings."

ASC Subtopic 310-30 does not prohibit an institution from placing a purchased credit-impaired loan accounted for individually, a pool of purchased credit-impaired loans with common risk characteristics, or a purchased credit-impaired debt security in nonaccrual status. Because a loan (including a loan aggregated with other loans with common risk characteristics) or debt security accounted for in accordance with ASC Subtopic 310-30 has evidence of deterioration of credit quality since origination, an acquiring institution must determine upon acquisition whether it is appropriate to recognize the accretable yield as income over the life of the loan, pool of loans, or debt security using the interest method. In order to apply the interest method, the institution must have sufficient information to reasonably estimate the amount and timing of the cash flows expected to be collected on the loan, loan pool, or debt security. Thus, when the amount and timing of the cash flows cannot be reasonably estimated at acquisition, the institution should place the purchased credit-impaired loan, pool, or debt security in nonaccrual status and then apply the cost recovery method or cash basis income recognition to the asset. (For purchased credit-impaired loans with common risk characteristics that are aggregated and accounted for as a pool, the determination of nonaccrual or accrual status should be made at the pool level, not at the individual loan level.) In addition, if a purchased credit-impaired loan or debt security is acquired primarily for the rewards of ownership of the underlying collateral, accrual of income is inappropriate and the loan or debt security should be placed in nonaccrual status. The amount of a purchased credit-impaired loan, pool of loans, or debt security in nonaccrual status should be reported in the appropriate items of Schedule RC-N, Past Due and Nonaccrual Loans, Leases, and Other Assets, column C.

When accrual of income on a purchased credit-impaired loan accounted for individually or a purchased credit-impaired debt security is appropriate (either at acquisition or at a later date when the amount and timing of the cash flows can be reasonably estimated), the delinquency status of the individual asset should be determined in accordance with its contractual repayment terms for purposes of reporting the amount of the loan or debt security as past due in the appropriate items of Schedule RC-N, column A or B. When accrual of income on a pool of purchased credit-impaired loans with common risk characteristics is appropriate, delinquency status should be determined individually for each loan in the pool in accordance with the individual loan's contractual repayment terms for purposes of reporting the amount of individual loans within the pool as past due in the appropriate items of Schedule RC-N, column A or B.

Purchased Credit-Impaired Loans and Debt Securities (cont.):

ASC Subtopic 310-30 prohibits an institution from "carrying over" or creating loan loss allowances in the initial accounting for purchased credit-impaired loans. This prohibition applies to the purchase of an individual impaired loan, a pool or group of impaired loans, and impaired loans acquired in a business combination. However, for a purchased credit-impaired loan accounted for individually (and not accounted for as a debt security), if upon subsequent evaluation it is probable based on current information and events that an institution will be unable to collect all cash flows expected at acquisition (plus additional cash flows expected to be collected arising from changes in estimate after acquisition), the purchased credit-impaired loan should be considered impaired for purposes of establishing an allowance pursuant to ASC Subtopic 450-20, Contingencies – Loss Contingencies or ASC Subtopic 310-10, Receivables – Overall, as appropriate. For purchased credit-impaired loans with common risk characteristics that are aggregated and accounted for as a pool, this impairment analysis should be performed subsequent to acquisition at the pool level as a whole and not at the individual loan level. An institution should include post-acquisition allowances on purchased credit-impaired loans and pools of purchased credit-impaired loans in the overall allowance for loan and lease losses it reports in Schedule RC, item 4.c, and Schedule RI-B, Part II, item 7, and disclose the amount of these post-acquisition allowances in Schedule RI-B, Part II, Memorandum item 4.

In Schedule RC-C, Part I, Loans and Leases, an institution should report the amount of a purchased credit-impaired loan in the appropriate loan category (items 1 through 9). Neither the accretable yield nor the nonaccretable difference associated with a purchased credit-impaired loan should be reported as unearned income in Schedule RC-C, Part I, item 11. In addition, an institution should report in Schedule RC-C, Part I, Memorandum items 7.a and 7.b, in the June and December reports only the outstanding balance and amount, respectively, of all purchased credit-impaired loans reported as held for investment in Schedule RC-C, Part I. An institution also should report the outstanding balance and amount of those held-for-investment purchased credit-impaired loans reported in Schedule RC-C, Part I, Memorandum items 7.a and 7.b, that are past due 30 through 89 days and still accruing, past due 90 days or more and still accruing, or in nonaccrual status as of the report date in Schedule RC-N, Memorandum items 9.a and 9.b, column A, B, or C, respectively, in the June and December reports only in accordance with the past due and nonaccrual guidance provided above in this Glossary entry.

For further information, refer to ASC Subtopic 310-30.

Put Option: See "Derivative Contracts."

Real Estate ADC Arrangements: See "Acquisition, Development, or Construction (ADC) Arrangements."

Real Estate, Loan Secured By: See "Loan Secured by Real Estate."

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

For purposes of the balance sheet of the Consolidated Report of Condition, reciprocal balances between the reporting bank and other depository institutions may be reported on a net basis in accordance with generally accepted accounting principles.

Renegotiated Troubled Debt: See "Troubled Debt Restructurings."

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

Repurchase/Resale Agreements (cont.):

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

General rule – Consistent with ASC Topic 860, Transfers and Servicing, repurchase and resale agreements involving financial assets (e.g., securities and loans), including dollar repurchase agreements, are either reported as (a) secured borrowings and loans or (b) sales and forward repurchase commitments based on whether the transferring ("selling") institution maintains control over the transferred assets. (See the Glossary entry for "Transfers of Financial Assets" for further discussion of control criteria.)

If a repurchase agreement both entitles and obligates the "selling" bank to repurchase or redeem the transferred assets from the transferee ("purchaser"), the "selling" bank should report the transaction as a secured borrowing if and only if the following conditions have been met:

- (1) The assets to be repurchased or redeemed are the same or "substantially the same" as those transferred, as defined by ASC Topic 860.
- (2) The "selling" institution has the ability to repurchase or redeem the transferred assets on substantially the agreed terms, even in the event of default by the transferee ("purchaser"). This ability is presumed to exist if the "selling" bank has obtained cash or other collateral sufficient to fund substantially all of the cost of purchasing replacement assets from others.
- (3) The agreement is to repurchase or redeem the transferred assets before maturity, at a fixed or determinable price.
- (4) The agreement is entered into concurrently with the transfer.

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

Repurchase agreements reported as secured borrowings – If a repurchase agreement qualifies as a secured borrowing, the "selling" institution should report the transaction as indicated below based on whether the agreement involves a security or some other financial asset.

- (1) Securities "sold" under agreements to repurchase are reported in Schedule RC, item 14.b, "Securities sold under agreements to repurchase."
- (2) Financial assets (other than securities) "sold" under agreements to repurchase are reported as follows:
 - (a) If the repurchase agreement has an original maturity of one business day (or is under a continuing contract) and is in immediately available funds, it should be reported in Schedule RC, item 14.a, "Federal funds purchased (in domestic offices)," if it is in a domestic office, and in Schedule RC-M, item 5.b, "Other borrowings," if it is in a foreign office.
 - (b) If the repurchase agreement has an original maturity of more than one business day or is not in immediately available funds, it should be reported in Schedule RC-M, item 5.b.

In addition, the "selling" institution may need to record further entries depending on the terms of the agreement. If the "purchaser" has the right to sell or repledge noncash assets, the "selling" institution

Repurchase/Resale Agreements (cont.):

should recategorize the transferred financial assets as "assets receivable" and report them in Schedule RC, item 11, "Other assets." Otherwise, the financial assets should continue to be reported in the same asset category as before the transfer (e.g., securities should continue to be reported in Schedule RC, item 2, "Securities," or item 5, "Trading assets," as appropriate).

Resale agreements reported as secured borrowings. Similarly, if a resale agreement qualifies as a secured borrowing, the "purchasing" institution should report the transaction as indicated below based on whether the agreement involves a security or some other financial asset.

- (1) Securities "purchased" under agreements to resell are reported in Schedule RC, item 3.b, "Securities purchased under agreements to resell."
- (2) Financial assets (other than securities) "purchased" under agreements to resell are reported as follows:
 - (a) If the resale agreement has an original maturity of one business day (or is under a continuing contract) and is in immediately available funds, it should be reported in Schedule RC, item 3.a, "Federal funds sold (in domestic offices)," if it is in a domestic office, and in Schedule RC, item 4.b, "Loans and leases held for investment," if it is in a foreign office.
 - (b) If the resale agreement has an original maturity of more than one business day or is not in immediately available funds, it should be reported in Schedule RC, item 4.b.

In addition, the "purchasing" institution may need to record further entries depending on the terms of the agreement. If the "purchasing" institution has the right to sell the noncash assets it has "purchased" and sells these assets, it should recognize the proceeds from the sale and report its obligation to return the assets in Schedule RC, item 20, "Other liabilities." If the "selling" institution defaults under the terms of the repurchase agreement and is no longer entitled to redeem the noncash assets, the "purchasing" bank should recognize these assets on its own balance sheet (e.g., securities should be reported in Schedule RC, item 2, "Securities," or item 5, "Trading assets," as appropriate) and initially measure them at fair value. However, if the "purchasing" bank has already sold the assets it has "purchased," it should derecognize its obligation to return the assets. Otherwise, the "purchasing" bank should not recognize the transferred financial assets (i.e., the financial assets "purchased" under the resale agreement) on its balance sheet.

Repurchase/resale agreements reported as sales – If a repurchase agreement does not qualify as a secured borrowing under ASC Topic 860, the selling bank should account for the transaction as a sale of financial assets and a forward repurchase commitment. The selling bank should remove the transferred assets from its balance sheet, record the proceeds from the sale of the transferred assets (including the forward repurchase commitment), and record any gain or loss on the transaction. Similarly, if a resale agreement does not qualify as a borrowing under ASC Topic 860, the purchasing bank should account for the transaction as a purchase of financial assets and a forward resale commitment. The purchasing bank should record the transferred assets on its balance sheet, initially measure them at fair value, and record the payment for the purchased assets (including the forward resale commitment).

Reserve Balances, Pass-through: See "Pass-through Reserve Balances."

Retail Sweep Arrangements: See "Deposits."

Revenue from Contracts with Customers: ASC Topic 606, Revenue from Contracts with Customers, when it becomes effective as a result of [Accounting Standards Update \(ASU\) 2014-09](#),¹ provides guidance on how an entity should recognize revenue from these transactions. The core principle of ASC Topic 606 is that an entity should recognize revenue at an amount that reflects the consideration to which it expects to be entitled in exchange for transferring goods or services to a customer as part of the entity's ordinary activities. ASU 2014-09 also added ASC Topic 610, Other Income, to the ASC. ASC Topic 610 applies to income recognition that is not within the scope of ASC Topic 606, other Topics (such as ASC Topics 840 and 842 on leases, as applicable), or other revenue or income guidance. ASC Topic 610 applies to an institution's sales of repossessed nonfinancial assets, such as other real estate owned (OREO). [See](#) the Glossary entry for "Foreclosed Assets" for guidance on the accounting and reporting for the sale of OREO and other repossessed nonfinancial assets.

ASC Topic 606 specifically excludes financial instruments and other contractual rights or obligations within the scope of ASC Topic 310, Receivables; ASC Topic 320, Investments–Debt Securities; ASC Topic 321, Investments–Equity Securities; ASC Topic 815, Derivatives and Hedging; ASC Topic 860, Transfers and Servicing, and certain other ASC Topics. Therefore, many common revenue streams in the financial sector, such as interest income, fair value adjustments, gains and losses on sales of financial instruments, and loan origination fees, are not within the scope of ASC Topic 606. However, the provisions of ASC Topic 606 may affect the timing for the recognition of, and the presentation of, those revenue streams within the scope of this accounting standard, such as certain fees associated with credit card arrangements, underwriting fees and costs, and deposit-related fees.

To achieve the core principle described above when accounting for transactions within the scope of ASC Topic 606, an institution should apply the following steps as set forth in ASC Topic 606:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the institution satisfies a performance obligation.

For further guidance on applying these steps, refer to ASC Topic 606.

Savings Deposits: [See](#) "Deposits."

Securities Activities: Institutions should categorize their investments in debt securities as trading, available-for-sale, or held-to-maturity consistent with ASC Topic 320, Investments–Debt Securities. Management should periodically reassess its security categorization decisions to ensure that they remain appropriate.

For purposes of the Consolidated Reports of Condition and Income, debt and equity 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.

Institutions may also elect to report debt securities within the scope of ASC Topic 320 at fair value in accordance with ASC Subtopic 825-10, Financial Instruments – Overall. For purposes of the

¹ For institutions that are public business entities, as defined under U.S. GAAP, the new standard is effective for fiscal years beginning after December 15, 2017, including interim reporting periods within those fiscal years. For institutions that are not public business entities (i.e., that are private companies), the new standard is effective for fiscal years beginning after December 15, 2018, and interim reporting periods within fiscal years beginning after December 15, 2019. Early application of the new standard is permitted. [See](#) the Glossary entries for "Public Business Entity" and "Private Company" for the definitions of these terms.

Securities Activities (cont.):

Consolidated Reports of Condition and Income, debt securities for which the fair value option is elected should be classified as trading assets with unrealized gains and losses recognized in current earnings and regulatory capital. In general, the fair value option may be elected for an individual security only when it is first recognized; this election is irrevocable.

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. Debt securities not categorized as trading or held-to-maturity must be reported as available-for-sale. An institution must report its available-for-sale debt 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 (i.e., in Schedule RC, item 26.b, "Accumulated other comprehensive income").

FASB [Accounting Standards Update No. 2016-01](#), "Recognition and Measurement of Financial Assets and Financial Liabilities" (ASU 2016-01), added ASC Topic 321, Investments – Equity Securities, to the ASC. Once ASU 2016-01 has been adopted, it eliminates the classification of equity securities with readily determinable fair values as available-for-sale equity securities that are measured at fair value with changes in fair value generally recognized in other comprehensive income.¹ Institutions that have adopted ASU 2016-01 must measure investments in equity securities, except those accounted for under the equity method and those that result in consolidation, at fair value with changes in fair value recognized in net income. However, for an equity security that does not have a readily determinable fair value, ASC Topic 321 permits an institution to elect to measure the security at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. When this measurement alternative is elected for an equity security without a readily determinable fair value, ASC Topic 321 requires the equity security to be written down to its fair value, with a charge to earnings, if a qualitative assessment indicates the security is impaired and the fair value of the security is less than its carrying value. For each equity security accounted for using this measurement alternative, the qualitative assessment must be made each reporting period by qualitatively considering impairment indicators to evaluate whether the security is impaired. Impairment indicators that an institution should consider include, but are not limited to, the indicators identified in ASC Subtopic 321-10.

The measurement guidance for investments in equity securities in ASC Topic 321 described above also applies to investments in other ownership interests, such as interests in partnerships, unincorporated joint ventures, and limited liability companies. However, the measurement guidance does not apply to Federal Home Loan Bank stock or Federal Reserve Bank stock.

Other-Than-Temporary Impairment (ASC Topic 320) – For institutions that have adopted ASC Topic 326, Financial Instruments–Credit Losses, this section is no longer applicable. Refer to the "Impairment of Individual Available-for-Sale Debt Securities (ASC Topic 326)" and "Accounting for Held-to-Maturity Debt Securities (ASC Topic 326)" sections below, as applicable.

Until an institution has adopted FASB [Accounting Standards Update No. 2016-13](#) (ASU 2016-13), which applies to held-to-maturity and available-for-sale debt securities, or [ASU 2016-01](#), which applies to equity securities, when the fair value of a debt or equity security (not held for trading) is less than its (amortized) cost basis, the security is impaired and the impairment is either temporary or other than temporary. Under ASC Topic 320, institutions must determine whether an impairment of an individual available-for-sale or held-to-maturity security is other than temporary. To make this determination, institutions should apply applicable accounting guidance including, but not limited to, ASC Topic 320, ASC Subtopic 325-40, Investments–Other – Beneficial Interests in Securitized Financial Assets, and [SEC Staff Accounting Bulletin No. 59, Other Than Temporary Impairment of Certain Investments in Equity Securities \(Topic 5.M. in the Codification of Staff Accounting Bulletins\)](#).

¹ For information on the ASU's effective dates and transition, institutions should refer to [ASU 2016-01](#).

Securities Activities (cont.):

Under ASC Topic 320, if an institution intends to sell a debt security, or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis, an other-than-temporary impairment has occurred and the entire difference between the security's amortized cost basis and its fair value at the balance sheet date must be recognized in earnings. In these cases, the fair value of the debt security would become its new amortized cost basis.

In addition, under ASC Topic 320, if the present value of cash flows expected to be collected on a debt security is less than its amortized cost basis, a credit loss exists. In this situation, if an institution does not intend to sell the security and it is not more likely than not that the institution will be required to sell the debt security before recovery of its amortized cost basis less any current-period credit loss, an other-than-temporary impairment has occurred. The amount of the total other-than-temporary impairment related to the credit loss must be recognized in earnings, but the amount of the total impairment related to other factors must be recognized in other comprehensive income, net of applicable taxes.

Until an institution has adopted [ASU 2016-13](#), other-than-temporary impairment losses on held-to-maturity and available-for-sale debt securities that must be recognized in earnings should be included in Schedule RI, items 6.a and 6.b, respectively. Other-than-temporary impairment losses that are to be of applicable taxes, should be reported in item 10 of Schedule RI-A, Changes in Bank Equity Capital, and included on the balance sheet in Schedule RC, item 26.b, "Accumulated other comprehensive income." The amount of other-than-temporary impairment losses on held-to-maturity and available-for-sale debt securities recognized in earnings during the current calendar year-to-date reporting period should be reported in Schedule RI, Memorandum item 14. For a held-to-maturity debt security on which the institution has recognized an other-than-temporary impairment loss related to factors other than credit loss in other comprehensive income, the institution should report the carrying value of the debt security in Schedule RC, item 2.a, and in column A of Schedule RC-B, Securities. Under ASC Topic 320, this carrying value should be the fair value of the held-to-maturity debt security as of the date of the most recently recognized other-than-temporary impairment loss adjusted for subsequent accretion of the impairment loss related to factors other than credit loss.

Impairment of Individual Available-for-Sale Debt Securities (ASC Topic 326) – This section of this Glossary entry applies to institutions that have adopted ASC Topic 326. Institutions that have not adopted ASC Topic 326 should continue to refer to the "Other-Than-Temporary Impairment (ASC Topic 320)" section above. For additional information on the maintenance of appropriate allowances for credit losses, institutions should refer to the [Interagency Policy Statement on Allowances for Credit Losses](#) issued in May 2020.

Standards for the accounting for impairment of available-for-sale debt securities are set forth in ASC Subtopic 326-30, Financial Instruments–Credit Losses–Available-for-Sale Debt Securities. Under this subtopic, an available-for-sale debt security is impaired if its fair value is less than its amortized cost basis. Thus, as of the end of each quarter, or more frequently if warranted, an institution must determine whether a decline in fair value below the amortized cost basis of an individual available-for-sale debt security has resulted from a credit loss or other factors. Credit losses are calculated individually, rather than collectively, using a discounted cash flow method to compare the present value of the cash flows expected to be collected with the amortized cost basis of the security. An ACL is established, with a charge to the provision for credit losses, to reflect the credit loss component of the decline in fair value below amortized cost. The ACL for an available-for-sale debt security is limited by the amount that the fair value is less than the amortized cost basis, which is referred to as the fair value floor. Noncredit impairment on an available-for-sale debt security that is not required to be recorded through the ACL should be reported, net of applicable income taxes, in Schedule RI-A, item 10, "Other comprehensive income."

An institution must reassess the credit losses on an individual available-for-sale debt security each quarter when there is an ACL on the security. The institution should record subsequent changes in the

Securities Activities (cont.):

ACL in the period of the change with a corresponding adjustment recorded through a provision for credit losses included in Schedule RI, item 4. A previously recorded ACL on an available-for-sale debt security should not be reversed to an amount below zero.

When evaluating impairment for available-for-sale debt securities, an institution may evaluate the amortized cost basis including accrued interest receivable, or may evaluate the accrued interest receivable separately from the remaining amortized cost basis. If evaluated separately, accrued interest receivable is excluded from both the fair value of the available-for-sale debt security and its amortized cost basis.

If an institution intends to sell an available-for-sale debt security or will more likely than not be required to sell the security before recovery of the amortized cost basis, the security's ACL should be written off and the amortized cost basis of the security should be charged down to its fair value at the reporting date with any incremental impairment reported in Schedule RI, item 6.b, "Realized gains (losses) on available for sale securities." The previous amortized cost basis of the debt security, less the amount of the charge-off, becomes the new amortized cost basis of the security. This new amortized cost basis is not increased for subsequent recoveries in fair value; rather, a subsequent increase in fair value after charge-off is included in other comprehensive income. The difference between the new amortized cost basis and the cash flows expected to be collected should be accreted to interest income according to applicable accounting standards.

An institution that has available-for-sale debt securities accounted for in accordance with ASC Subtopic 325-40, Investments—Other—Beneficial Interests in Securitized Financial Assets, should refer to that subtopic to account for changes in cash flows expected to be collected.

Accounting for Expected Credit Losses on Held-to-Maturity Debt Securities (ASC Topic 326) – Institutions that have not adopted ASC Topic 326 should continue to refer to the "Other-Than-Temporary Impairment (ASC Topic 320)" section above.

Institutions that have adopted ASC Topic 326 should refer to the Glossary entry for "Allowance for Credit Losses" for information on estimating the allowance for credit losses on held-to-maturity debt securities. Such institutions should include provisions for credit losses on held-to-maturity debt securities in Schedule RI, item 4.

Practices Considered Trading Activities – 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 debt 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.

Securities Activities (cont.):

- (3) **Pair-offs** – Pair-offs are security purchase transactions that are closed-out or sold at, or prior to, settlement date. In a pair-off, an institution commits to purchase a security. Then, prior to the predetermined settlement date, the institution will pair-off the purchase with a sale of the same security. Pair-offs are settled net when one party to the transaction remits the difference between the purchase and the sale price to the counterparty. Pair-offs may also involve the same sequence of events using swaps, options on swaps, forward commitments, options on forward commitments, or other off-balance sheet derivative contracts.
- (4) **Extended Settlements** – In the U.S., regular-way settlement for federal government and federal agency securities (except mortgage-backed securities and derivative contracts) is one business day after the trade date. Regular-way settlement for corporate and municipal securities is three business days after the trade date. For mortgage-backed securities, it can be up to 60 days or more after the trade date. The use of extended settlements may be offered by securities dealers in order to facilitate speculation on the part of the purchaser, often in connection with pair-off transactions. Securities acquired through the use of a settlement period in excess of the regular-way settlement periods in order to facilitate speculation should be reported as trading assets.
- (5) **Repositioning Repurchase Agreements** – A repositioning repurchase agreement is a funding technique offered by a dealer in an attempt to enable an institution to avoid recognition of a loss. Specifically, an institution that enters into a "when-issued" trade or a "pair-off" (which may include an extended settlement) that cannot be closed out at a profit on the payment or settlement date will be provided dealer financing in an effort to fund its speculative position until the security can be sold at a gain. The institution purchasing the security typically pays the dealer a small margin that approximates the actual loss in the security. The dealer then agrees to fund the purchase of the security, typically buying it back from the purchaser under a resale agreement. Any securities acquired through a dealer financing technique such as a repositioning repurchase agreement that is used to fund the speculative purchase of securities should be reported as trading assets.
- (6) **Short Sales** – A short sale is the sale of a security that is not owned. The purpose of a short sale generally is to speculate on a fall in the price of the security. (For further information, see the Glossary entry for "Short Position.")

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

See also the Glossary entries for "Accrued Interest Receivable," "Allowance for Credit Losses," "Purchased Credit-Deteriorated Assets," and "Trading Account."

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

Most securities borrowing/lending transactions do not qualify as sales under ASC Topic 860, Transfers and Servicing, because the securities borrowing/lending agreement entitles and obligates the securities

Securities Borrowing/Lending Transactions (cont.):

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 a transaction does not qualify as a sale, the securities lender (the transferor) and the securities borrower (the transferee) should account for the transaction as a secured borrowing 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" by the securities lender are considered pledged as collateral against the amount borrowed. The securities lender should recognize the cash or securities received as "collateral" as an asset on its balance sheet with a corresponding liability for the obligation to return the "collateral" received. The securities lender should continue to report the "loaned" securities on its balance sheet in the same asset category as before the transfer, e.g., as available-for-sale securities, held-to-maturity securities, or trading assets, as appropriate. "Loaned" securities that the securities lender reports as available-for-sale or held-to-maturity securities in Schedule RC-B, Securities, should also be reported as "Pledged securities" in Memorandum item 1 of that schedule. Similarly, for banks filing the FFIEC 031 report form, "loaned" securities that the securities lender reports as trading assets in Schedule RC-D, Trading Assets and Liabilities, should be reported as "Pledged securities" in Memorandum item 4.a of that schedule, if applicable.

When a securities borrowing/lending transaction does not qualify as a sale, the securities borrower should not recognize at inception the "loaned" securities transferred to it as assets on its balance sheet. Rather, at the inception of a transaction in which the securities borrower pledges cash collateral, the securities borrower should derecognize the cash pledged to the securities lender and recognize a corresponding receivable for the borrower's claim on the cash that the securities lender is obligated to return in the future. If the securities borrower pledges securities as collateral to the securities lender, the securities borrower should record no balance sheet entry for the pledged securities at inception, but it should report these securities as pledged securities in the Call Report in the same manner as discussed above for a securities lender. If the securities lender later defaults under the terms of the securities borrowing/lending agreement and is no longer entitled to redeem the "loaned" securities, the securities lender should remove these securities from its balance sheet. Additionally, the securities borrower should now recognize the "loaned" securities as assets on its balance sheet (and report these securities, e.g., as available-for-sale securities, held-to-maturity securities, or trading assets, as appropriate, if debt securities had been loaned) and initially measure them at fair value.

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

Securities, Participations in Pools of: See "Repurchase/Resale Agreements."

Servicing Assets and Liabilities: The accounting and reporting standards for servicing assets and liabilities are set forth in ASC Subtopic 860-50, Transfers and Servicing – Servicing Assets and Liabilities, and ASC Topic 948, Financial Services-Mortgage Banking. A summary of the relevant sections of these accounting standards follows. For further information, see ASC Subtopic 860-50, ASC Topic 948, and the Glossary entry for "Transfers of Financial Assets."

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

Servicing Assets and Liabilities (cont.):

Servicing is inherent in all financial assets; it becomes a distinct asset or liability for accounting purposes only in certain circumstances as discussed below. Servicing assets result from contracts to service financial assets under which the benefits of servicing (estimated future revenues from 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 under 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.

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

- (1) The bank's transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that meets the requirements for sale accounting; or
- (2) An acquisition or assumption of a servicing obligation that does not relate to financial assets of the bank or its consolidated affiliates included in the Consolidated Reports of Condition and Income being presented.

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

A bank that transfers its financial assets to an unconsolidated entity in a transfer that qualifies as a sale in which the bank obtains the resulting securities and classifies them as debt securities held-to-maturity in accordance with ASC Topic 320, Investments—Debt Securities, may either separately recognize its servicing assets or servicing liabilities or report those servicing assets or servicing liabilities together with the assets being serviced.

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

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

Servicing Assets and Liabilities (cont.):

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

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

For purposes of these reports, servicing assets resulting from contracts to service loans secured by real estate (as defined for Schedule RC-C, Part I, item 1, in the Glossary entry for "Loans Secured by Real Estate") should be reported in Schedule RC-M, item 2.a, "Mortgage servicing assets." Servicing assets resulting from contracts to service all other financial assets should be reported in Schedule RC-M, item 2.c, "All other intangible assets." When reporting the carrying amount of mortgage servicing assets in Schedule RC-M, item 2.a, and nonmortgage servicing assets in Schedule RC-M, item 2.c, banks should include all classes of servicing accounted for under the amortization method as well as all classes of servicing accounted for under the fair value measurement method. The fair value of all recognized mortgage servicing assets should be reported in Schedule RC-M, item 2.a.(1), regardless of the subsequent measurement method applied to these assets. The amount of mortgage servicing assets reported in Schedule RC-M, item 2.a, should be used when determining the amount of such assets, net of associated deferred tax liabilities, that exceeds the common equity tier 1 capital deduction thresholds in Schedule RC-R, Part I. Servicing liabilities should be reported in Schedule RC-G, item 4, "All other liabilities." If the amount of servicing liabilities is greater than \$100,000 and exceeds 25 percent of "All other liabilities," this amount should be itemized and described in Schedule RC-G, item 4.f, 4.g, or 4.h, as appropriate.

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

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

Settlement Date Accounting: See "Trade Date and Settlement Date Accounting."

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

Short Position: When a bank sells an asset that it does not own, it has established a short position.

If on the report date a bank is in a short position, it shall report its liability to purchase the asset in Schedule RC, item 15, "Trading liabilities." In this situation, the right to receive payment shall be reported in Schedule RC-F, item 6, "All other assets." Short positions shall be reported gross. Short trading positions shall be revalued consistent with the method used by the reporting bank for the valuation of its trading assets.

Significant Subsidiary: See "Subsidiaries."

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

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

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

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

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

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

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

The organization costs of forming a holding company and the costs of other holding company start-up activities are sometimes paid by the bank that will be owned by the holding company. Because these are the holding company's costs, whether or not the holding company formation is successful, they

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

Start-Up Activities (cont.):

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

STRIPS: See "Coupon Stripping, Treasury Receipts, and STRIPS."

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

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

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

Subsidiaries: The treatment of subsidiaries in the Consolidated 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.

Subsidiaries (cont.):

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 Consolidated Reports of Condition and Income (in accordance with the guidance in the General Instructions on the Scope of the "Consolidated Bank" Required to be Reported in the Submitted Reports) and in associated companies is accounted for using the equity method of accounting and is reported in Schedule RC, item 8, "Investments in unconsolidated subsidiaries and associated companies," or item 9, "Direct and indirect investments in real estate ventures," as appropriate.

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.

See also "Equity Method of Accounting."

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 Consolidated 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.

Time Deposits: See "Deposits."

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

Under trade date accounting, assets purchased shall be recorded in the appropriate asset category on the trade date and the bank's obligation to pay for those assets shall be reported in Schedule RC-G, item 4, "All other liabilities." Conversely, when an asset is sold, it shall be removed on the trade date from the asset category in which it was recorded, and the proceeds receivable resulting from the sale shall be reported in Schedule RC-F, item 6, "All other assets." Any gain or loss resulting from such transaction shall also be recognized on the trade date. On the settlement date, disbursement of the payment or receipt of the proceeds will eliminate the respective "All other liabilities" or "All other assets" entry resulting from the initial recording of the transaction.

Trade Date and Settlement Date Accounting (cont.):

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

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 ASC Topic 860, Transfers and Servicing, 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."

Trading Account: Trading activities typically include (a) regularly underwriting or dealing in securities; interest rate, foreign exchange rate, commodity, equity, and credit derivative contracts; other financial instruments; and other assets for resale, (b) acquiring or taking positions in such items principally for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements, and (c) acquiring or taking positions in such items as accommodations to customers, provided that acquiring or taking such positions meets the definition of "trading" in ASC Topic 320, Investments—Debt Securities, and ASC Topic 815, Derivatives and Hedging, and the definition of "trading purposes" in ASC Topic 815.

For purposes of the Consolidated Reports of Condition and Income, all debt securities within the scope of ASC Topic 320 that a bank has elected to report at fair value under a fair value option with changes in fair value reported in current earnings should be classified as trading securities. In addition, for purposes of these reports, banks may classify assets (other than debt securities within the scope of ASC Topic 320 for which a fair value option is elected) and liabilities as trading if the bank applies fair value accounting, with changes in fair value reported in current earnings, and manages these assets and liabilities as trading positions, subject to the controls and applicable regulatory guidance related to trading activities. For example, a bank would generally not classify a loan to which it has applied the fair value option as a trading asset unless the bank holds the loan, which it manages as a trading position, for one of the following purposes: (1) for market making activities, including such activities as accumulating loans for sale or securitization; (2) to benefit from actual or expected price movements; or (3) to lock in arbitrage profits.

All trading assets should be segregated from a bank's other assets and reported in Schedule RC, item 5, "Trading assets." In addition, banks that (1) reported total trading assets (Schedule RC, item 5) of \$10 million or more in any of the four preceding calendar quarters, or (2) meet the FDIC's definition of a large or highly complex institution for deposit insurance assessment purposes should detail the types of assets and liabilities in the trading account in Schedule RC-D, Trading Assets and Liabilities, and the levels within the fair value measurement hierarchy in which the trading assets and liabilities fall in Schedule RC-Q, Assets and Liabilities Measured at Fair Value on a Recurring Basis. A bank's failure to establish a separate account for assets that are used for trading purposes does not prevent such assets from being designated as trading for purposes of these reports. For further information, see ASC Topic 320.

Trading Account (cont.):

All trading account assets should be reported at their fair value as defined by ASC Topic 820, Fair Value Measurement, with unrealized gains and losses recognized in current income. When a security or other asset is acquired, a bank should determine whether it intends to hold the asset for trading or for investment (e.g., for securities, available-for-sale or held-to-maturity). A bank should not record a newly acquired asset in a suspense account and later determine whether it was acquired for trading or investment purposes. Regardless of how a bank categorizes a newly acquired asset, management should document its decision.

All trading liabilities should be segregated from other transactions and reported in Schedule RC, item 15, "Trading liabilities." The trading liability account includes the fair value of derivative contracts held for trading that are in loss positions and short positions arising from sales of securities and other assets that the bank does not own. (See the Glossary entry for "Short Position.") Trading account liabilities should be reported at fair value as defined by ASC Topic 820 with unrealized gains and losses recognized in current income in a manner similar to trading account assets.

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

Transaction Account: See "Deposits."

Transfers of Financial Assets: The accounting and reporting standards for transfers of financial assets are set forth in ASC Topic 860, Transfers and Servicing. Banks must follow ASC Topic 860 for purposes of these reports. ASC Topic 860 limits the circumstances in which a financial asset, or a portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset or when the transferor has continuing involvement with the transferred financial asset. ASC Topic 860 also defines a "participating interest" (which is discussed more fully below) and establishes the accounting and reporting standards for loan participations, syndications, and other transfers of portions of financial assets. A summary of these accounting and reporting standards follows. For further information, see ASC Topic 860.

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

A transferor is an entity that transfers a financial asset, an interest in a financial asset, or a group of financial assets that it controls to another entity. A transferee is an entity that receives a financial asset, an interest in a financial asset, or a group of financial assets from a transferor.

In determining whether a bank has surrendered control over transferred financial assets, the bank must first consider whether the entity to which the financial assets were transferred would be required to be

¹ ASC Topic 860 defines an interest-only strip receivable as the contractual right to receive some or all of the interest due on a bond, mortgage loan, collateralized mortgage obligation, or other interest-bearing financial asset.

Transfers of Financial Assets (cont.):

consolidated by the bank. If it is determined that consolidation would be required by the bank, then the transferred financial assets would not be treated as having been sold in the bank's Consolidated Reports of Condition and Income even if all of the other provisions listed below are met.¹

Determining Whether a Transfer Should be Accounted for as a Sale or a Secured Borrowing – A transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale if and only if all of the following conditions are met:

- (1) The transferred financial assets have been isolated from the transferor, i.e., put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Transferred financial assets are isolated in bankruptcy or other receivership only if the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its consolidated affiliates included in the financial statements being presented. For multiple step transfers, an entity that is designed to make remote the possibility that it would enter bankruptcy or other receivership (bankruptcy-remote entity) is not considered a consolidated affiliate for purposes of performing the isolation analysis. Notwithstanding the isolation analysis, each entity involved in the transfer is subject to the applicable guidance on whether it must be consolidated.
- (2) Each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interest) has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor.
- (3) The transferor, its consolidated affiliates included in the financial statements being presented, or its agents do not maintain effective control over the transferred financial assets or third-party beneficial interests related to those transferred assets. Examples of a transferor's effective control over the transferred financial assets include, but are not limited to (a) an agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity, (b) an agreement that provides the transferor with both the unilateral ability to cause the holder to return specific financial assets and a more-than-trivial benefit attributable to that ability, other than through a cleanup call, or (c) an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them.

If a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset does not meet the conditions for sale treatment, or if a transfer of a portion of an entire financial interest does not meet the definition of a participating interest (discussed below), the transferor and the transferee shall account for the transfer as a secured borrowing with pledge of collateral. The transferor shall continue to report the transferred financial assets in its financial statements with no change in their measurement (i.e., the original basis of accounting for the transferred financial assets is retained).

¹ The requirements in ASC Subtopic 810-10, Consolidation – Overall, should be applied to determine when a variable interest entity should be consolidated. For further information, refer to the Glossary entry for "Variable Interest Entity."

Transfers of Financial Assets (cont.):

Accounting for a Transfer of an Entire Financial Asset or a Group of Entire Financial Assets That Qualifies as a Sale¹ – Upon the completion of a transfer of an entire financial asset or a group of entire financial assets that satisfies all three of the conditions to be accounted for as a sale, the transferee(s) (i.e., purchaser(s)) must recognize all assets obtained and any liabilities incurred and initially measure them at fair value. The transferor (seller) should:

- (1) Derecognize or remove the transferred financial assets from the balance sheet.
- (2) Recognize and initially measure at fair value servicing assets, servicing liabilities, and any other assets obtained (including a transferor's beneficial interest in the transferred financial assets) and liabilities incurred in the sale.
- (3) Recognize in earnings any gain or loss on the sale.

If, as a result of a change in circumstances, a bank transferor regains control of a transferred financial asset after a transfer that was previously accounted for as a sale because one or more of the conditions for sale accounting in ASC Topic 860 are no longer met or a transferred portion of an entire financial asset no longer meets the definition of a participating interest, such a change generally should be accounted for in the same manner as a purchase of the transferred financial asset from the former transferee (purchaser) in exchange for a liability assumed. The transferor should recognize (rebook) the financial asset on its balance sheet together with a liability to the former transferee, measuring the asset and liability at fair value on the date of the change in circumstances. If the rebooked financial asset is a loan, it must be reported as a loan in Schedule RC-C, Part I, either as a loan held for sale or a loan held for investment, based on facts and circumstances, in accordance with generally accepted accounting principles. The liability to the former transferee should be reported as a secured borrowing in Schedule RC-M, item 5.b, "Other borrowings." This accounting and reporting treatment applies, for example, to U.S. Government-guaranteed or -insured residential mortgage loans backing Government National Mortgage Association (GNMA) mortgage-backed securities that a bank services after it has securitized the loans in a transfer accounted for as a sale. If and when individual loans later meet delinquency criteria specified by GNMA, they are eligible for repurchase (buy-back) and the bank is deemed to have regained effective control over these loans. The delinquent loans must be brought back onto the bank's books and recorded as loans, regardless of whether the bank intends to exercise the buy-back option.

Banks should refer to ASC Topic 860 for implementation guidance for accounting for transfers of certain lease receivables, securities lending transactions, repurchase agreements including "dollar rolls," "wash sales," loan syndications, loan participations (discussed below), risk participations in bankers acceptances, factoring arrangements, and transfers of receivables with recourse. However, this accounting standard does not provide guidance on the accounting for most assets and liabilities recorded on the balance sheet following a transfer accounted for as a sale. As a result, after their initial measurement or carrying amount allocation, these assets and liabilities should be accounted for in accordance with the existing generally accepted accounting principles applicable to them.

Participating Interests – Before considering whether the conditions to be accounted for as a sale have been met (as discussed above), the transfer of a portion of an entire financial asset must first meet the definition of a participating interest. If the transferred portion of the entire financial asset is a qualifying participating interest (as defined below), then it should be determined whether the transfer of the participating interest meets the sales conditions discussed above.

¹ The guidance in this section of this Glossary entry does not apply to a transfer of a participating interest in an entire financial asset that qualifies as a sale. The accounting for such a transfer is discussed in a separate section later in this Glossary entry.

Transfers of Financial Assets (cont.):

A participating interest in an entire financial asset, as defined by ASC Topic 860, has all of the following characteristics:

- (1) From the date of the transfer, it must represent a proportionate (pro rata) ownership interest in an entire financial asset;
- (2) From the date of the transfer, all cash flows received from the entire financial asset, except any cash flows allocated as compensation for servicing or other services performed (which must not be subordinated and must not significantly exceed an amount that would fairly compensate a substitute service provider should one be required), must be divided proportionately among the participating interest holders in an amount equal to their share of ownership;
- (3) The rights of each participating interest holder (including the lead lender) must have the same priority, no interest is subordinated to another interest, and no participating interest holder has recourse to the lead lender or another participating interest holder other than standard representations and warranties and ongoing contractual servicing and administration obligations; and
- (4) No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to do so.

Thus, under ASC Topic 860, so-called "last-in, first-out" (LIFO) participations in which all principal cash flows collected on the loan are paid first to the party acquiring the participation do not meet the definition of a participating interest. Similarly, so-called "first-in, first-out" (FIFO) participations in which all principal cash flows collected on the loan are paid first to the lead lender do not meet the definition of a participating interest. As a result, neither LIFO nor FIFO participations transferred on or after the beginning of an institution's first annual reporting period that begins after November 15, 2009 (i.e., January 1, 2010, for a bank with a calendar year fiscal year) will qualify for sale accounting and instead must be reported as secured borrowings.

The participating interest definition also applies to transfers of government-guaranteed portions of loans, such as those guaranteed by the Small Business Administration (SBA). In this regard, for a transfer of the guaranteed portion of an SBA loan at a premium that settled before February 15, 2011, the "seller" was obligated by the SBA to refund the premium to the "purchaser" if the loan was repaid within 90 days of the transfer. This premium refund obligation was a form of recourse, which meant that the transferred guaranteed portion of the loan did not meet the definition of a "participating interest" for the 90-day period that the premium refund obligation existed. As a result, the transfer was required to be accounted for as a secured borrowing during this period. After the 90-day period, assuming the transferred guaranteed portion and the retained unguaranteed portion of the SBA loan then met the definition of a "participating interest," the transfer of the guaranteed portion could be accounted for as a sale if all of the conditions for sale accounting were met. In contrast, for transfers of guaranteed portions of SBA loans at a premium that settled on or after February 15, 2011, the SBA has eliminated the premium refund requirement. With the elimination of the premium refund obligation from such transfers, the transferred guaranteed portion and the retained unguaranteed portion of the SBA loan should normally meet the definition of a "participating interest" on the transfer date. Assuming the definition of "participating interest" is met and all of the conditions for sale accounting are met, the transfer of the guaranteed portion of an SBA loan at a premium on or after February 15, 2011, would qualify as a sale on the transfer date. The conditions for sale accounting are described above under "Determining Whether a Transfer Should be Accounted for as a Sale or a Secured Borrowing" in this Glossary entry.

On the other hand, if the guaranteed portion of the SBA loan is transferred at par in a so-called "par sale" in which the "seller" agrees to pass interest through to the "purchaser" at less than the contractual

Transfers of Financial Assets (cont.):

interest rate and the spread between the contractual rate and the pass-through interest rate significantly exceeds an amount that would fairly compensate a substitute servicer, the excess spread is viewed as an interest-only strip. The existence of this interest-only strip results in a disproportionate sharing of the cash flows on the entire SBA loan, which means that the transferred guaranteed portion and the retained unguaranteed portion of the SBA loan do not meet the definition of a "participating interest," which precludes sale accounting. Instead, the transfer of the guaranteed portion must be accounted for as a secured borrowing.

Accounting for a Transfer of a Participating Interest That Qualifies as a Sale – Upon the completion of a transfer of a participating interest that satisfies all three of the conditions to be accounted for as a sale, the participating institution(s) (the transferee(s)) shall recognize the participating interest(s) obtained, other assets obtained, and any liabilities incurred and initially measure them at fair value. The originating lender (the transferor) must:

- (1) Allocate the previous carrying amount of the entire financial asset between the participating interest(s) sold and the participating interest that it continues to hold based on their relative fair values at the date of the transfer.
- (2) Derecognize the participating interest(s) sold.
- (3) Recognize and initially measure at fair value servicing assets, servicing liabilities, and any other assets obtained and liabilities incurred in the sale.
- (4) Recognize in earnings any gain or loss on the sale.
- (5) Report any participating interest(s) that continue to be held by the originating lender as the difference between the previous carrying amount of the entire financial asset and the amount derecognized.

Additional Considerations Pertaining to Participating Interests – When evaluating whether the transfer of a participating interest in an entire financial asset satisfies the conditions for sale accounting under ASC Topic 860, an originating lender's right of first refusal on a bona fide offer to the participating institution from a third party, a requirement for a participating institution to obtain the originating lender's permission to sell or pledge the participating interest that shall not be unreasonably withheld, or a prohibition on the participating institution's sale of the participating interest to the originating lender's competitor (if other potential willing buyers exist) is a limitation on the participating institution's rights, but is presumed not to constrain a participant from exercising its right to pledge or exchange the participating interest. However, if the participation agreement constrains the participating institution from pledging or exchanging its participating interest, the originating lender presumptively receives more than a trivial benefit, has not relinquished control over the participating interest, and should account for the transfer of the participating interest as a secured borrowing.

A loan participation agreement may give the originating lender the contractual right to repurchase a participating interest at any time. In this situation, the right to repurchase is effectively a call option on a specific participating interest, i.e., a participating interest that is not readily obtainable in the marketplace. Regardless of whether this option is freestanding or attached, it either constrains the participating institution from pledging or exchanging its participating interest or results in the originating lender maintaining effective control over the participating interest. As a consequence, the contractual right to repurchase precludes sale accounting and the transfer of the participating interest should be accounted for as a secured borrowing, not as a sale.

In addition, under a loan participation agreement, the originating lender may give the participating institution the right to resell the participating interest, but reserves the right to call the participating

Transfers of Financial Assets (cont.):

interest at any time from whoever holds it and can enforce that right by discontinuing the flow of interest to the holder of the participating interest at the call date. In this situation, the originating lender has maintained effective control over the participating interest and the transfer of the participating interest should be accounted for as a secured borrowing, not as a sale.

When an originating FDIC-insured lender transfers a loan participation with recourse, the participation generally will not be considered isolated from the transferor, i.e., the originating lender, in the event of an FDIC receivership. [Section 360.6 of the FDIC's regulations](#) limits the FDIC's ability to reclaim loan participations transferred "without recourse," as defined in the regulations, but does not limit the FDIC's ability to reclaim loan participations transferred with recourse. Under [Section 360.6](#), a participation that is subject to an agreement that requires the originating lender to repurchase the participation or to otherwise compensate the participating institution due to a default on the underlying loan is considered a participation "with recourse." As a result, a loan participation transferred "with recourse" generally should be accounted for as a secured borrowing and not as a sale for financial reporting purposes. This means that the originating lender should not remove the participation from its loan assets on the balance sheet, but should report the secured borrowing in Schedule RC-M, item 5.b, "Other borrowings."

Reporting Transfers of Loan Participations That Do Not Qualify for Sale Accounting – If a transfer of a portion of an entire financial asset does not meet the definition of a participating interest, or if a transfer of a participating interest does not meet all of the conditions for sale accounting under ASC Topic 860, the transfer must be reported as a secured borrowing with pledge of collateral. In these situations, because the transferred loan participation does not qualify for sale accounting, the originating lender must continue to report the transferred participation (as well as the retained portion of the loan) as a loan on the Consolidated Report of Condition balance sheet (Schedule RC), normally in item 4.b, "Loans and leases held for investment," and in the appropriate loan category in Schedule RC-C, Part I, Loans and Leases. The originating lender should report the transferred loan participation as a secured borrowing on the Call Report balance sheet in Schedule RC, item 16, "Other borrowed money," and in the appropriate subitem or subitems in Schedule RC-M, item 5.b, "Other borrowings;" in Schedule RC-M, item 10.b, "Amount of 'Other borrowings' that are secured;" and in Schedule RC-C, Part I, Memorandum item 14, "Pledged loans and leases." As a consequence, the transferred loan participation should be included in the originating lender's loans and leases for purposes of determining the appropriate level for the lender's allowance for loan and lease losses (or allowance for credit losses, if the institution has adopted ASC Topic 326, Financial Instruments–Credit Losses).

A bank that acquires a nonqualifying loan participation (or a qualifying participating interest in a transfer that does not meet all of the conditions for sale accounting) should normally report the loan participation or participating interest in item 4.b, "Loans and leases held for investment," on the Consolidated Report of Condition balance sheet (Schedule RC) and in the loan category appropriate to the underlying loan, e.g., as a "commercial and industrial loan" in item 4 or as a "loan secured by real estate" in item 1, in Schedule RC-C, Part I, Loans and Leases. Furthermore, for risk-based capital purposes, the acquiring bank should assign the loan participation or participating interest to the risk-weight category appropriate to the underlying borrower or, if relevant, the guarantor or the nature of the collateral.

"Purchased" Loans Originated By Others – Some institutions have entered into various residential mortgage loan purchase programs. These programs often function like traditional warehouse lines of credit; however, in some cases, the mortgage loan transfers are legally structured as purchases by the institution rather than as pledges of collateral to secure the funding. Under these programs, an institution provides funding to a mortgage loan originator while simultaneously obtaining an interest in the mortgage loans subject to a takeout commitment. A takeout commitment is a written commitment from an approved investor (generally, an unrelated third party) to purchase one or more mortgage loans from the originator.

Transfers of Financial Assets (cont.):

Although the facts and circumstances of each program must be carefully evaluated to determine the appropriate accounting, an institution should generally account for a mortgage purchase program with continuing involvement by the originator, including takeout commitments, as a secured borrowing with pledge of collateral, i.e., a loan to the originator secured by the residential mortgage loans, rather than a purchase of mortgage loans.

When loans obtained in a mortgage purchase program do not qualify for sale accounting, the financing provided to the originator (if not held for trading purposes) should be reported in Schedule RC-C, Part I, item 9.a, "Loans to nondepository financial institutions," and on the balance sheet in Schedule RC, item 4.a, "Loans and leases held for sale," or item 4.b, "Loans and leases, net of unearned income," as appropriate. For risk-based capital purposes, a loan to a mortgage loan originator secured by residential mortgages that is reported in Schedule RC-C, Part I, item 9.a, should be assigned a 100 percent risk weight, or if relevant, the risk weight category appropriate to the exposure as discussed in the regulatory capital rules, and included in the appropriate column of Schedule RC-R, Part II, item 4.d or 5.d, based on its balance sheet classification.

In situations where the transaction between the mortgage loan originator and the transferee (acquiring) institution is accounted for as a secured borrowing with pledge of collateral, the transferee (acquiring) institution's designation of the financing provided to the originator as held for sale is appropriate only when the conditions in ASC Subtopic 310-10, Receivables – Overall, and the [2001 Interagency Guidance on Certain Loans Held for Sale](#) have been met. In these situations, the mortgage loan originator's planned sale of the pledged collateral (i.e., the individual residential mortgage loans) to a takeout investor is not relevant to the transferee institution's designation of the loan to the originator as held for investment or held for sale. In situations where the transferee institution simultaneously extends a loan to the originator and transfers an interest (for example, a participation interest) in the loan to the originator to another party, the transfer to the other party also should be evaluated to determine whether the conditions in ASC Topic 860 for sale accounting treatment have been met. If this transfer qualifies to be accounted for as a sale, the portion of the loan to the originator that is retained by the transferee institution should be classified as held for investment when the transferee has the intent and ability to hold that portion for the foreseeable future or until maturity or payoff (which is generally in the near term).

Financial Assets Subject to Prepayment – Financial assets such as interest-only strips receivable, other beneficial interests, loans, debt securities, and other receivables, but excluding financial instruments that must be accounted for as derivatives, that can contractually be prepaid or otherwise settled in such a way that the holder of the financial asset would not recover substantially all of its recorded investment do not qualify to be accounted for at amortized cost. After their initial recording on the balance sheet, financial assets of this type must be subsequently measured at fair value like available-for-sale securities or trading securities.

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

Treasury Receipts: See "Coupon Stripping, Treasury Receipts, and STRIPS."

Treasury Stock: Treasury stock is stock that the bank has issued and subsequently acquired, but that has not been retired or resold. As a general rule, treasury stock, whether carried at cost or at par value, is a deduction from a bank's total equity capital. For purposes of the Consolidated Reports of Condition and Income, the carrying value of treasury stock should be reported (as a negative number) in Schedule RC, item 26.c, "Other equity capital components."

"Gains" and "losses" on the sale, retirement, or other disposal of treasury stock are not to be reported in Schedule RI, Income Statement, but should be reflected in Schedule RI-A, item 6, "Treasury stock

Treasury Stock (cont.):

transactions, net." Such gains and losses, as well as the excess of the cost over the par value of treasury stock carried at par, are generally to be treated as adjustments to Schedule RC, item 25, "Surplus."

For further information, see ASC Subtopic 505-30, Equity – Treasury Stock.

Troubled Debt Restructurings: The accounting standards for troubled debt restructurings are set forth in ASC Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors, and, for institutions that have adopted ASC Topic 326, Financial Instruments–Credit Losses, in ASC Topic 326. Institutions should refer to the Glossary entries for "Allowance for Loan and Lease Losses" and "Allowance for Credit Losses," as applicable, when considering measurement of the allowance for loan losses or allowance for credit losses (allowance, when used interchangeably) for TDRs.

A troubled debt restructuring (TDR) is a restructuring in which an institution, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. The restructuring of a loan or other debt instrument (hereafter referred to collectively as a "loan") may include, but is not necessarily limited to: (1) the transfer from the borrower to the institution of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of the loan (see the Glossary entry for "Foreclosed Assets" for further information), (2) a modification of the loan terms, such as a reduction of the stated interest rate, principal, or accrued interest or an extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, or (3) a combination of the above. A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not to be reported as a TDR. Modifications of loans should be evaluated to determine if a TDR exists in totality. In some instances a borrower may have been able to add additional collateral or a guarantor to a loan which fully compensates for a concession made by the institution.

See the Glossary entry for "Nonaccrual Status" for a discussion of the conditions under which a nonaccrual asset which has undergone a TDR (including those that involve a multiple note structure) may be returned to accrual status.

A TDR in which an institution receives physical possession of the borrower's assets should be accounted for in accordance with ASC Subtopic 310-40. Thus, in such situations, the loan should be treated as if assets have been received in satisfaction of the loan and reported as described in the Glossary entry for "Foreclosed Assets."

A TDR may include both a modification of terms and the acceptance of property in partial satisfaction of the loan. The accounting for such a restructuring is a two-step process: (i) the recorded amount (or amortized cost basis if the institution has adopted ASC Topic 326) of the loan is reduced by the fair value (less cost to sell, if appropriate) of the property received, and (ii) the institution should measure any impairment (or expected credit losses if the institution has adopted ASC Topic 326) on the remaining recorded balance, or amortized cost basis, as applicable, of the restructured loan in accordance with ASC Topic 310 (or ASC Subtopic 326-20 if the institution has adopted ASC Topic 326) and record any related allowance.

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

Troubled Debt Restructurings (cont.):

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

Once an obligation has been restructured in a TDR, it continues to be considered a TDR until paid in full or otherwise settled, sold, or charged off (or meets the conditions discussed below under "Accounting for a Subsequent Restructuring of a Troubled Debt Restructuring"). The loan must be reported in the appropriate loan category in Schedule RC-C, Part I, items 1 through 9, and in the appropriate loan category in:

- Schedule RC-C, Part I, Memorandum item 1, if it is in compliance with its modified terms, or
- Schedule RC-N, items 1 through 7, and Memorandum item 1, if it is not in compliance with its modified terms.

However, for a loan that is a TDR for which the concession did not include a reduction of principal, if the restructuring agreement specifies a contractual interest rate that is a market interest rate at the time of the restructuring and the loan is in compliance with its modified terms, the loan need not continue to be reported as a TDR in Schedule RC-C, Part I, Memorandum item 1, in calendar years after the year in which the restructuring took place. A market interest rate is a contractual interest rate that at the time of the restructuring is greater than or equal to the rate that the institution was willing to accept for a new loan with comparable risk. To be considered in compliance with its modified terms, a loan that is a TDR must be in accrual status and must be current or less than 30 days past due on its contractual principal and interest payments under the modified repayment terms.

Accounting for a Subsequent Restructuring of a TDR – When a loan has previously been modified in a TDR, the lending institution and the borrower may subsequently enter into another restructuring agreement. The facts and circumstances of each subsequent restructuring of a TDR loan should be carefully evaluated to determine the appropriate reporting by the institution under U.S. GAAP. Under certain circumstances it may be acceptable not to report a subsequently restructured loan as a TDR. The banking agencies will not object to an institution no longer reporting such a loan as a TDR if at the time of the subsequent restructuring the borrower is not experiencing financial difficulties and, under the terms of the subsequent restructuring agreement, no concession has been granted by the institution to the borrower. To meet these conditions for removing the TDR designation, the subsequent restructuring agreement must specify market terms, including a contractual interest rate not less than a market interest rate for new debt with similar credit risk characteristics and other terms no less favorable to the institution than those it would offer for such new debt. When determining whether the borrower is experiencing financial difficulties, the institution's assessment of the borrower's financial condition and prospects for repayment after the restructuring should be supported by a current, well-documented credit evaluation performed at the time of the restructuring. When assessing whether a concession has been granted by the institution, the agencies consider any principal forgiveness on a cumulative basis to be a continuing concession. Accordingly, a TDR loan with any principal forgiveness would retain the TDR designation after subsequent restructurings.

If at the time of the subsequent restructuring the institution appropriately demonstrates that a loan meets the conditions discussed above, the loan need no longer be disclosed as a TDR in the Call Report.

The recorded investment or amortized cost basis, as applicable, should not change at the time of the subsequent restructuring (unless cash is advanced or received). When there have been charge-offs prior to the subsequent restructuring, consistent with Call Report instructions, any expected recoveries

Troubled Debt Restructurings (cont.):

of amounts previously charged off are not added to the recorded investment in, or the amortized cost basis of, the TDR, as applicable. For institutions that have not adopted ASC Topic 326, no recoveries should be recognized until collections on amounts previously charged off have been received. For institutions that have adopted ASC Topic 326, expected recoveries of amounts previously charged off should be considered as part of the allowance estimate but are not included in the amortized cost basis of the TDR. Similarly, if interest payments were applied to the recorded investment in, or amortized cost basis of, the TDR, as applicable, prior to the subsequent restructuring, the application of these payments to the recorded investment or amortized cost basis, as applicable, should not be reversed nor reported as interest income at the time of the subsequent restructuring.

If the TDR designation is removed from a loan that meets the conditions discussed above and the loan is later modified in a TDR, the loan should be reported as a TDR.

Measurement of Impairment on a TDR when ASC Topic 326 Has Not Been Adopted – This section of this Glossary entry applies to institutions that have not adopted ASC Topic 326. Institutions that have adopted ASC Topic 326 should refer to the “Measurement of Expected Credit Losses on a TDR when ASC Topic 326 Has Been Adopted” section below.

All loans whose terms have been modified in a TDR, including both commercial and retail loans, are impaired loans. Therefore, an institution should measure any impairment on the restructured loan in accordance with ASC Topic 310, Receivables, and should refer to the Glossary entry for "Loan Impairment."

An institution measuring the allowance on a TDR that is not collateral dependent using the present value of expected future cash flows method (i.e., discounted cash flow method) should discount the cash flows using the effective interest rate of the original or modified loan prior to the restructuring that resulted in the TDR classification. For a residential mortgage loan with a “teaser” or starter rate that is less than the loan's fully indexed rate, the starter rate is not the original effective interest rate. ASC Topic 310 also permits an institution to aggregate impaired loans that have risk characteristics in common with other impaired loans, such as modified residential mortgage loans that represent TDRs, and use historical statistics along with a composite effective interest rate as a means of measuring the impairment of these loans.

For a subsequently restructured TDR, if at the time of the subsequent restructuring the institution appropriately determines that the loan no longer meets the conditions discussed above, the impairment on the loan need no longer be measured as a TDR (i.e., as an impaired loan) in accordance with ASC Topic 310 and the Glossary entry for “Loan Impairment.” Accordingly, going forward, the loan's allowance should be measured under ASC Subtopic 450-20, Contingencies – Loss Contingencies.

For a subsequently restructured TDR on which there was principal forgiveness and therefore does not meet the conditions discussed above, the impairment on the TDR should continue to be measured as a TDR (i.e., as an impaired loan) in accordance with ASC Topic 310.

Measurement of Expected Credit Losses on a TDR when ASC Topic 326 Has Been Adopted – This section of this Glossary entry applies to institutions that have adopted ASC Topic 326. Institutions that have not adopted ASC Topic 326 should continue to refer to the “Measurement of Impairment on a TDR when ASC Topic 326 Has Not Been Adopted” section above.

An institution should measure any expected credit losses on loans whose terms have been modified in a TDR in accordance with ASC Topic 326 as set forth in the Glossary entry for "Allowance for Credit Losses." ASC Topic 326 allows an institution to use any appropriate loss estimation method to estimate ACLs for TDRs. However, there are circumstances when specific measurement methods are required. For purposes of the Consolidated Reports of Condition and Income, if a TDR, or a loan for which a TDR is reasonably expected, is collateral-dependent, the ACL must be estimated using the fair value of collateral.

Troubled Debt Restructurings (cont.):

An institution measuring the allowance on a TDR, or a pool of TDRs with shared risk characteristics, using the present value of expected future cash flow method (i.e., discounted cash flow method) should discount the cash flows using the effective interest rate of the original or modified loan prior to the restructuring that resulted in the TDR classification. For a residential mortgage loan with a “teaser” or starter rate that is less than the loan’s fully indexed rate, the starter rate is not the original effective interest rate.

When there is a reasonable expectation of executing a TDR or if a TDR has been executed, the expected effect of the modification (e.g., a term extension or an interest rate concession) is included in the estimate of the allowance.

If the TDR designation is removed from a loan balance when it is appropriate for the loan to no longer be reported as a TDR, given the change in the loan’s risk characteristics, the institution should determine whether the loan should be included in a pool of loans with similar risk characteristics for allowance measurement purposes or evaluated for expected credit losses on an individual basis.

See also the Glossary entries for “Allowance for Credit Losses” or “Allowance for Loan and Lease Losses,” as applicable, “Amortized Cost Basis,” and “Foreclosed Assets.”

Trust Preferred Securities: As bank investments, trust preferred securities are hybrid instruments possessing characteristics typically associated with debt obligations. Although each issue of these securities may involve minor differences in terms, under the basic structure of trust preferred securities a corporate issuer, such as a bank holding company, first organizes a business trust or other special purpose entity. This trust issues two classes of securities: common securities, all of which are purchased and held by the corporate issuer, and trust preferred securities, which are sold to investors. The business trust’s only assets are deeply subordinated debentures of the corporate issuer, which the trust purchases with the proceeds from the sale of its common and preferred securities. The corporate issuer makes periodic interest payments on the subordinated debentures to the business trust, which uses these payments to pay periodic dividends on the trust preferred securities to the investors. The subordinated debentures have a stated maturity and may also be redeemed under other circumstances. Most trust preferred securities are subject to mandatory redemption upon the repayment of the debentures.

Trust preferred securities meet the definition of a security in ASC Topic 320, Investments–Debt Securities, and in ASC Topic 321, Investments–Equity Securities. Because of the mandatory redemption provision in the typical trust preferred security, investments in trust preferred securities would normally be considered debt securities for financial accounting purposes. Accordingly, regardless of the authority under which a bank is permitted to invest in trust preferred securities, banks should report these investments as debt securities for purposes of these reports (unless, based on the specific facts and circumstances of a particular issue of trust preferred securities, the securities would be considered equity securities under ASC Topic 321 rather than debt securities under ASC Topic 320). If not held for trading purposes, an investment in trust preferred securities issued by a single U.S. business trust should be reported in Schedule RC-B, item 6.a, “Other domestic debt securities.” If not held for trading purposes, an investment in a structured financial product, such as a collateralized debt obligation, for which the underlying collateral is a pool of trust preferred securities issued by U.S. business trusts should be reported in Schedule RC-B, item 5.b, “Structured financial products,” and, for banks with \$10 billion or more in total assets, in the appropriate subitem of Schedule RC-B, Memorandum item 6, “Structured financial products by underlying collateral or reference assets.”

U.S. Banks: See “Banks, U.S. and Foreign.”

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

Valuation Allowance: In general, a valuation allowance is an account established against a specific asset category or to recognize a specific liability, with the intent of absorbing some element of estimated loss. Such allowances are created by charges to expense in the Consolidated Report of Income and those established against asset accounts are netted from the accounts to which they relate for presentation in the Consolidated Report of Condition. Provisions establishing or augmenting such allowances are to be reported as "Other noninterest expense" except for the provision for loan and lease losses, which is reported in a separate, specifically designated income statement item on Schedule RI.

Variable Interest Entity: A variable interest entity (VIE), as described in ASC Subtopic 810-10, Consolidation – Overall, is an entity in which equity investors do not have sufficient equity at risk for that entity to finance its activities without additional subordinated financial support or, as a group, the holders of the equity investment at risk lack one or more of the following three characteristics: (a) the power, through voting rights or similar rights, to direct the activities of an entity that most significantly impact the entity's economic performance, (b) the obligation to absorb the expected losses of the entity, or (c) the right to receive the expected residual returns of the entity.

Variable interests in a VIE are contractual, ownership, or other pecuniary interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests. For example, equity ownership in a VIE would be a variable interest as long as the equity ownership is considered to be at risk of loss.

ASC Subtopic 810-10 provides guidance for determining when a bank or other company must consolidate certain special purposes entities, such as VIEs. Under ASC Subtopic 810-10, a bank must perform a qualitative assessment to determine whether it has a controlling financial interest in a VIE. This must include an assessment of the characteristics of the bank's variable interest or interests and other involvements (including involvement of related parties and de facto agents), if any, in the VIE, as well as the involvement of other variable interest holders. The assessment must also consider the entity's purpose and design, including the risks that the entity was designed to create and pass through to its variable interest holders. In making this assessment, only substantive terms, transactions, and arrangements, whether contractual or noncontractual, are to be considered. Any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a VIE, the bank's power over a VIE, or the bank's obligation to absorb losses or its right to receive benefits of the VIE are to be disregarded when applying the provisions of ASC Subtopic 810-10.

If a bank has a controlling financial interest in a VIE, it is deemed to be the primary beneficiary of the VIE and, therefore, must consolidate the VIE. An entity is deemed to have a controlling financial interest in a VIE if it has both of the following characteristics:

- The power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance.
- The obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity.

If a bank holds a variable interest in a VIE, it must reassess each reporting period to determine whether it is the primary beneficiary. Based on a bank's reassessment it may be required to consolidate or deconsolidate the VIE if a change in the bank's status as the primary beneficiary has occurred.

ASC Subtopic 810-10 provides guidance on the initial measurement of a VIE that the primary beneficiary must consolidate. For example, if the primary beneficiary and the VIE are not under common control, the initial consolidation of a VIE that is a business is a business combination and must be accounted for in accordance with ASC Topic 805, Business Combinations. If a bank is required to deconsolidate a VIE, it must follow the guidance for deconsolidating subsidiaries in ASC Subtopic 810-10.

Variable Interest Entity (cont.):

When a bank is required to consolidate a VIE because it is the primary beneficiary, the standard principles of consolidation apply after initial measurement (see "Rules of Consolidation" in the General Instructions). The assets and liabilities of consolidated VIEs should be reported on the Consolidated Report of Condition balance sheet (Schedule RC) in the balance sheet category appropriate to the asset or liability. An institution that consolidates one or more VIEs must complete Schedule RC-V, Variable Interest Entities, to report, by balance sheet category, (a) the assets of consolidated VIEs that can be used only to settle obligations of the consolidated VIEs and (b) the liabilities of consolidated VIEs for which creditors do not have recourse to the general credit of the reporting institution. Such an institution also must report in Schedule RC-V the total amount of assets and the total amount of liabilities of its consolidated VIEs that do not meet these criteria.

When-Issued Securities Transactions: Transactions involving securities described as "when-issued" or "when-as-and-if-issued" are, by their nature, conditional, i.e., their completion is contingent upon the issuance of the securities. The accounting for contracts for the purchase or sale of when-issued securities or other securities that do not yet exist is addressed in ASC Topic 815, Derivatives and Hedging. Such contracts are excluded from the requirements of ASC Topic 815 as a regular-way security trade only if:

- (1) There is no other way to purchase or sell that security;
- (2) Delivery of that security and settlement will occur within the shortest period possible for that type of security; and
- (3) It is probable at inception and throughout the term of the individual contract that the contract will not settle net and will result in physical delivery of a security when it is issued.

A contract for the purchase or sale of when-issued securities may qualify for the regular-way security trade exclusion even though the contract permits net settlement or a market mechanism to facilitate net settlement of the contract exists (as described in ASC Topic 815). A bank should document the basis for concluding that it is probable that the contract will not settle net and will result in physical delivery.

If a when-issued securities contract does not meet the three criteria above, it should be accounted for as a derivative at fair value on the balance sheet (Schedule RC) and reported as a forward contract in Schedule RC-L, item 12.b. Such contracts should be reported on a gross basis on the balance sheet unless the criteria for netting in ASC Subtopic 210-20, Balance Sheet – Offsetting, are met. (See the Glossary entry for "Offsetting" for further information.)

If a when-issued securities contract qualifies for the regular-way security trade exclusion, it is not accounted for as a derivative. If the bank accounts for these contracts on a trade-date basis, it should recognize the acquisition or disposition of the when-issued securities on its balance sheet (Schedule RC) at the inception of the contract. If the bank accounts for these contracts on a settlement-date basis, contracts for the purchase of when-issued securities should be reported as "Other off-balance sheet liabilities" in Schedule RC-L, item 9, and contracts for the sale of when-issued securities should be reported as "Other off-balance sheet assets" in Schedule RC-L, item 10, subject to the existing reporting thresholds for these two items.

Trading in when-issued securities normally begins when the U.S. Treasury or some other issuer of securities announces a forthcoming issue. (In some cases, trading may begin in anticipation of such an announcement and should also be reported as described herein.) Since the exact price and terms of the security are unknown before the auction date, trading prior to that date is on a "yield" basis. On the auction date the exact terms and price of the security become known and when-issued trading continues until settlement date, when the securities are delivered and the issuer is paid. If physical delivery is taken on settlement date and settlement date accounting is used, the securities purchased by the bank shall be reported on the balance sheet as held-to-maturity securities in Schedule RC, item 2.a, available-for-sale securities in Schedule RC, item 2.b, or trading assets in Schedule RC, item 5, as appropriate.