

FFIEC

Federal Financial Institutions Examination Council

Washington, D.C. 20006

Call Report Date: September 30, 2004

Third 2004 Call, Number 229

Supplemental Instructions

September 2004 Call Report Materials

A sample set of the September 30, 2004, report form applicable to your bank is enclosed. Banks with domestic offices only must file the FFIEC 041 report form. Banks with domestic and foreign offices must file the FFIEC 031 report form.

Please retain the enclosed sample report form for reference. Sample forms also are available on both the FFIEC's Web site (www.ffiec.gov/ffiec_report_forms.htm) and the FDIC's Web site (www.fdic.gov/regulations/resources/call/index.html). A paper copy of the Call Report forms, including the cover (signature) page, can be printed from the Web sites. In addition, banks that use Call Report software generally can print paper copies of blank forms from their software.

Submission of Completed Reports

All banks should continue to submit their Call Reports electronically to the banking agencies' electronic collection agent, Electronic Data Systems Corporation (EDS), using one of the two methods described in the agencies' cover letter for the September 30, 2004, report date. For assistance in submitting Call Reports to EDS, contact EDS toll free at (800) 255-1571.

Banks are required to maintain in their files a signed and attested record of the completed Call Report that has been submitted to EDS showing at least the title of each Call Report item and the reported amount. Either the cover page of the enclosed sample set of report forms, a photocopy of the cover page, or a copy of the cover page printed from Call Report software or from the FFIEC's or the FDIC's Web site should be used to fulfill the signature and attestation requirement. The signed cover page should be attached to the Call Report that is placed in the bank's files.

Currently, Call Report preparation software products marketed by DBI Financial Systems, Inc.; Financial Architects US; FRS, an S1 Corporation Business; IDOM, Inc.; Information Technology, Inc.; The InterCept Group; and Jack Henry & Associates, Inc. (previously Sheshunoff Information Services) have been certified for electronic submission by EDS. The addresses and telephone numbers of the vendors with EDS certified Call Report software are listed at the end of these Supplemental Instructions.

Amending Previously Submitted Reports

Should your bank find that it needs to revise certain Call Report information in a previously submitted report, an amended Call Report data file may be electronically submitted to EDS. Otherwise, contact your Call Report analyst at the FDIC (for national and FDIC-supervised banks) or at your Federal Reserve District Bank (for state member banks) and arrange to provide the amended data by telephone, fax, or electronic mail.

FFIEC Instruction Books

The most recent update to your Call Report instruction book was distributed with the June 2004 Call Report materials. Copies of the Call Report instructions may be obtained from the FDIC's Reports

Analysis and Quality Control Section (telephone toll free at 800-688-FDIC) or from your Federal Reserve District Bank. The Call Report instructions are also available on both the FFIEC's and the FDIC's Web sites.

EITF Issue No. 03-1 on Other-Than-Temporary Impairment

In March 2004, the FASB ratified the consensus reached by its Emerging Issues Task Force (EITF) on EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. The EITF's consensus applies to debt and equity securities accounted for under FASB Statement No. 115, i.e., held-to-maturity securities and available-for-sale securities, and to equity securities that do not have readily determinable fair values that are accounted for at cost. The consensus establishes a three-step process for determining when an investment is impaired, whether that impairment is other than temporary, and how to measure the impairment loss if the impairment is deemed to be other than temporary. This process is to be applied to individual securities. An individual security is considered impaired if its fair value is less than its cost. If, upon evaluation, the impairment of an individual security is determined to be other than temporary (which does not mean permanent), an impairment loss must be recognized in earnings for the difference between the security's cost and its fair value.

Banks must follow the recognition and measurement guidance in EITF Issue No. 03-1, except for the provisions relating to interest rate impairments of debt securities that cannot contractually be prepaid or otherwise settled in such a way that the bank would not recover substantially all of its cost, beginning with their Call Reports for September 30, 2004. The FASB is expected to finalize a proposal by September 30 to defer the effective date of these interest rate impairment provisions. The deferral would last until the effective date of additional proposed guidance from the FASB on the application of these interest rate impairment provisions.

AICPA Statement of Position 03-3 on Purchased Loans

In December 2003, the AICPA issued Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*. In general, this Statement of Position applies to purchased impaired loans, i.e., loans that a bank has purchased, including those acquired in a purchase business combination, when 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. The Statement of Position does not apply to the loans that a bank has originated.

Under this Statement of Position, a purchased impaired loan is initially recorded at its purchase price (in a purchase business combination, the present value of amounts to be received). The Statement of Position limits the yield that may be accreted on the loan (the accretable yield) to the excess of the bank's estimate of the undiscounted principal, interest, and other cash flows expected at acquisition to be collected on the loan over the bank's initial investment in the loan. The excess of contractually required cash flows over the cash flows expected to be collected on the loan, 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. After acquisition, increases in the cash flows expected to be collected generally should be recognized prospectively as an adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected should be recognized as an impairment.

The Statement of Position prohibits a bank from "carrying over" or creating valuation allowances in the initial accounting for purchased 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 purchase business combination.

The Statement of Position applies to loans acquired in fiscal years beginning after December 15, 2004, with early adoption permitted. Banks must follow this Statement of Position for Call Report purposes in accordance with its effective date based on their fiscal years.

GNMA Mortgage Loan Optional Repurchase Program

Government National Mortgage Association (GNMA) mortgage-backed securities are backed by residential mortgage loans that are insured or guaranteed by the Federal Housing Administration (FHA), the Department of Veterans Affairs/Veterans Administration (VA), or the Farmers Home Administration (FmHA). GNMA programs allow financial institutions to buy back individual delinquent mortgage loans that meet certain criteria from the securitized loan pool for which the institution provides servicing. At the servicer's option and without GNMA's prior authorization, the servicer may repurchase such a delinquent loan for an amount equal to 100 percent of the remaining principal balance of the loan. Under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, this buy-back option is considered a conditional option until the delinquency criteria are met, at which time the option becomes unconditional.

When the loans backing a GNMA security are initially securitized, Statement No. 140 permits the issuer of the security to treat the transaction as a sale for accounting purposes because the conditional nature of the buy-back option means that the issuer does not maintain effective control over the loans. The loans are removed from the issuer's balance sheet. When individual loans later meet GNMA's specified delinquency criteria and are eligible for repurchase, the issuer (provided the issuer is also the servicer) is deemed to have regained effective control over these loans and, under Statement No. 140, the loans can no longer be reported as sold. The delinquent GNMA loans must be brought back onto the issuer-servicer's books as assets and initially recorded at fair value, regardless of whether the issuer intends to exercise the buy-back option. An offsetting liability also would be recorded. Whether or not these rebooked delinquent loans are repurchased, the issuer-servicer should report them as loans on the Call Report balance sheet (Schedule RC) and related schedules. These loans should be reported as held for sale (Schedule RC, item 4.a) or held for investment (Schedule RC, item 4.b), based on facts and circumstances, in accordance with generally accepted accounting principles. These loans should not be reported as "Other assets" (Schedule RC, item 11). The offsetting liability should be reported as "Other borrowed money" (Schedule RC, item 16).

For risk-based capital purposes, these rebooked loans should be risk-weighted in the same manner as all other FHA, VA, and FmHA loans, i.e., at 20 percent to the extent of the conditional guarantee. For leverage capital purposes, these rebooked loans should be included in the bank's average total assets.

Accounting for Deferred Compensation Agreements, Including Indexed Retirement Plans

On February 11, 2004, the banking agencies issued an Interagency Advisory on Accounting for Deferred Compensation Agreements and Bank-Owned Life Insurance. The agencies believe the guidance in the advisory on the appropriate accounting for deferred compensation agreements and bank-owned life insurance (BOLI) is consistent with generally accepted accounting principles. The advisory also identifies the proper Call Report items in which to report information on these agreements and on BOLI. An appendix to the advisory provides basic examples of one acceptable method of deferred compensation agreement accounting. The advisory can be accessed on each of the agencies' Web sites. In addition, the accounting and reporting guidance in the advisory was incorporated into the update to the Call Report instruction book that was included in the March 2004 Call Report materials. Please refer to the Glossary entries for "Deferred Compensation Agreements" and "Bank-Owned Life Insurance" for further information.

FASB Statement No. 149 and Loan Commitments That Must Be Accounted for as Derivatives

FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, provides guidance on the circumstances in which a loan commitment must be accounted for as derivative. Under Statement No. 149, loan commitments that relate to the origination of mortgage loans that will be held for sale, commonly referred to as interest rate lock commitments, must be accounted for as derivatives by the issuer of the commitment. Under a typical interest rate lock commitment, the borrower can choose to (1) “lock-in” the current market rate for a fixed-rate loan, i.e., a fixed interest rate lock commitment; (2) set the interest rate to adjust based upon a market index rate, i.e., an adjustable interest rate lock commitment; or (3) wait until a future date to set the interest rate and allow the interest rate to “float” with market interest rates until the rate is set, i.e., a floating interest rate lock commitment. In contrast, commitments to originate mortgage loans that will be held for investment purposes and commitments to originate other types of loans are not considered derivatives. In addition, for commitments to purchase or sell existing loans, the definition of a derivative in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, should be applied to these commitments to determine whether they meet this definition and are subject to the provisions of Statement No. 133 (see page A-26 of the Glossary section of the Call Report instructions).

Because they are derivatives, interest rate lock commitments should not be reported as unused commitments in item 1 of Schedule RC-L, Derivatives and Off-Balance Sheet Items. Instead, interest rate lock commitments must be reported on the balance sheet (Schedule RC) at fair value. Consistent with Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 105, in recognizing commitments to originate mortgage loans that will be held for sale that are entered into after March 31, 2004, a bank may not consider the expected cash flows related to the associated servicing of the mortgage loan. Further, no other internally developed intangible assets should be recorded as part of the loan commitment derivative. This SEC Staff Accounting Bulletin can be accessed at www.sec.gov/interps/account/sab105.htm.

For Call Report purposes, interest rate lock commitments should be reported with a bank’s over-the-counter written interest rate options. The par value of the mortgage loans to be originated under these loan commitment derivatives must be reported in Schedule RC L, item 12.d.(1), column A, and in Schedule RC-L, item 14, column A. Banks must also report the fair value of their interest rate lock commitments in the appropriate subitem of Schedule RC-L, item 15.b. As with written options, interest rate lock commitments are outside the scope of the credit conversion process that applies to derivatives under the agencies’ risk-based capital standards. However, if the fair value of any of these commitments after initial recognition is positive and therefore reported as an asset, this positive fair value is subject to the risk-based capital standards and must be risk weighted as an on-balance sheet asset.

The unused portion of loan commitments that are not considered derivatives should continue to be reported in Schedule RC-L, item 1. If such unused commitments have an original maturity exceeding one year, they are subject to the risk-based capital standards and must be reported in Schedule RC-R, item 53.

FASB Interpretation No. 46 (Revised)

The FASB issued Interpretation No. 46 (Revised), *Consolidation of Variable Interest Entities*, in December 2003. Revised Interpretation No. 46 replaces Interpretation No. 46, which was issued in January 2003. This interpretation explains how to identify a “variable interest entity” and how an institution should assess its interests in a variable interest entity to decide whether to consolidate that entity. Variable interest entities often are created for a single specified purpose, for example, to facilitate securitization, leasing, hedging, research and development, and reinsurance. Most small banks are unlikely to have any “variable interests” in variable interest entities.

In general, a variable interest entity is an entity in which either the controlling financial interests are not voting interests or the equity investors do not bear the entity’s residual economic risks. A variable interest is a contractual or ownership interest in an entity that changes when the fair value of the entity’s net assets (exclusive of variable interests) changes. An organization that has a variable interest (or a

combination of variable interests) that will absorb a majority of a variable interest entity's expected losses if they occur, receive a majority of the entity's expected residual returns if they occur, or both, is the "primary beneficiary" of the variable interest entity and must consolidate it.

For Call Report purposes, banks with variable interests in variable interest entities must apply the provisions of Interpretation No. 46 (Revised) to those entities in accordance with the interpretation's effective date and transition provisions, a summary of which follows. Special provisions of the revised interpretation apply to organizations that have fully or partially applied Interpretation No. 46 prior to the issuance of the revision. Otherwise, application of the revised interpretation (or Interpretation No. 46) was required of banks that are public companies, or subsidiaries of public companies, that have interests in variable interest entities or potential variable interest entities commonly referred to as special-purpose entities beginning December 31, 2003. Application of Interpretation No. 46 (Revised) by banks that are public companies (other than small business issuers), or subsidiaries of such public companies, for all other types of variable interest entities was required beginning March 31, 2004. Application of Interpretation No. 46 (Revised) by banks that are small business issuers, or subsidiaries of small business issuers, to variable interest entities other than special-purpose entities is required beginning December 31, 2004. Application of Interpretation No. 46 (Revised) by banks that are neither public companies nor subsidiaries of public companies is required immediately for variable interest entities created after December 31, 2003, and for all other variable interest entities at the beginning of the first fiscal year beginning after December 15, 2004 (January 1, 2005, for calendar year banks).

The assets and liabilities of a consolidated variable interest entity should be reported on the Call Report balance sheet (Schedule RC) on a line-by-line basis according to the asset and liability categories shown on the balance sheet. This reporting treatment also carries over to the other schedules in both the Report of Condition and the Report of Income.

Reporting Asset-Backed Commercial Paper Conduits in Schedules RC-L, RC-R, and RC-S

An asset-backed commercial paper (ABCP) program is usually carried out through a bankruptcy-remote, special-purpose entity, which generally is sponsored and administered by a bank to provide funding to its corporate customers by purchasing asset pools from, or extending loans to, those customers. The program provides funding for these assets through the issuance of commercial paper into the market. Typically, the sponsoring organization provides liquidity and credit enhancements to earn a favorable external rating on the commercial paper issued by the ABCP program. Because these programs typically are sponsored by large banking organizations, the reporting and regulatory capital requirements applicable to these programs should have no impact on most small banks.

For purposes of Memorandum item 3 of Schedule RC-S, Servicing, Securitization, and Asset Sale Activities, banks must report the requested information on credit enhancements and liquidity facilities provided to ABCP conduits regardless of their accounting treatment for the conduit. Thus, whether or not a bank must consolidate the conduit for reporting purposes in accordance with FASB Interpretation No. 46 (Revised), the bank must report its maximum credit exposure arising from and its unused commitments to conduit structures in Memorandum items 3.a and 3.b, respectively.

On July 28, the banking agencies issued a final rule amending their risk-based capital standards to make permanent an existing interim risk-based capital treatment for assets in ABCP conduits that sponsoring banks are required to consolidate in accordance with Interpretation No. 46 (Revised). Under the final rule, sponsoring banks are permitted to exclude the consolidated ABCP program assets from their risk weighted asset bases when they calculate their risk-based capital ratios. The final rule also requires banks to hold risk-based capital against eligible ABCP program liquidity facilities with an original maturity of one year or less that provide liquidity support to these programs by imposing a 10 percent credit conversion factor on such facilities effective September 30, 2004. Eligible liquidity facilities with an original maturity exceeding one year remain subject to the current 50 percent credit conversion factor. All liquidity facilities that provide liquidity support to ABCP will be treated as eligible liquidity facilities until September 30, 2005. Beginning September 30, 2005, however, ineligible liquidity facilities (both short term and long-

term) will be treated as direct credit substitutes or recourse obligations and will be subject to a 100 percent credit conversion factor. For all liquidity facilities, the resulting credit equivalent amount is risk weighted according to the underlying assets, after consideration of any collateral, guarantees, or external ratings, if applicable. Banks involved with ABCP programs should refer to the final rule for complete information on the risk-based capital treatment of these programs.

In addition, any minority interests in consolidated ABCP programs are not eligible for inclusion in Tier 1 capital (or total risk-based capital). The final rule also does not alter the accounting rules for balance sheet consolidation under Interpretation No. 46 (Revised), nor does it affect the denominator of the Tier 1 leverage capital ratio calculation, which continues to be based primarily on on-balance sheet assets as reported under generally accepted accounting principles.

Under the agencies' final rule, bank sponsors of any consolidated ABCP programs should include the consolidated assets in the appropriate balance sheet asset categories when completing items 34 through 43, column A, in Schedule RC-R, Regulatory Capital. The amounts of these consolidated assets should also be reported in items 34 through 43, column B, "Items not Subject to Risk-Weighting," unless the bank has chosen to consolidate the ABCP program assets onto its balance sheet for risk-based capital purposes, as permitted under the final rule, and risk weights them accordingly. However, unless this consolidation option has been chosen, sponsoring banks must continue to hold risk-based capital against all exposures arising in connection with these programs, whether or not the programs are consolidated for accounting purposes, including direct credit substitutes, recourse obligations, residual interests, and loans. These exposures should be reported in the appropriate items of Schedule RC-R. Furthermore, banks that provide eligible liquidity facilities to ABCP programs, whether or not they are the program sponsor, must report these facilities in the following manner in Schedule RC-R, item 53 (unless a sponsor has chosen the consolidation option). The full amount of the unused portion of an eligible liquidity facility with an original maturity exceeding one year should be reported in item 53, column A. For an eligible liquidity facility with an original maturity of one year or less, 20 percent of the unused portion of the facility should be reported in item 53, column A, to produce the effect of a 10 percent conversion factor when reporting the credit equivalent amount of the liquidity facility in item 53, column B. Finally, any minority interests in consolidated asset-backed commercial paper programs should not be included in Schedule RC-R, item 6, "Qualifying minority interests in consolidated subsidiaries."

For those ABCP programs that a bank consolidates onto its Call Report balance sheet, any credit enhancements and liquidity facilities the bank provides to the conduit should not be reported in Schedule RC-L, Derivatives and Off-Balance Sheet Items. In contrast, for programs that are not consolidated, a bank should report the credit enhancements and liquidity facilities it provides to the programs in the appropriate items of Schedule RC-L.

Reporting of Funds Invested Through Bentley Financial Services, Inc.

Banks should continue to follow the guidance provided on this subject in the Call Report Supplemental Instructions for June 30, 2003. These Supplemental Instructions can be accessed via the FFIEC's Web site (www.ffiec.gov/PDF/FFIEC_forms/FFIEC031_041_suppinst0603.pdf 183k (PDF Help)).

Call Report Software Vendors

For information on available Call Report software, banks should contact:

DBI Financial Systems, Inc.
P.O. Box 14027
Bradenton, Florida 34280
Telephone: (800) 774-3279
www.e-dbi.com

Financial Architects US
12040 Provincetowne Drive
Charlotte, North Carolina
28277
Telephone: (800) 763-7070
www.finarch.com

FRS, an S1 Corporation
Business
2815 Coliseum Centre Drive,
Suite 300
Charlotte, North Carolina
28217
Telephone: (704) 501-5619
www.frsglobal.com

IDOM, Inc.
One Gateway Center, Third Floor
Newark, New Jersey 07102
Telephone: (973) 648-0900
www.idomusa.com

Information Technology, Inc.
1345 Old Cheney Road
Lincoln, Nebraska 68512
Telephone: (402) 423-2682
www.itinw.net

The InterCept Group
27200 Agoura Road, Suite
100
Calabasas Hills, California
91301
Telephone: (800) 825-3772
www.intercept.net

Jack Henry & Associates, Inc.
Regulatory Filing Group
(previously Sheshunoff Information
Services)
807 Las Cimas Parkway, Suite 300
Austin, Texas 78746
Telephone: (800) 688-9191
filing.jackhenry.com