a new extension of credit with comparable risk. This may arise as a result of reductions in the recorded amount of the loan prior to the restructuring (e.g., by charge-offs). All loans and held-to-maturity debt securities that have undergone troubled debt restructurings and that are in compliance with their modified terms must be reported as restructured assets in Schedule RC-C, Memorandum item 1 (on the FFIEC 034) or 2 (on the FFIEC 031, 032, and 033), and Schedule RC-B, Memorandum item 4, respectively. However, a restructured asset that is in compliance with its modified terms and yields a market rate need not continue to be reported as a troubled debt restructuring in the appropriate memorandum item in these schedules in calendar years after the year in which the restructuring took place.

A restructuring 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. First, the recorded amount of the loan is reduced by the fair value of the property received. Second, the institution should measure any impairment on the remaining recorded balance of the restructured loan in accordance with the guidance concerning impaired loans set forth in FASB Statement No. 114.

A restructuring 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 the lesser of its fair value or the recorded amount of the original borrower's loan.

A credit analysis should be performed for a restructured loan in conjunction with its restructuring to determine its collectability and estimated credit loss. When available information confirms that a specific restructured loan, or a portion thereof, is uncollectible, the uncollectible amount should be charged off against to the allowance for loan and lease losses at the time of the restructuring. As is the case for all loans, the credit quality of restructured loans should be regularly reviewed. The bank should periodically evaluate the collectibility of the restructured loan so as to determine whether any additional amounts should be charged to the allowance for loan and lease losses or, if the restructuring involved an asset other than a loan, to another appropriate account.

For purposes of Schedules RC-B, RC-C, and RC-N, a restructured debt security or loan is an extension of credit to a borrower with financial difficulties that has been restructured by means of a modification of terms. On the other hand, the recorded amount of an asset received by a bank in full or partial satisfaction of a loan is not reportable as a restructured loan. Also, a loan to a purchaser of "other real estate owned" by the reporting bank for the purpose of facilitating the disposal of such real estate is not considered a restructured loan.

Foreclosed Assets: An asset (including a borrower's own equity securities) received in full satisfaction of a loan should be recorded at the lesser of (1) the fair value of the asset or (2) the recorded amount of the loan (plus the amount of any senior debt to which the property is subject) at the time of the foreclosure or repossession. (The recorded amount of a 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.) The lesser of these two amounts becomes the "cost" of the foreclosed asset. The amount by which the recorded amount of the loan exceeds the fair value of the asset is a loss which must be charged to the allowance for loan and lease losses at the time of foreclosure or repossession. If an asset is sold shortly after it was received in a foreclosure or repossession, the value received in the sale shall be substituted for the fair value estimated at the time of foreclosure or repossession and adjustments made to the loss charged against the allowance. 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.

An asset received in partial satisfaction of a loan should be recorded at the fair value of the asset at the time of foreclosure and this fair value becomes the "cost" of the foreclosed asset. (For further information, see the Glossary entry for "troubled debt restructurings.") The amount of any senior debt to which foreclosed real estate is subject at the time of foreclosure must be reported as a liability in Schedule RC, item 17, "Mortgage indebtedness and obligations under capitalized leases."

After foreclosure, each foreclosed real estate asset (including each "in-substance" foreclosed real estate asset) 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 an asset received in a foreclosure or repossession is held for more than a short period of time, any additional losses in value and any gain or loss from the sale or disposition of the asset is not to 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. Such additional declines in value and the gain or loss from the sale or disposition shall be reported net on the Report of Income as "other noninterest income" or "other noninterest expense," as appropriate.

Offsetting of Amounts Associated With Conditional and Exchange Contracts

The Call Report instructions have to date briefly addressed the topic of offsetting, i.e., netting assets and liabilities, in the General Instructions (page 10b, dated 6-91). The Financial Accounting Standards Board issued Interpretation No. 39 on offsetting in March 1992 and this interpretation took effect in 1994. As a result, a new Glossary entry for "offsetting" is being added to the Call Report instructions.

Offsetting: Offsetting is the presenting of recognized assets and liabilities on a net basis in the balance sheet. Except where specifically required by the instructions for the Reports of Condition and Income, banks shall not offset or otherwise net any assets and liabilities when preparing these reports. However, banks are permitted to offset assets and liabilities recognized in the Report of Condition for forward, interest rate swap, currency swap, option, and other conditional or exchange contracts executed with the same counterparty when a "right of setoff" exists. Under FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts," a right of setoff exists when all of the following conditions are met:

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

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

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

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

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

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

Income From the Sale and Servicing of Mutual Funds and Annuities

The instructions for reporting this income in Schedule RI, Memorandum item 2, have been revised in response to questions raised since this information began to be collected in the first quarter 1994 Call Report.

Memorandum item 2, Income from the sale and servicing of mutual funds and annuities (in domestic offices). Report the amount of income earned by the reporting bank during the calendar year to date from the sale and servicing of mutual funds and annuities (in domestic offices).

Include in this item:

(1) Income earned in connection with mutual funds and annuities that are sold on bank premises or are otherwise sold by the reporting bank, through a bank subsidiary, or by affiliated or unaffiliated entities from whom the bank receives income. This income may be in the form of fees or sales commissions at the time of the sale or fees, including a share of another entity's fees, that are earned over the duration of the account (e.g., annual fees, Rule 12b-1 fees or "trailer fees," and redemption fees). Commissions should be reported as income as earned at the time of the sale (i.e., on an accrual basis), but may be reported as income when payment is received if the results would not differ materially from those obtained using an accrual basis.

(2) Income from leasing arrangements with affiliated and unaffiliated entities who lease space in bank offices for use in selling mutual funds and annuities. Income from leasing arrangements should be reported as income as earned (i.e., on an accrual basis), but may be reported as income when payment is received if the results would not differ materially from those obtained using an accrual basis.

(3) Fees for providing investment advisory services for proprietary mutual funds and annuities.

(4) Fees for providing securities custody, transfer agent, and other operational and ancillary services to mutual funds and annuities that are sold on bank premises or are otherwise sold by the reporting bank, through a bank subsidiary, or by affiliated or unaffiliated entities from whom the bank receives income at the time of the sale or over the duration of the account.

Also include income from sales conducted through the reporting bank's trust department that are not executed in a fiduciary capacity (e.g., trustee, executor, administrator, conservator), but exclude income from sales conducted by the trust department that are executed in a fiduciary capacity.

In general, this income will have been included in the amount of "Other fee income" reported in Schedule RI, item 5.b.(1) on the FFIEC 034; item 5.f.(1) on the FFIEC 031, 032, and 033. However, income from leasing arrangements, or the portion thereof, that is fixed in amount and does not vary based on sales volume may have been reported as a deduction from Schedule RI, item 7.b, "Expenses of premises and fixed assets." Thus, the income to be included in this item should be reported gross rather than net of expenses incurred by the reporting bank or a consolidated subsidiary.

Exclude fees earned for providing securities custody, transfer agent, and other operational and ancillary services to third party mutual funds and annuities that are not sold on bank premises and are not otherwise sold by the reporting bank, through a bank subsidiary, or by affiliated or unaffiliated entities from whom the bank receives income at the time of the sale or over the duration of the account.

Instructional Changes Affecting Schedule RC-R, "Risk-Based Capital"

With the expansion of the information on the notional amounts of off-balance sheet derivatives in Schedule RC-L, as discussed above, and the banking agencies' decision to use the amortized cost rather than the fair value of available-for-sale debt securities when calculating regulatory capital ratios, the definition of "adjusted total assets" in Schedule RC-R, item 1, is being modified accordingly. Banks with total assets of less than $1 billion determine the ratio of their "total capital" to their "adjusted total assets" each quarter to determine whether they are required to complete the entire risk-based capital schedule or only a portion of the schedule.

In addition, for those banks that complete Schedule RC-R in its entirety, the amortized cost of available-for-sale debt and equity securities should be reported in items 4 through 7 of this schedule. The difference between the fair value and the amortized cost of these securities should be reported in Schedule RC-R, item 8. Furthermore, to the extent that the amount of net deferred tax assets carried on the balance sheet and reported in Schedule RC-F, item 2, includes the deferred tax effects of any unrealized holding gains and losses on available-for-sale debt securities, these deferred tax effects may be excluded from the net deferred tax asset amount reported as a 100 percent risk weight asset in Schedule RC-R, item 7.a. If these deferred tax effects are excluded, they should be reported in Schedule RC-R, item 8, and this treatment must be followed consistently over time.

The portion of the instruction to Schedule RC-R, item 1, addressing "adjusted total assets" has been revised as follows:

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

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

80% of U.S. Government-sponsored agencies (not held for trading)	- 0.8 x (Schedule RC-B, item 2.b, sum of columns A and C, plus item 4.a.(2), sum of columns A and C, plus item 4.b.(1), sum of columns A and C)
PLUS:	
Allowance for Loan and Lease Losses	+ Schedule RC, item 4.b
Unused Commitments	+ Schedule RC-L, sum of items 1.a through 1.e
Financial Standby Letters of Credit, Net	+ Schedule RC-L, item 2 minus item 2.a
Performance Standby Letters of Credit, Net	+ Schedule RC-L, item 3 minus item 3.a
Commercial Letters of Credit	+ Schedule RC-L, item 4
Participations Acquired in Acceptances	+ Schedule RC-L, item 6
Securities Lent	+ Schedule RC-L, item 8
Mortgages Transferred with Recourse	+ Schedule RC-L, sum of items 9.a.(1), 9.b.(1), and 9.c.(1)
When-Issued Securities	+ Schedule RC-L, sum of items 10.a and 10.b
Forward Contracts	+ Schedule RC-L, item 14.b, sum of columns A through D
Exchange-Traded Purchased Options	+ Schedule RC-L, item 14.c.(2), sum of columns A through D
Over-the-Counter Purchased Options	+ Schedule RC-L, item 14.d.(2), sum of columns A through D
Swaps	+ Schedule RC-L, item 14.e, sum of columns A through D
Other Off-Balance Sheet Liabilities	+ Schedule RC-L, item 12
EQUALS:	= Adjusted Total Assets

As mentioned above, the banking agencies have decided to use the amortized cost rather than the fair value of available-for-sale debt securities when calculating regulatory capital ratios. Thus, unrealized holding gains and losses on available-for-sale debt securities are excluded from the definition of Tier 1 capital. However, net unrealized holding losses on available-for-sale equity securities with readily determinable fair values will be deducted when calculating Tier 1 capital. The instructions for reporting average total assets in Schedule RC-K, "Quarterly Averages," are being revised to be consistent with the regulatory capital treatment of available-for-sale securities.

Item 7 (on the FFIEC 034), item 9 (on the FFIEC 031, 032, and 033), Total assets. Report the quarterly average for the bank's total assets, as defined for "Total assets," on Schedule RC, item 12.a on the FFIEC 034, item 12 on the FFIEC 031, 032, and 033, except that this quarterly average should reflect all debt securities (not held for trading) at amortized cost, available-for-sale equity securities with readily determinable fair values at the lower of cost or fair value, and equity securities without readily determinable fair values at historical cost. In addition, to the extent that net deferred tax assets included in the bank's total assets, if any, include the deferred tax effects of any unrealized holding gains and losses on available-for-sale debt securities, these deferred tax effects may be excluded from the determination of the quarterly average for total assets. If these deferred tax effects are excluded, this treatment must be followed consistently over time.

Other Instructional Clarifications

As previously noted in Financial Institutions Letter FIL-69-94, dated November 1, 1994, the Call Report instructions are being clarified in response to questions about the reporting of lines of credit extended to bank insiders, participations in pools of residential mortgages, refundable loan commitment fees, and stock subscription payments. A more detailed discussion of these instructional matters follows.

"Extensions of credit" to executive officers, directors, principal shareholders, and their related interests -- Banks report information on "extensions of credit" to insiders in Schedule RC-M, item 1. As defined in Federal Reserve Board Regulation O, an "extension of credit" includes the granting of a line of credit. Banks that have granted a line of credit to an insider often ask what they should report as the amount of the extension of credit in this situation. The Call Report instructions for Schedule RC-M, item 1, are being revised to indicate that the amount of the extension of credit is normally the total amount of the line of credit extended to the insider, not just the current balance of the funds that have been advanced to the insider under the line of credit.

Glossary entry for "participations in pools of residential mortgages" -- Questions have been asked periodically about the meaning of the term "residential mortgages" as it is used in this Glossary entry. The term refers to first lien 1-to-4 family residential mortgages and the Glossary entry is being clarified accordingly.

Refundable loan commitment fees -- Prior to loan closing, refundable loan commitment fees that a bank holds meet the definition of a "deposit" in the FDI Act. A reference to these fees is being added to the list of items that are to be reported as deposits in the "Definitions" section of the instructions for Schedule RC-E, "Deposit Liabilities."

Stock subscription payments -- Payments that a bank has received from stock subscribers prior to the issuance of the stock may be either refundable or nonrefundable under the terms of the stock offering. When the payments are refundable, the funds held by the bank meet the definition of a "deposit" in the FDI Act. When they are nonrefundable, the funds would be considered "other liabilities" and not a deposit. This distinction is being explained in the relevant instructions.