NOTE: Remove pages A-1 and A-2 (dated 5-89) and replace them with these revised pages.

GLOSSARY

The definitions in this Glossary apply to the 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.

Acceptances: See "bankers acceptances."

Accounting Changes: Changes in accounting principles -- The accounting principles that banks have adopted for the preparation of their Reports of Condition and Income should be changed only in the direction of more preferable accounting practices. 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 standards that are adopted by the Financial Accounting Standards Board (or such other body officially designated to establish accounting principles) may apply retroactively and may require or allow a bank to restate prior years' financial statements prepared in accordance with generally accepted accounting principles. Because each Report of Income covers a single discrete period, retroactive restatement of prior years' Reports of Condition and Income is not permitted. However, the effects of restatement should be reported in the Reports of Condition and Income in a manner consistent with a bank's financial statements for the same reporting period prepared in accordance with generally accepted accounting principles. Therefore, if restatement of prior periods is required (or if the bank elects to restate prior periods if restatement is allowed but not required), the effect on the amount of undivided profits at the beginning of the year in which the new standard is first adopted for purposes of the Reports of Condition and Income (net of applicable income taxes, if any) is to be excluded from net income and reported as a direct adjustment to equity capital in Schedule RI-A, item 9, and detailed in Schedule RI-E, item 5.

On the other hand, if a new standard must be applied retroactively but restatement of prior years' financial statements is not allowed (or if the bank elects not to restate prior periods if restatement is allowed but not required), the effect of the retroactive application on undivided profits at the beginning of the year in which the new standard is first adopted for purposes of the Reports of Condition and Income is to be included in net income like the cumulative effect of a change in accounting principle as described above. The amount of this effect (net of applicable income taxes, if any) is to be reported in Schedule RI, item 11, and detailed in Schedule RI-E, item 3.

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 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 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.

Accounting Changes (cont.):

Corrections of accounting errors -- A bank may become aware of an error in a Report of Condition or 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 a report for a prior period may result from:

(1) a mathematical mistake;

(2) a mistake in applying accounting principles; or

(3) the improper use of information that existed when the Reports of Condition and Income for prior periods were prepared.

When a bank's primary federal bank regulatory agency determines that the bank's 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 refilings will not be retroactively required for a period exceeding five years. If amended reports are not required, the bank should report the effect of such corrections on undivided profits at the beginning of the year, net of applicable income taxes, in Schedule RI-A, item 10, "Corrections of material accounting errors from prior years," and in Schedule RI-E, item 6. 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 Report of Income to be filed and not as a direct adjustment to undivided profits.

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 10, "Corrections of material accounting errors from prior years," and in Schedule RI-E, item 6. 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.

For further information on these three topics, see APB Opinion No. 20, "Accounting Changes," as amended.

Accounting Errors, Corrections of: See "accounting changes."

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

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

NOTE: Strike the instructions for "Cash Management Arrangements" through "Commercial Paper" on page A-10a (dated 3-90), remove page A-8a (dated 6-95) through page A-10 (dated 3-96), and replace them with these revised pages.

Brokered Deposits (cont.):

(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 430(a) of the Internal Revenue Code of 1986; or

(9) an agent or nominee whose primary purpose is not the placement of funds with depository institutions. (For purposes of applying this ninth exclusion from the definition of deposit broker, "primary purpose" does not mean "primary activity," but should be construed as "primary intent.")

Notwithstanding these nine exclusions, 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 such institution, which engages, directly or indirectly, in the solicitation of deposits by offering rates of interest 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.[1] For purposes of these reports, 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, see Section 337.6(b) of the FDIC's Rules and 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 such as so-called Section 20 affiliates) who then reoffer and/or resell these deposit instruments to one or more investors, regardless of the minimum denomination which the investor must purchase, are considered brokered deposits.

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

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

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

[1] 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 Report of Condition.

Business Combinations (cont.):

number of shares issued and outstanding (including the shares issued in connection with the acquisition) multiplied by par or stated value.

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

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

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

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

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

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

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

Business Combinations (cont.):

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

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

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

When push down accounting is used by a bank in the preparation of its Reports of Condition and Income, both of the following conditions should be met:

(1) An arm's-length purchase acquisition resulting in a substantive change in control of at least 80 percent must have occurred, and

(2) The push down adjusting entries eliminated the undivided profits account (therefore, the entire undivided profits of the bank before the acquisition will not be available for the payment of dividends after the acquisition).

In the Reports of Condition and Income for the remainder of the year in which the acquisition occurs, a bank shall report the initial increase or decrease in its equity capital that results from the application of push down accounting in item 6, "Changes incident to business combinations, net," of Schedule RI-A, Changes in Equity Capital. In addition, when push down accounting is used, no income or expense for the period of the calendar year prior to the acquisition date should be included in subsequent Reports of Income.

Reorganization -- A combination of two or more entities involving related parties is considered a reorganization and not a business combination. For example, two subsidiary banks of a bank holding company may combine into one bank which is a change in legal organization but not a change in the entity. The assets and liabilities transferred in the combination are accounted for at historical cost in a manner similar to that in "pooling of interests" accounting as described above.

A bank holding company's investment in a bank or other business that was acquired in a purchase business combination may differ from the book value of the net assets in that bank's or business's financial statements because push down accounting was not applied. This situation will generally exist with respect to acquisitions that occurred prior to the September 30, 1989, effective date of the push down accounting instructions set forth above in this Glossary entry.

A bank holding company may transfer its ownership interest in an acquired bank or other business to another one of its subsidiary banks subsequent to its acquisition of the bank or other business. When this occurs, the financial statements of the surviving bank must be adjusted, as set forth in FASB Emerging Issues Task Force Issue No. 90-5, to reflect the assets and liabilities of the acquired bank or other business at the historical cost included in the holding company's financial statements. The necessity and extent of such adjustments should be determined in consultation with the bank's primary federal supervisory authority.

For further details on the general treatment of business combinations, see APB Opinion No. 16 and FASB Statement No. 72, "Accounting for Certain Acquisitions of Banking or Thrift Institutions."

Call Option: See "derivative contracts."

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

Capitalization of Interest Costs (cont.):
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 FASB Statement No. 34, "Capitalization of Interest Costs," as amended.

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 "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 which 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 which 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 5, "Other debt securities," unless held for trading and therefore reportable in Schedule RC, item 5, "Trading assets."

NOTE: Strike the portion of the Glossary entry for "Deposits" on page A-19 (dated 3-93) and insert these pages after page A-18. In addition, strike the Glossary entry for "Futures, forward, and standby contracts" on pages A-24a through A-26 (dated 3-95).

Deposits (cont.):

(b) Noninterest-bearing deposit accounts consist of deposit accounts on which the issuing depository institution pays no compensation to the holder for the use of the funds.

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. Up to three, but no more than three, of the six transfers 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.

Example 4

A savings deposit permits up to three, but no more than three, "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 to manage (position or hedge) their exposure to market risk (including interest rate risk and foreign exchange risk), cash flow risk, and other risks in their operations. Although certain accounting standards address specific types of derivatives (e.g., futures, foreign currency forwards, and some swaps), authoritative guidance for other types of derivatives is limited. Further, the existing guidance does not provide consistent accounting treatment among those types of derivatives that are addressed. Therefore, accounting practice for many types of derivatives has evolved primarily through industry convention and by analogy to the guidance for futures and foreign currency transactions.

Banks should follow generally accepted accounting principles (GAAP), consistent with the guidance provided in these instructions, to account for futures, forwards, options, swaps, and similar derivative instruments in their Call Reports. The interpretive guidance included in this Glossary entry falls within the range of GAAP, and banks that deviate from this guidance when preparing their Call Reports may be required to justify those departures.

Derivative Contracts (cont.):

Mortgage derivative products such as Collateralized Mortgage Obligations (CMOs) and Real Estate Mortgage Investment Conduits (REMICs) are not covered under this guidance as they are normally considered debt securities.

Types of Derivatives:

A derivative contract is a financial instrument whose value depends on, or is derived from, the value of an underlying asset, reference rate, or index. Derivative financial instruments that are covered by these instructions include futures, forwards, options, swaps, and other financial contracts with similar characteristics.

Financial instruments that contain embedded derivatives generally should be reported based on the primary characteristics of the instrument. For example, a bank granting a mortgage loan would generally provide the borrower an embedded option to prepay the remaining principal outstanding on the loan at any time. The bank would account for the transaction as a loan and not as an option. Similarly, a structured note that provides its issuer with an option to pay off principal at specified points in time would be categorized as a debt security.

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.

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.

Derivative Contracts (cont.):

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.

Reporting Derivative Contracts:

At the inception of a derivative transaction, an institution should classify the derivative instrument into one of two categories: "trading" or "other than trading" (end-user derivatives) based on the reasons for entering into the transaction.

All derivatives classified as "trading" should be marked to market. Changes in fair value on trading derivatives should be reflected in current period income as trading gains or losses. Trading derivatives with positive fair values should be reported as trading assets. Trading derivatives with negative fair values should be reported as trading liabilities. The trading liabilities account should be reported separately from the trading assets account. Netting of trading assets and liabilities is prohibited except as permitted under FASB Interpretation No. 39. (See the Glossary entry for "offsetting.")

Hedge Accounting -- Consistent with the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide for Banks and Savings Institutions and other relevant accounting literature, derivative financial instruments should generally be marked to market, with resulting market value gains and losses recognized in current earnings. However, if certain criteria are met, an institution may recognize the gains and losses on instruments used for hedging at the same time that it recognizes the effects of related changes of the items hedged. In other words, market value gains and losses are either reported currently or deferred, for both the hedging instrument and the hedged item to achieve income symmetry. This accounting treatment is referred to as "hedge accounting."

In practice, "hedge accounting" has become a generic term used to describe several accounting methods designed to achieve income symmetry. One form of "hedge accounting" is "deferral accounting." "Deferral accounting" generally means that market value gains and losses are not recognized in current income. Instead, gain or loss recognition is deferred until a future reporting period. Depending on the specific accounting guidance and derivative instrument, the market value gain or loss may be deferred as a basis adjustment of the hedged item or otherwise deferred until a future period.

Another form of "hedge accounting" for derivatives is "accrual" accounting (also referred to as synthetic instrument accounting). Under accrual accounting, cash receivable or payable under the terms of the derivative contract are accrued to income and considered adjustments to the interest income or expense of the hedged item. However, market value gains and losses on the hedged item are not recorded.

Institutions should determine whether hedge accounting is appropriate for a derivative by evaluating these instructions, the relevant accounting literature, industry practice, and the particular facts and circumstances of the situation. If hedging criteria are met, the gains or losses associated with a derivative designated as "other than trading" may be deferred and recognized consistent with gains or losses on the item that is being hedged.

Under GAAP, hedge accounting criteria vary based on the instrument used and the position being hedged. In addition to the criteria required in specific accounting standards, institutions using hedge accounting should meet the following minimum requirements:

(1) The hedging transaction should be consistent with risk management policies of the institution.

(2) Derivative instruments and the hedged assets, liabilities, firm commitments, or anticipated transactions must be designated when the hedging transaction is initiated. Adequate documentation of the designation must be maintained.

Derivative Contracts (cont.):

If the hedged asset or liability is marked to market, the hedging instrument should also be marked to market with the changes in the fair values of both recognized consistently (either in income, or in the case of available-for-sale securities, in equity). Furthermore, derivatives used for speculative purposes, market making, or other nonhedging purposes do not qualify for hedge accounting and must be accounted for at fair value with changes in fair value reported in current income. Mark-to-market accounting is also appropriate if a derivative is designated as a hedge, but applicable criteria for hedge accounting are not met.

Valuation of open positions -- The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

The fair value of a futures contract or exchange-traded option contract is to be based on published price quotations. Quoted market prices in active markets provide the best evidence of fair value and should be used as the basis for measurement, if available. However, quoted market prices may not be readily available for some derivative instruments such as forwards, swaps, or over-the-counter option contracts. In those cases, an institution should estimate fair value based on the best information available. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option adjusted spread models and fundamental analysis. (See FASB Statement No. 125, paragraphs 42-44, for additional information about estimating fair value.) The notional amount of assets deliverable under derivative contracts generally should not be reported in the balance sheet.

Accounting for the Credit Quality of Derivatives -- The fair value of derivative contracts generally should reflect the credit quality of the counterparties. Therefore, when derivative contracts are marked to market, deterioration or improvement in credit quality of the counterparties should be reflected as an adjustment to the fair value of the derivatives. Institutions should follow the guidance in FASB Statement No. 105 and the AICPA's Audit and Accounting Guide for Banks and Savings Institutions which requires that any reserves or allowances for credit losses on derivatives be reported on the balance sheet separate from the allowance for loan and lease losses account.

Margin Accounts and Performance Bonds -- Funds deposited as margin should be reported as initial deposits, generally as other assets. When the reporting bank, as either buyer or seller of futures contracts, has posted a performance bond in the form of a margin account deposited with a broker or exchange, the current balance (as of the report date) of that margin account shall be reported in the Report of Condition in Schedule RC-F, Other Assets. Amounts deposited with exchanges to settle daily margin requirements should also be reported in Schedule RC-F.

Reporting Open Derivative Contracts -- Derivative contracts are outstanding (i.e., open) until they have been terminated by acquisition or delivery of the underlying financial instruments, or, for futures contracts, by offset, or, for option contracts, by expiring unexercised. These contracts can be "offset" by the liquidating of a purchase of futures through the sale of an equal number of contracts of the same delivery month on the same underlying instrument on the same exchange, or the covering of a short sale of futures through the purchase of an equal number of contracts of the same delivery month on the same underlying instrument on the same exchange.

Open derivatives contracts to sell securities or other assets should not be treated as a sale of all, or any part, of the underlying assets, nor netted against recorded asset values. Further, open derivatives contracts to purchase securities or other assets, should not be reported as a purchase of such assets, nor be added to recorded asset values. Only when the termination of an open position in a derivatives contract results in the acquisition of the underlying asset should the underlying asset be reported in the balance sheet. Open positions in futures, forwards, options, and swaps are reported in Schedule RC-L, Off-Balance Sheet Items.

Termination of Derivative Contracts -- For terminated derivatives that qualified and were reported as hedges, the unamortized balance of any realized deferred gain or loss should be reported in Schedule RC-M, item 11, "Net unamortized realized deferred gains (losses) on off-balance sheet derivative contracts included in assets and liabilities reported in Schedule RC." For terminated derivatives that did not qualify as hedges, any gain or loss should be reported in the Report of Income in "All other noninterest income," "Other noninterest expense," or "Trading revenue," as appropriate.

Derivative Contracts (cont.):
Accounting Treatment:

The following is a brief summary of GAAP for certain derivatives and additional guidance that is applicable for Call Report purposes.

Foreign Currency Transactions -- The primary authoritative accounting guidance for forwards, futures, and swaps involving foreign currencies is FASB Statement No. 52, "Foreign Currency Translation." Under this accounting standard, gains and losses on foreign currency transactions are recognized in income unless the transaction qualifies as a hedge of a foreign currency commitment or a net investment in a foreign entity. (See the Glossary entry for "Foreign Currency Transactions and Translation" and Statement No. 52 for additional information about accounting for foreign currency transactions, including hedges of foreign operations.)

Statement No. 52 generally permits the gain or loss on contracts or transactions that effectively hedge foreign currency commitments to be deferred from income and included in the measurement of the related foreign currency transaction. Losses should not be deferred, however, if it is estimated that deferral would lead to recognizing losses in later periods. A foreign currency transaction shall be considered a hedge of an identifiable foreign currency commitment provided both of the following conditions are met: (a) the foreign currency transaction is designated as, and is effective as, a hedge of a foreign currency commitment, and (b) the foreign currency commitment is firm. The standard does not permit hedges of anticipated transactions. See Statement No. 52 for the specific criteria that must be met for a foreign currency transaction to qualify for hedge accounting treatment.

The hedge criteria in Statement No. 52 may also be applied to hedges using assets or liabilities denominated in a foreign currency. For example, an asset or liability denominated in a foreign currency may be designated as a hedge of a foreign currency commitment and the gain or loss from the asset or liability may be deferred and included in the measurement of the transaction resulting from the commitment. In addition, an asset or liability denominated in a foreign currency may effectively be hedged under Statement No. 52 if the gain or loss on both the foreign currency denominated asset or liability and the hedging instrument are recognized currently in income. Current recognition of the offsetting gains and losses in income eliminates the need to defer gains and losses on the hedging instrument.

Futures Contracts -- The accounting for futures contracts, except foreign currency futures contracts (which are covered under FASB Statement No. 52), is established in FASB Statement No. 80, "Accounting for Futures Contracts."

Under Statement No. 80, changes in the market value of futures contracts are recognized in income unless certain criteria are met. If the criteria are met, an institution may be able to defer market value gains or losses and recognize these amounts as adjustments to the carrying amount of the hedged item. The Statement No. 80 criteria include:

(1) designation by management of the hedge position at inception,

(2) the item being hedged exposes the institution to price (or interest rate) risk,

(3) the futures contract reduces the bank's exposure to risk at the enterprise or business unit level, and

(4) changes in the market values of both the hedged item and the futures contract are highly correlated at the inception of the hedge and on an ongoing basis so that the change in the fair value of the futures contract will substantially offset the effects of price or interest rate changes on the hedged item.

For Call Report purposes, "high correlation" is achieved when cumulative changes in the value of the futures contract and the hedged item (the cash position) are at least 80 percent correlated. This may also be expressed as a range of 80 percent to 125 percent. Thus, if correlation is less than 80 percent or greater than 125 percent, it would not normally be acceptable to defer gains or losses on the futures contract.

To satisfy the criterion that changes in the values of the hedged item(s) and futures contract(s) are highly correlated at inception, an institution must consider actual correlation in relevant past periods.

Derivative Contracts (cont.):

When making this assessment, the analysis period should normally cover at least the preceding 12 months. In addition, once a hedge is in place, the Statement No. 80 deferral criteria require an institution to assess correlation on a regular basis. Accordingly, institutions should assess correlation at least quarterly, but more frequent assessments may be warranted in certain circumstances. Documentation of the correlation analyses should be retained.

Statement No. 80 also indicates that a futures contract may qualify as a hedge of an anticipated transaction if the following two additional criteria are met:

(1) the significant characteristics and expected terms of the anticipated transaction are identified, and

(2) it is probable that the anticipated transaction will occur.

To satisfy the requirement that it is probable that an anticipated transaction will occur, a high level of assurance is necessary for the related futures contract to qualify as a hedge. Probability should be supported by observable facts and circumstances. The likelihood that a transaction will take place can be supported by the frequency of similar past transactions, substantial commitment of resources to an activity, and the length of time to the anticipated transaction date. As indicated in FASB Emerging Issues Task Force (EITF) Issue No. 86-34, the Statement No. 80 probability criterion is difficult to meet when the anticipated transactions are expected to take place over a relatively long period of time (e.g., more than one year). See Statement No. 80 for further discussion of probability.

Forward Contracts -- Institutions should refer to FASB Statement No. 80 and the preceding guidance for futures contracts for guidance on accounting for domestic forward contracts. Foreign currency forward rate agreements and foreign currency forward contracts are generally accounted for under FASB Statement No. 52.

Interest Rate Swaps -- The EITF has issued some guidance on accounting for interest rate swaps. For example, EITF Issue No. 84-7 applies to the early termination of swaps that hedge a financial instrument. Under this guidance, gain or loss from early termination should be deferred and amortized as a yield adjustment to the underlying financial instrument if the financial instrument is not marked to market. EITF Issue No. 84-36 indicates that if a company entering into a swap has an underlying debt obligation on its balance sheet, it may account for the swap like a hedge of that obligation and record interest expense using the revised rate. (FASB Statement No. 52 provides guidance on the use of hedge accounting for currency swaps.)

In practice, many interest rate swaps are accounted for in a manner consistent with the underlying asset or liability to which they are designated. For example, if an institution uses a swap to change a fixed interest rate asset to a variable rate asset (or vice versa), it would accrue the interest payable or receivable as an adjustment to interest income or expense. Accordingly, when an institution uses a swap to alter the interest rate characteristics of an underlying asset or liability, it does not recognize any market value gain or loss on the swap. Instead, it records interest income or expense using the revised interest rate, with any fees or other payments amortized as yield adjustments. Consistent with EITF Issues No. 84-7 and No. 84-36, the gain or loss on a terminated interest rate swap should be deferred and recognized over the life of the hedged item if this item is not marked to market. If the financial instrument is marked to market with gains and losses recognized in current earnings, the gain or loss on termination should also be recognized in income.

Banks are generally permitted to account for interest rate swaps as hedges in the Call Report when permitted in accordance with GAAP, provided the swap is linked with a specific asset or liability or pool of assets and liabilities. However, interest rate swaps containing leverage, or not meeting the general guidance for hedge accounting (as stated above in these instructions) should be marked to market.

Purchased Options -- Virtually no authoritative literature has been issued for the accounting for purchased options. In the absence of specific guidance, some institutions have adopted some aspects of an AICPA Issues Paper released in 1986. However, this paper is not authoritative. Accordingly, accounting practice for purchased options has developed primarily by analogy to FASB Statements No. 80 and No. 52 and where addressed, by the AICPA's Audit and Accounting Guide for Banks and Savings Institutions.

Derivative Contracts (cont.):

For hedges of foreign currency risk involving purchased options, EITF Issue No. 90-17, "Hedging with Purchased Options," provides limited guidance. Under this guidance, when an option has little or no intrinsic value[1] and it hedges an anticipated transaction that is probable, an institution may use hedge accounting for the gains or losses on the option, if the following criteria are met:

(1) The item to be hedged exposes the hedging enterprise to foreign currency risk.

(2) The purchased option is designated as a hedge and reduces the enterprise's exposure to risk.

(3) The significant characteristics and expected terms of the anticipated transaction are identified.

(4) It is probable that the anticipated transaction will occur.

Purchased options that hedge assets and liabilities marked to market through income should also be marked to market through income. In practice, for purchased options that hedge assets and liabilities carried at cost (or lower of cost or market), institutions recognize market value gain or loss in the appropriate period to match the timing of recognition of income or expense of the hedged item. The premium paid is typically amortized over the life of the option.

Institutions typically account for purchased interest rate caps, floors, collars, and similar option-based instruments used for hedging purposes like interest rate swaps. Accordingly, in practice, interest payable or receivable on such instruments is accrued as an adjustment to interest income or expense on the assets or liabilities being hedged and the market value gain or loss on the option-based instrument is not recognized in income.

As with an interest rate swap, to qualify for hedge accounting, a purchased option, interest rate cap, floor, collar, or similar instrument must be designated as a hedge and linked with a specific asset or liability, or pool of assets or liabilities. Again, hedging treatment depends on the specific facts and circumstances. In the absence of sufficient evidence that a hedge is being undertaken, the instrument should be marked to market.

Written Options - Written options do not qualify as hedges for accounting purposes. Such options should be marked to market through current earnings.

A loss on a written option should be reported in the Report of Income in "Other noninterest expense" or "Trading revenue," as appropriate. An accumulated loss position should be reported as a liability in the Report of Condition in Schedule RC-G, Other Liabilities, or in Schedule RC, item 15.b, "Trading liabilities," as appropriate.

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[1] The market value of an option includes an intrinsic value component and a time value component. The intrinsic value of a call option, for example, is the excess, if any, of the market price of the underlying item over the exercise price of the option. Thus, an option may have no intrinsic value. The time value of a call option is the difference between the total premium for an option and the option's intrinsic value. The time value component is affected by several factors, including the probability that the price of the underlying item will move above the exercise price during the exercise period.

NOTE: Remove pages A-21 and A-22 (dated 3-93) and pages A-22a and A-22b (dated 6-96) and replace them with these revised pages.

Edge and Agreement Corporation (cont.):
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 Method of Accounting: See the instruction to Report of Condition Schedule RC-M, item 8.b, "Investments in unconsolidated subsidiaries and associated companies."

Extinguishments of Liabilities: The accounting and reporting standards for extinguishments of liabilities
occurring after December 31, 1996, are set forth in FASB Statement No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." Under Statement No. 125, 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.

Extraordinary Items: Extraordinary items are material events and transactions that are (1) unusual and (2) infrequent. Both of those conditions must exist in order for an event or transaction to be reported as an extraordinary item.

To be unusual, an event or transaction must be highly abnormal or clearly unrelated to the ordinary and typical activities of banks. An event or transaction which is beyond bank management's control is not automatically considered to be unusual.

To be infrequent, an event or transaction should not reasonably be expected to recur in the foreseeable future. Although the past occurrence of an event or transaction provides a basis for estimating the likelihood of its future occurrence, the absence of a past occurrence does not automatically imply that an event or transaction is infrequent.

Only a limited number of events or transactions qualify for treatment as extraordinary items. Among these are losses which result directly from a major disaster such as an earthquake (except in areas where earthquakes are expected to recur in the foreseeable future), an expropriation, or a prohibition under a newly enacted law or regulation.

For further information, see APB Opinion No. 30, "Reporting the Results of Operations."

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 Reports of Condition and Income.

Federal Funds Transactions: For purposes of the Reports of Condition and Income, federal funds transactions involve the reporting bank's lending (federal funds sold) or borrowing (federal funds purchased) of immediately available funds for one business day or under a continuing contract, regardless of the nature of the contract or of the collateral, if any. However, due bills and borrowings from the Discount and Credit Department of a Federal Reserve Bank are excluded from federal funds.

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.

Federal Funds Transactions (cont.):
The borrowing and lending of immediately available funds is for 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 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. Federal funds include only those exchanges of immediately available funds that are for one business day (or under a continuing contract).

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 four types of transactions provided that the transactions meet the above criteria (i.e., immediately available funds for 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 securities under agreements to resell (repurchase) and similar transactions, regardless of the terminology used, where a feature of the transaction is the resale (repurchase) of identical or substantially similar securities. (Security resale and repurchase agreements of more than one business day maturity with this same feature are not covered by the term "federal funds," but they are part of the total amount of security resale and repurchase agreements which are combined with federal funds in items 3 and 14 on the balance sheet (Schedule RC). The term "federal funds" and the term "security repurchase (resale) agreement" both include security repurchase (resale) agreements of one business day maturity or under a continuing contract and thus overlap to that extent.)
(3) Purchases (sales) of loans or other assets under agreements to resell (repurchase) that have one business day maturities (or are under continuing contracts) and are in immediately available funds.
(4) Purchases (sales) of participations in pools of securities.

Any borrowing or lending of immediately available funds that matures in more than one business day, other than security 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 foreclosed assets are set forth in FASB Statement No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings," and FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." A summary of the relevant provisions of these accounting standards follows. For further information, see FASB Statements No. 15 and 121.

A bank that receives from a borrower in full satisfaction of a loan either receivables from third parties, an equity interest in the borrower, or other types of assets (except long-lived assets that will be sold) shall account for those assets at their fair value at the time of the restructuring. A bank that receives long-lived assets that will be sold, such as real estate, from a borrower in full satisfaction of a loan shall account for those long-lived assets at their fair value less cost to sell. This fair value (less cost to sell) becomes the "cost" of the foreclosed asset. The amount, if any, by which the recorded amount of the loan exceeds the fair value (less cost to sell) 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. (The recorded amount of 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.)

Foreclosed Assets (cont.):

If an asset is sold shortly after it is received in a foreclosure or repossession, it would generally be appropriate to substitute the value received in the sale (net of the cost to sell for long-lived assets that will be sold such as real estate) for the fair value (less cost to sell for long-lived assets that will be sold such as real estate) that had been estimated at the time of foreclosure or repossession. Any adjustments should be 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 accounted for as described above and the recorded amount of the loan should be reduced by the fair value (less cost to sell) of the asset at the time of foreclosure.

For purposes of these reports, foreclosed assets include loans where the bank, as creditor, has received physical possession of a borrower's assets, regardless of whether formal foreclosure proceedings take place. In such situations, 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.

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, item 16, "Other borrowed money."

After foreclosure, each foreclosed real estate asset (including any real estate for which the bank receives physical possession, regardless of whether formal foreclosure proceedings take place) 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 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. 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."

Dispositions of Foreclosed Real Estate -- The primary accounting guidance for sales of foreclosed real estate is FASB Statement No. 66, "Accounting for Sales of Real Estate." This standard, 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.

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:

(1) A sale has been consummated;
(2) The buyer's initial investment (down payment) and continuing investment (periodic payments) are adequate to demonstrate a commitment to pay for the property;
(3) The receivable is not subject to future subordination; and
(4) 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 the Appendix A to FASB Statement No. 66. 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

Foreclosed Assets (cont.):
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.

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 bank 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.

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.

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 the aggregate payments by the borrower exceed the recorded amount of the loan or 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.

Reduced-Profit Method -- This method is used in certain situations where the bank 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.

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 until sufficient payments or other events have occurred which allow the use of one of the other methods.

The preceding discussion represents a brief summary of the methods included in FASB Statement No. 66 for accounting for sales of real estate. Refer to FASB Statement No. 66 for a more complete description of the accounting principles that apply to sales of real estate, including the determination of the down payment percentage.

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, lendings, forward exchange contracts) denominated in currencies 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.

NOTE: Remove page A-30a (dated 9-30-89) and replace it with this revised page.

FEDERAL INCOME TAX RATES APPLICABLE TO BANKS

Year	First $25,000	Second $25,000	Third $25,000	Fourth $25,000	Over $100,000	Capital Gains	Alternative Minimum Tax
1987	15%	16.5%	27.5%	37%	[1]	Regular tax rates	20%
1988-1992	15%	15%	25%	34%	[2]	Regular tax rates	20%
1993-1997	15%	15%	25%	34%	[3]	Regular tax rates	20%

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

Interest-Bearing Account: See "deposits."

Interest Capitalization: See "capitalization of interest cost."

Internally Developed Computer Software: Costs associated with the development of computer software for a bank's internal use should be accounted for in a manner consistent with generally accepted accounting principles and in accordance with the bank's (or its parent holding company's) accounting policy for other financial reporting purposes. Accordingly, if these costs are expensed as incurred in other financial reports issued by the bank (or its parent holding company), they should be reported in the same manner in the Reports of Condition and Income (i.e., as a period cost component of "Other noninterest expense"). This is considered the preferable accounting method. However, if the bank (or its parent holding company) has previously adopted an accounting policy of capitalizing and amortizing these costs for other financial reporting purposes, the bank may use this accounting method for purposes of the Reports of Condition and Income. A bank that does not currently capitalize these costs should not adopt this method for purposes of these reports.

The costs of internally developed computer software to be sold, leased, or otherwise marketed as a separate product or as part of a product or process should be reported in accordance with FASB Statement No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed."

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

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[1] A 42.5% tax rate applies to taxable income from $100,001 to $335,000; a 40% tax rate applies to taxable income from $335,001 to $1,000,000; a 42.5% tax rate applies to taxable income from $1,000,001 to $1,405,000; and a 40% tax rate applies to taxable income over $1,405,000.

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

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

NOTE: Remove pages A-36a and A-36b (dated 3-95) and replace them with these revised pages.

Loan Fees (cont.):
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.

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 (1-8 on FFIEC 034) 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: **The accounting standard for impaired loans is FASB Statement No. 114, "Accounting by Creditors for Impairment of a Loan." For further information, refer to FASB Statement No. 114.**

Each institution is responsible for maintaining an allowance for loan and lease losses (allowance) adequate to absorb estimated credit losses in its entire loan and lease portfolio. As indicated in the Interagency Policy Statement on the Allowance for Loan and Lease Losses dated December 21, 1993, a bank should rely on several methods when analyzing its loan and lease portfolio and determining the appropriate level for its allowance. FASB Statement No. 114 sets forth measurement methods for estimating the portion of the overall allowance for loan and lease losses attributable to impaired loans. For comprehensive guidance on the maintenance of an adequate allowance, banks should refer to the Interagency Policy Statement 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 Banking Circular 201 (BC-201) and the section of the Comptroller's Handbook for National Bank Examiners discussing the allowance for loan and lease losses.

In general, certain loans are impaired under FASB Statement No. 114 when, based on current information and events, it is likely that an institution will be unable to collect all amounts due according to the contractual terms of the loan agreement, (i.e., both principal and interest). An institution should apply its normal loan review procedures when determining whether a loan covered by FASB Statement No. 114 is impaired. When a loan is deemed impaired under FASB Statement No. 114, an institution may choose to measure impairment using (1) 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), (2) the loan's observable market price, or (3) the fair value of the collateral, if the loan is collateral dependent. (See the additional regulatory reporting guidance on collateral dependent loans in the following paragraph.) 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

Loan Impairment (cont.):

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 Reports of Condition and Income, impairment of a collateral dependent loan must be measured using the fair value of the collateral. In general, any portion of the recorded investment in a collateral dependent loan (including recorded accrued interest, net deferred loan fees or costs, and unamortized premium or discount) in excess of the fair value of the collateral that can be identified as uncollectible should be promptly charged off against the allowance for loan and lease losses.

An additional allowance for estimated credit losses on an impaired loan over and above what is specified by FASB Statement No. 114 will not be automatically required by the federal banking agencies. However, an additional allowance on certain impaired loans is not precluded and may be necessary based on consideration of institution-specific factors, such as historical loss experience compared with estimates of such losses and concerns about the reliability of cash flow estimates, the quality of an institution's loan review function, or controls over its process for estimating its allowance for impaired loans under FASB Statement No. 114.

FASB Statement No. 114 also addresses the accounting by creditors for all loans that are restructured in a troubled debt restructuring involving a modification of terms, except loans that are measured at fair value or the lower of cost or fair value. 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. Since full collection of principal and interest is not expected for impaired loans, income accrual should normally be discontinued on such loans at the time that they first become impaired. Any cash payments received on impaired loans 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 that Glossary entry.

NOTE: Remove pages A-40a and A-40b (dated 9-93), pages A-41 and A-42 (dated 3-96), and page A-42a (dated 3-95), and replace them with these revised pages.

Nonaccrual Status (cont.):

(1) The criteria for amortization (i.e., accretion of discount) specified in AICPA Practice Bulletin No. 6[1] are met with respect to a loan or other debt instrument acquired at a discount (because there is uncertainty as to the amounts or timing of future cash flows) from an unaffiliated third party (such as another institution or the receiver of a failed institution), including those that the seller had maintained in nonaccrual status.

(2) The asset upon which principal or interest is due and unpaid for 90 days or more is a consumer loan or a loan secured by a 1-to-4 family residential property. Nevertheless, such loans should be subject to other alternative methods of evaluation to assure that the bank's net income is not materially overstated.

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, 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 "income earned, not collected on loans" 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 "income earned, not collected on loans" account.

Treatment of cash payments and criteria for the cash basis recognition of income -- When doubt exists as to the collectability of the remaining book balance of an asset in nonaccrual status, any payments received must be applied to reduce principal 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 principal. 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 book balance of the asset (i.e., after charge-off of identified losses, if any) is deemed to be fully collectible.[2] A bank's determination as to the ultimate collectability of the asset's remaining book balance 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 principal, 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 book balance at the contractual rate. A bank may also choose to account for the contractual interest in its entirety either as income, reduction of principal, or recovery of prior charge-offs, depending on the condition of the loan, consistent with its accounting policies for other financial reporting purposes.

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[1] American Institute of Certified Public Accountants Practice Bulletin No. 6, "Amortization of Discounts on Certain Acquired Loans," August 1989.

[2] An asset subject to the cost recovery method required by AICPA Practice Bulletin No. 6 should follow that method for reporting purposes.

Nonaccrual Status (cont.):

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.

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 has been acquired at a discount (because there is uncertainty as to the amounts or timing of future cash flows) from an unaffiliated third party and meets the criteria for amortization (i.e., accretion of discount) specified in AICPA Practice Bulletin No. 6, 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.

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

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

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

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

Noninterest-Bearing Account: See "deposits."

Nontransaction Account: See "deposits."

NOW Account: See "deposits."

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

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

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

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

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

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

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

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

See also "reciprocal balances."

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

Option: See "derivative contracts."

Organization Costs: Organization costs are the direct costs incurred to incorporate and charter a bank. Such direct 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. Organization costs incurred by newly chartered banks should be capitalized and amortized using the straight-line method over a period not to exceed five years. The unamortized balance of a bank's organization costs should be included in Schedule RC, item 10, "Intangible assets," and as "All other identifiable intangible assets" in Schedule RC-M, item 6.b.(2).

Organization Costs (cont.):
Pre-opening expenses such as salaries and employee benefits, rent, depreciation, supplies, directors' fees, training, travel, postage, and telephone are not considered organization costs and should not be capitalized. In addition, allocated internal costs (e.g., management salaries) shall not be capitalized as organization costs. Pre-opening expenses incurred from the bank's inception through the date the bank commenced operations should be reported in the appropriate items of Schedule RI, Income Statement, each quarter during the calendar year in which operations commenced.

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

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

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

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

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

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

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

Participations: See "transfers of assets."

Participations in Acceptances: See "bankers acceptances."