



FEDERAL RESERVE BANK *of* NEW YORK

## **FFIEC 002 Reporting Seminar**

Thursday, November 15, 2012



FEDERAL RESERVE BANK *of* NEW YORK

## **Fair Value and Schedule Q**

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## Overview

- ASC 825-10-25, “Financial Instruments: Overall: Recognition: Fair Value Option” (FAS 159)
- ASC 820-10-35, “Fair Value Measurement: Overall: Subsequent Measurement” (FAS 157)
- Fair Value on the FFIEC 002: Schedule Q, “Financial Assets and Liabilities Measured at Fair Value”



## ASC 825-10-25, Financial Instruments, Fair Value Option

- ASC 825-10-25 discusses the “the fair value option” which allows the reporting entity to elect fair value measurement to an asset or liability in the balance sheet.
- The accounting treatment dictates that the elected asset or liability is measured at fair value on the balance sheet and changes to fair value are realized through the income statement.



### **ASC 820-10-35: Fair Value Measurement**

- Defines fair value for financial reporting
- Establishes a framework for measuring fair value
- Enhances disclosures surrounding fair value measurements of assets and liabilities (Schedule Q)



### **Fair Value Definition**

- Price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- The reported fair value is based off the exit price, not the entry price.
  - Exit price – the price that would be received or paid to sell an asset or transfer a liability, in a hypothetical transaction
  - Entry price – the price that would be received or paid to acquire an asset or assume liability, in an actual transaction



## **ASC 820-10-20, “Fair Value Measurement: Overall: Glossary”**

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets/liabilities that the reporting entity has the ability to assess at the measurement date
- Level 2 inputs are inputs other than quoted prices included within level 1 that are observable for the asset/liability either directly or indirectly (e.g. yield curves, interest rates...etc)
- Level 3 inputs are unobservable inputs for the asset/liability . The inputs reflect the reporting entity’s own assumptions about the assumptions a market participant would make in pricing the exit price of an asset/liability



## **Level 1 Measurement Definition and Types of Products and Instruments**

- Level 1 fair value measurement inputs are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Typical Products:
  - U.S. Treasury securities
  - U.S. Government agency MBS
  - Equity securities
  - Exchange-traded derivatives
  - Physical commodities
  - Fund investments



## Level 2 Measurement Definition

- Level 2 fair value measurement inputs are inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.
- This includes:
  - Observed market prices for similar instruments
  - Relevant broker quotes
  - Discounted cash flows



## Level 2 Measurement Definition

- If the asset or liability has a specified contractual term, a Level 2 input must be observable for substantially the full term of the asset or liability.
- Depending on the specific factors related to an asset or a liability, certain adjustments to Level 2 inputs may be necessary to determine the fair value of the asset or liability. If those adjustments are significant to the asset or liability's fair value in its entirety, the adjustments may render the fair value measurement to a Level 3 measurement.



## Level 2 Products and Instruments

- Level 2 products and instruments capture the majority of assets and liabilities measured at fair value on the balance sheet.
  
- Typical Products:
  - Securities financing agreements
  - Conforming residential mortgages held for sale
  - Plain vanilla options
  - Interest rate, foreign exchange, and credit default swaps



## Level 3 Measurement Definition and Products and Instruments

- Level 3 fair value measurement inputs are unobservable inputs that are significant to the fair value measurement of the asset or liability.
  
- Typical Products:
  - Mortgage Servicing Rights
  - Private equity investments
  - CDOs and CLOs
  - Structured credit derivatives
  - Long-dated equity and exotic options



### **Schedule Q, Financial Assets and Liabilities Measured at Fair Value**

- Schedule Q captures financial assets and liabilities measured at fair value on a recurring basis, i.e. annually or more frequently
  
- It is to be completed by branches and agencies that:
  - Have reported total assets of \$500 million or greater as of the preceding December 31; or
  - Have reported total assets less than \$500 million as of the preceding December 31 and either:
    - Have elected the fair value option; or
    - Reported trading assets of \$2 million or more in any of the four preceding calendar quarters



### **Schedule Q, Financial Assets and Liabilities Measured at Fair Value**

- Column A, Total Fair Value Reported on Schedule RAL
  - Report the total fair value of those assets and liabilities reported on Schedule RAL reported at fair value on a recurring basis or that the branch has elected to report at fair value under a fair value option
  
  - Amounts reported on Column A should equal amounts for these items included within Schedule RAL



## Schedule Q, Financial Assets and Liabilities Measured at Fair Value

- Columns C, D, E, Fair Value Measurements
  - Report in Columns C, D, and E the fair value amounts which fall in Levels 1, 2, and 3, respectively
  - Column A = Columns C+D+E – Column B



## Schedule Q, Financial Assets and Liabilities Measured at Fair Value

- Column B, Amounts Netted in the Determination of Total Fair Value
  - Report any netting adjustments (ASC 210-20, “Balance Sheet: Offsetting”) (FIN 39), Offsetting of Amount Related to Certain Contracts, and FAS 41, Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements) related to the gross amounts reported in Columns C, D, and E separately in a manner consistent with industry practice.
  - The amounts reported in the three levels should match the total amount report in Column A, less netted amounts in Column B for each instrument type.





## Reporting of Assets and Liabilities on Schedule Q

### Securities

- All securities within the scope of ASC 320, “Investments - Debt & Equity Securities” (FAS 115), that a bank has elected to report at fair value under the fair value option should be classified as trading securities even if the securities were not acquired principally for the purpose of trading
  - Schedule Q, Line 5(b): Report as “Other trading assets”
  - Breakout in Line 5(b)(1), “Nontrading securities at fair value with changes in fair value reported in current earnings (included in Schedule Q, Line 5(b))
- Available-for-sale securities for which the fair value option has not been elected



## Reporting of Assets and Liabilities on Schedule Q

### Loans

- Loans held for trading should be reported on Line 5(b), “Other Trading Assets”
- Loans held for sale for which the fair value option was elected should be reported on Line 3, “Loans held for sale ”
- Loans held for investment for which the fair value option was elected should be reported on Line 4, “Loans held for investment”
- Loans held for sale or investment for which the fair value option was not elected but are measured at fair value on a recurring basis should be reported on Line 6, “All other assets”



## Reporting of Assets and Liabilities on Schedule Q

### Trading Assets and Liabilities

- The positive and negative fair value of trading derivatives should be reported on Line 5(a) or Line 10(a) respectively
- Other trading assets or liabilities should be reported on Line 5(b) and includes items such as:
  - Loans held for trading
  - Nontrading securities under a fair value option
- The amount of nontrading securities reported on Line 5(b) should also be disclosed on Line 5(b)(1)
- Amounts reported should continue to equal amounts reported on Schedule RAL



## Reporting of Assets and Liabilities on Schedule Q

### All Other Assets and Liabilities

- Report all other assets or liabilities that are measured at fair value on a recurring basis or under a fair value option not included elsewhere on Schedule Q on Line 6 or Line 13
- This includes (among others):
  - Positive and negative fair values of Nontrading derivatives
  - Interest only strips receivables
  - Positive and negative fair values of Loan Commitments
- In addition, any component exceeding \$25,000 and more than 25% of the amount reported in Line 6 or 13 should be itemized on Memoranda Line M1 or Line M2, in items a through f



## Reporting of Assets and Liabilities on Schedule Q

### Fair Value of Nontrading Interest Rate Swaps (Level 2)

Dollar Amounts in Thousands	(Column A) Total Fair Value Reported on Schedule RAL			(Column B) LESS: Amounts Netted in the Determination of Total Fair Value			(Column C) Level 1 Fair Value Measurements			(Column D) Level 2 Fair Value Measurements			(Column E) Level 3 Fair Value Measurements				
	RCFD	BI	MI	Thou	RCFD	BI	MI	Thou	RCFD	BI	MI	Thou	RCFD	BI	MI	Thou	
<b>ASSETS</b>																	
1. Available-for-sale securities	1773				G474				G475				G476				G477
2. Federal funds sold and securities purchased under agreements to resell	RCFD																
3. Loans and leases held for sale	G478				G479				G480				G481				G482
4. Loans and leases held for investment	G483				G484				G485				G486				G487
5. Trading assets:	RCXX																
a. Derivative assets	3543				G493				G494				G495				G496
b. Other trading assets:	RCFD																
(1) Nontrading securities at fair value with changes in fair value reported in current earnings (included in Schedule Q, item 5.b above)	G497				G498				G499				G500				G501
6. All other assets	F240				F684				F692				F241				F242
7. Total assets measured at fair value on a recurring basis (sum of items 1 through 5.b plus item 6)	G391				G392				G395				G396				G804
8. Deposits	G502				G503				G504				G505				G506
<b>LIABILITIES</b>																	
9. Federal funds purchased and securities sold under agreements to repurchase	F252				F686				F684				F253				F254
10. Trading liabilities:	G507				G508				G509				G510				G511
a. Derivative liabilities:	RCXX																
(1) Nontrading securities at fair value with changes in fair value reported in current earnings (included in Schedule Q, item 5.b above)	3547				G512				G513				G514				G515
b. Other trading liabilities	G516				G517				G518				G519				G520
11. Other borrowed money	G521				G522				G523				G524				G525
12. Subordinated notes and debentures	G526				G527				G528				G529				G530
13. All other liabilities	G805				G806				G807				G808				G809
14. Total liabilities measured at fair value on a recurring basis (sum of items 8 through 13)	G531				G532				G533				G534				G535



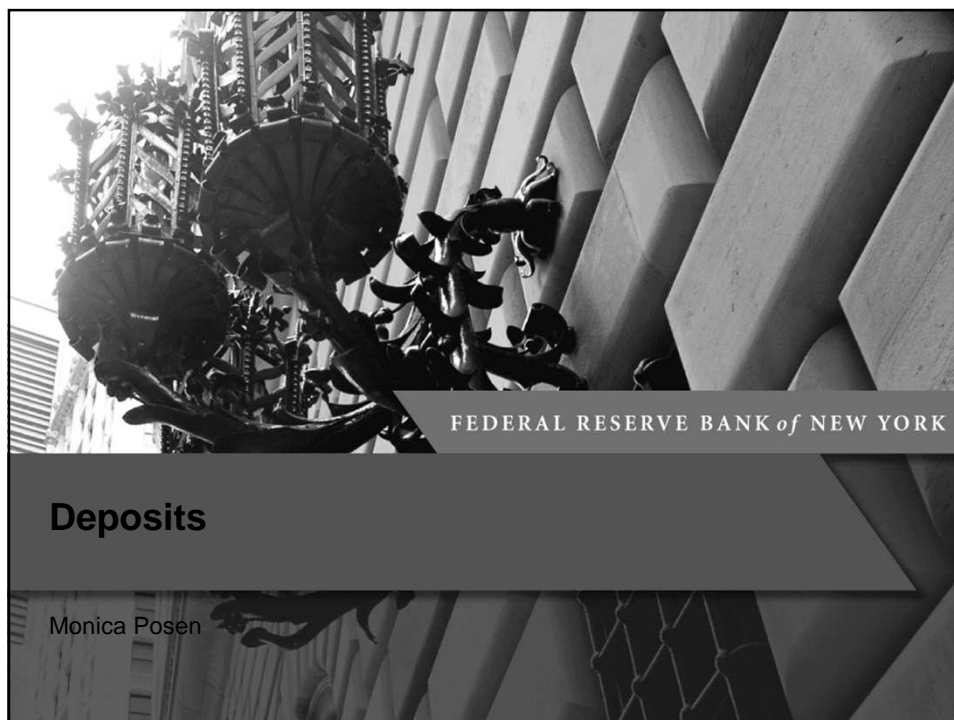
## Reporting of Assets and Liabilities on Schedule Q

Dollar Amounts in Thousands	(Column A) Total Fair Value Reported on Schedule RAL			(Column B) LESS: Amounts Netted in the Determination of Total Fair Value			(Column C) Level 1 Fair Value Measurements			(Column D) Level 2 Fair Value Measurements			(Column E) Level 3 Fair Value Measurements				
	RCFD	BI	MI	Thou	RCFD	BI	MI	Thou	RCFD	BI	MI	Thou	RCFD	BI	MI	Thou	
<b>Memoranda</b>																	
1. All other assets (itemize and describe amounts included in Schedule Q, item 6, that are greater than \$25,000 and exceed 25% of item 6):																	
a. Mortgage servicing assets	G536				G537				G538				G539				G540
b. Nontrading derivative assets	G541				G542				G543				G544				G545
c.	G546				G547				G548				G549				G550
d.	G551				G552				G553				G554				G555
e.	G556				G557				G558				G559				G560
f.	G561				G562				G563				G564				G565
2. All other liabilities (itemize and describe amounts included in Schedule Q, item 13, that are greater than \$25,000 and exceed 25% of item 13):																	
a. Loan commitments (not accounted for as derivatives)	F261				F689				F697				F262				F263
b. Nontrading derivative liabilities	G566				G567				G568				G569				G570
c.	G571				G572				G573				G574				G575
d.	G576				G577				G578				G579				G580
e.	G581				G582				G583				G584				G585
f.	G586				G587				G588				G589				G590



## Reporting of Assets and Liabilities on Schedule Q

- Review and reassess Schedule Q reporting criteria and Schedule Q memoranda reporting threshold
- Include items measured at fair value on a recurring basis as well as those under a fair value option
- Confirm instruments are reported in the appropriate fair value measurement level
- Verify amounts reported on Schedule Q match those reported elsewhere on the report



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## Deposits

Monica Posen

## Objectives

- Definition of Deposit
- Deposit vs. Borrowing
- FFIEC 002 vs. FR 2900
- Overdrafts
- Sweep Arrangements
- Credit Balances and Cash Collateral
- Other Issues



## Definition of a Deposit

- Federal Deposit Insurance Act
- Federal Reserve Regulation D



## Definition of a Deposit

- The unpaid balance of money or its equivalent received or held by a depository institution in the usual course of business and for which it has given or is obligated to give credit.
- Money received or held by a depository institution, or the credit given for money or its equivalent, received or held by the depository institution in the usual course of business.



## Definition of a Deposit

- Transaction Accounts
  - Demand deposits
  - NOW Accounts
  - Other
- ATS Accounts
- Telephone/Preauthorized Transfer Accounts



## Definition of a Deposit

- Nontransaction Accounts
  - Time deposits
  - Savings deposits



## Deposits vs. Borrowings

- Similarities
  - Major sources of funding for banking institutions
  - Liabilities on the balance sheet
- Differences
  - Legal and Regulatory
    - The underlying contractual agreement identifies the item as a deposit or borrowing
    - If a transaction is called a deposit it must be reported as a deposit



## Definitional Differences - FFIEC 002 vs. FR 2900

- Preparers should be aware of all definitional differences between FFIEC 002 and FR 2900
- A complete list of the legitimate reporting differences between the two reports can be found at the following link:
  - [http://www.federalreserve.gov/reportforms/legitdifferences/LD\\_FR2900BA\\_201206.pdf](http://www.federalreserve.gov/reportforms/legitdifferences/LD_FR2900BA_201206.pdf)



## Definitional Differences Suspense Accounts

- FFIEC 002
  - All suspense account items should be reported in their final disposition account type
- FR 2900
  - All suspense account items to be reported in other demand deposits, unless past experience supports a more accurate classification





## Definitional Differences ASC 825 Fair Value Option

- FFIEC 002
  - Upon adoption of ASC 825-10-25, “Financial Instruments: Overall: Recognition: Fair Value Option ” (formerly FAS 159) deposits (excluding demand deposits) may be measured at fair value
- FR 2900
  - Deposits reported based on contracted obligation, not fair value



## Overdrafts

- A depository institution honors a check or draft drawn against a deposit account in which insufficient funds are on deposit
  - Customer’s Overdrafts
  - Reporting Institution’s Overdrafts



## Overdrafts: Customer

- Overdrawn balance should be raised to zero (Schedule A), reported as a loan (Schedule C), and generally not netted against other deposit balances
- Customer overdrafts can be
  - Unplanned
    - No advance contractual agreement to honor the check or draft
    - Reported as “All other loans” on Schedule C - EXCEPT for overdrafts of foreign governments/official institutions and depository institutions (reported according to counterparty as “Loans to depository institutions and acceptances of other banks” and “Loans to foreign governments and official institutions,” respectively)
  - Planned
    - A contractual agreement has been made in advance to allow credit extensions
    - Reported as loans on Schedule C according to counterparty



## Overdrafts: Customer

- Overdrawn customer balances should generally not be netted against credit balances on Schedule E
  - Exception: Separate transaction accounts of a single depositor that are established under a bona fide cash management arrangement
    - Regarded as a single account
    - Overdraft in one of the accounts of a single customer netted against related transaction accounts of the customer and extension of credit arises only if the combined accounts of the customer are overdrawn



## Overdrafts: Reporting Institution

- Overdrafts on deposit accounts held with other depository institutions (e.g., “due from” accounts)
- Balance raised to 0 on Schedule A
- Reported as borrowings on Schedule P, according to counterparty



## Overdrafts Summary

Type of Overdraft	Reporting Treatment
Customer Unplanned	“All other loans” on Schedule C, Line 8 (except for unplanned overdrafts of depository institutions, foreign governments and foreign official institutions, which are reported according to counterparty)
Customer Planned	Loans on Schedule C, according to counterparty
Reporting Institution	Borrowings on Schedule P, according to counterparty



## Sweep Accounts

- Agreements where funds in excess of predetermined balances are “swept” into a higher-yielding investment or another deposit account
  - Swept balances should be reported based on the nature of the investment into which they are swept and counterparty
  - Funds swept back to the transaction account are subject to the six transfer rule as stated in Regulation D



## Credit Balances

- Credit balances are balances booked by the reporting institution and owed to third parties that are incidental to or arise from the exercise of banking powers.
- Reported by U.S. Agencies
- Reported as transaction accounts on the FFIEC 002, while on the FR 2900, they may be reported as transaction, savings, or time deposits.



## Cash Collateral

- Cash collateral received (e.g. in connection with loans or letters of credit) should be reported as a deposit or a credit balance
  - Report as a transaction or nontransaction account balance on Schedule E depending on the terms of the collateral agreement
- Cash collateral is NOT reported as “other borrowed money”



## Cash Collateral

- Example
  - A U.S. Branch of a Foreign Bank issues a commercial letter of credit of \$100,000 in which \$30,000 is fully collateralized
    - The non-collateralized portion (\$70,000) should be reported on Schedule L, Line 4
    - The collateralized portion (\$30,000) should be reported as a deposit on Schedule E, according to maturity and counterparty



## Other Issues

- Brokered Certificates of Deposit issued in \$100,000 amounts under a master certificate of deposit
  - Included in Schedule O, Memorandum 1
  - Excluded from Schedule E, Memorandum 1.a or 1.c
- IBF deposit liabilities include deposits, placements and acknowledgements of advance, or similar instruments
  - **Not** issued in negotiable or bearer form
  - **Are** issued to other IBFs or to non-related non-U.S. addressees, including banks.



## Review

- Always distinguish between deposits and borrowings
- Overdrawn balances should not be netted against good balances (exception: separate transaction accounts of a single depositor that are established under a bona fide cash management arrangement)
- To keep good documentation of sweep activities
- Deposits (exception: transaction accounts) are eligible for fair value reporting under the fair value option on the FFIEC 002 but not on the FR2900





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## Loans

Zina Rakhovich

### Objectives

- Overview
- Loan Classification
- General and Specific Reserves
- Allowance for Credit Losses
- ASC 825-10-25, “Financial Instruments: Overall:  
Recognition: Fair Value Option (formerly FAS 159)
- Common Reporting Questions
- Summary



## Loan Overview

- Loans and leases held for trading purposes are reported as “Trading assets” at FV on Schedule RAL in Line 1.f
- Loans held for sale should be reported at the lower of cost or fair value (LOCOM) on Schedule C, as applicable
- All other loans should be reported at amortized cost on Schedule C, as applicable
  - Net of unearned income, specific reserves and unamortized loan fees
- Loans accounted for under a Fair Value Option and not held for trading should be reported at FV on Schedule C, as applicable



## Loan Classification

- All loans are classified according to collateral, borrower or the purpose of the loan
  - Real estate
  - Borrower (securities broker dealer)
  - Primary business of counterparty





## Loan Classification

- Real estate: Loans secured by real estate, whether originated or purchased (mortgages, construction and land development) except for loans to state and political subdivisions
  - Schedule C, Line 1, Memoranda 5 and 6
  - Schedule RAL, Line 1.f.(5), Memoranda 5 and 6



## Loan Classification

- Loans to purchase securities: Loans to brokers and dealers (not secured by real estate) and loans for the purpose of purchasing and carrying securities, except for loans to depository institutions
  - Schedule C, Line 7, Memoranda 5 and 6
  - Schedule RAL, Line 1.f.(5), Memoranda 5 and 6



## Loan Classification

- Counterparty: Loans not secured by real estate or for the purpose of purchasing and carrying securities should be classified according to the primary business of the counterparty
  - Schedule C, Lines 2, 3, 4, 6, 8 or 9  
Memoranda 5 and 6
  - Schedule RAL, Line 1.f.(5), Memoranda 5 and 6



## General Allowance for Loan Losses ("General Reserves")

- General allowance for loan losses represents reserves that are maintained against the loan portfolio to absorb probable losses
- Branches and agencies are not required to hold general reserves at the branch or agency level (SR Letter 94-4)
- General reserves may still be maintained by an institution as part of its internal credit policy



## General Reserves

- Report General Reserves gross on Schedule M, Part I, Line 2.a, Column B, as “due to” and do not net against loans reported on Schedule C
  - Also report on Schedule M, Part IV, “Amount of allowance for loan losses” (Line 1)
- Provision should be included in the calculation of the bank’s net income and reported on Schedule M, Part I, Line 2.a, Column A or B



## Specific Reserves - ASC 310-10-35, “Receivables: Overall: Subsequent Measurement”

- If an identified loss exists, the amount of the loss should be charged-off or a specific reserve should be established against the loan
  - Specific loan loss reserves are only maintained for identified losses



## Specific Reserves

- A full or partial write-down of a loan through a direct charge off/specific reserves, cannot be reversed at a later date (the cost basis cannot be “written-up”)



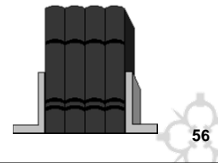
## Specific Reserves

- The provision for specific loan loss reserve is reported in the same manner as the provision for general loan loss reserves on Schedule M, Part I, in Line 2.a
- Loans should be reported net of specific reserves for identified losses on Schedule C (and throughout the report)



## Allowance for Credit Losses

- The AICPA's Audit Guide for Banks and Savings Institutions requires the allocation on the balance sheet of the allowance for credit losses



## Allowance for Credit Losses

- Portion of the allowance related to trading assets should be reported in "Trading assets" on Schedule RAL, Line 1.f
- Portions of the allowance related to off-balance-sheet credit commitments should be reported in "Other liabilities" on Schedule RAL, Line 4.f

Note: Since derivative products are reported at fair value, the credit reserve is part of the fair value reported on the balance sheet



## Allowance for Credit Losses

- Allowance for credit losses is established to cover counterparty risk only
  - A separate valuation reserve is established to cover market losses associated with the trading account and should be excluded from credit reserves



## ASC 825-10-25, “Financial Instruments: Overall: Recognition: Fair Value Option”

- Loans that the bank has elected to report at FV under the fair value option are reported on Schedule C
  - Those loans that are held for trading should be reported as such on Schedule RAL, “Trading assets” (Line 1.f)
- No general or specific reserves should be established for loans reported at FV (part of the fair value)



### **Loans Measured at Fair Value (Schedule C, Memoranda 5)**

- Collects FV information on loans reported on Schedule C that are accounted for at FV, including:
  - Loans measured under ASC 825-10-25
  - Loans held for sale, if the loan is reported at market value or any loan accounted for under a Fair Value hedge
- Memoranda 5 discloses loans into three categories:
  - Loans secured by real estate (Lines M.5.a.(1) through M.5.a.(5))
  - Commercial and industrial (Line M.5.b)
  - Other (M.5.c)



### **Unpaid Principal of Loans Measured at Fair Value (Schedule C, Memoranda 6)**

- Collects the outstanding unpaid principal balance of the loans that are accounted for at FV and reported in Memoranda 5
- Memoranda 6 is comprised of three categories
  - Loans secured by real estate (Lines M.6.a.(1) through M.6.a.(5))
  - Commercial and industrial loans (Line M.6.b)
  - Other loans (M.6.c)



## Common Reporting Questions

Question: Can Specific Reserve be reversed?

Answer: Once a loan is written-down through a specific reserve or charge-off, a new cost basis for the loan is established. Changing the cost basis by re-booking or writing-up the loan is not permitted.



## Common Reporting Questions

Question: How should loans to qualified REIT subsidiaries be reported?

Answer: Since the REIT has complete ownership of the assets, liabilities, and income of the qualified REIT subsidiaries, these entities are not treated as a separate corporation from the REIT. Loans to nonbank financial institutions, including REITs, whose primary business is to extend credit for business purposes or for financing personal expenditures should be reported on Schedule C, "Loans to other financial institutions" (Line 3), unless secured by Real Estate.





## Common Reporting Questions

Question: How should loans guaranteed by the Small Business Administration (SBA) and collateralized by real estate be reported on Schedule C?

Answer: All loans should be reported based on the collateral, borrower or the purpose of the loan. All loans that are secured by a lien on real property for which the lien is central to the extension of the credit, regardless of the purpose of the loan, should be reported on Schedule C, "Loan secured by real estate" (Line 1) as appropriate.



## Common Reporting Questions

Question: How should a loan purchased at a premium or discount be reported?

Answer: A loan purchased at a premium or discount should be reported net of the premium or unearned income (discount) to the extent possible. The premium or discount should be deferred and amortized/accreted respectively over the life of the related loan as an adjustment to the yield.



## Common Reporting Questions

Question: How is a guarantee issued by a related party for a loan made by the reporting institution reported?

Answer: The loan to the non-related party should be reported on Schedule C as appropriate and the guarantee received on Schedule M, Part V, "All other off-balance-sheet contingent claims (assets) greater than or equal to ½ of total claims on nonrelated parties as reported on Schedule RAL, item 1i" (Line 8).



## Key Points

- Loan classification
  - Secured by real estate
  - Purchase or carry securities
  - Primary business of counterparty
- Loans should be reported at
  - FV, LOCOM or amortized cost
  - Fair value option does not determine classification
  - Reserves should not be established for FVO loans
- Allowance for Credit Losses should be allocated on Schedule RAL as appropriate





## **Reporting of Off-Balance-Sheet Items**

FASB website references for the financial instruments and leases project:

[WWW.FASB.ORG](http://WWW.FASB.ORG)

## Reporting of Off-Balance-Sheet Items

- Reporting of derivative contracts
- ASC 815, Derivatives and Hedging, (FAS 133)
- Examples of derivative contracts
- Reporting of other off-balance sheet commitments and contingencies



## Definitions

What is a “derivative”?

- A derivative instrument is a financial instrument or other contract with all of the following characteristics:
  - It has (1) one or more underlying and (2) one or more notional amounts or payment provisions or both
  - Requires little or no initial net investment
  - Its terms require or permit net settlement



## Reporting of Derivative Contracts

- Balance Sheet Reporting (Schedule RAL)
- Income Statement Effect (Schedule M, Part I, Line 2.a)
- Schedule L and M, Part V (Disclosures and Fair Value Examples)



## Schedules L and M, Part V Disclosures & Fair Value Examples

### Schedules L and M Part V Disclosures

- Notional Value
  - Risk characteristics
  - Purpose
- Fair Values
  - Risk characteristics
  - Purpose
- Credit Derivatives



## Schedules L and M, Part V Disclosures & Fair Value Examples

### Schedules L and M Part V Disclosures

- Schedule L includes off-balance sheet transactions with nonrelated institutions and related non-depository institutions
- Schedule M, Part V, includes off-balance sheet transactions with related depository institutions



## Reporting of Notional Values

- The notional value to be reported for an off-balance sheet derivative contract is the underlying or contractual amount specified at the inception of the contract upon which the exchange of funds is based.



## Reporting of Notional Values

- For example, a swap contract with a stated notional amount of \$1,000,000 whose terms call for quarterly settlement of the difference between 5.0% and LIBOR has an effective notional amount of \$1,000,000



## Reporting of Notional Values

- Contracts with multiple risk characteristics should be classified based upon the predominant risk characteristic
- Report in Line 9 the notional amount of all outstanding futures and forward contracts, exchange-traded and over-the-counter option contracts, and swap contracts, as appropriate based on the predominant risk characteristic



### **Gross Positive and Negative Fair Value**

- Report the gross positive and negative fair values of derivative contracts held for trading on Line 12a and FAS 133 Hedging on Line 12b



### **Reporting of Derivative Contracts on Balance Sheet & Income Statement**

- The FV of derivative contracts held for trading should be reported gross (unless ASC 210-20-45, “Balance Sheet Offsetting: Other Presentation Matters”, (also known as FIN 39) on Schedule RAL, Line 1.f(5), “Trading assets” or in Line 4.e, “Trading liabilities” and in Schedule RAL Memoranda items 10 and 11.
- The gain/loss should be reported as a part of the calculation of unremitted profit/loss on Schedule M, Part I, Line 2.a





## ASC 815 (FAS 133) – Derivatives & Hedging

- ASC 815 – Derivatives & Hedging
  - Accounting and reporting standards for derivative instruments and hedging activities
  - Cash flow hedging/Fair value hedging
  - Embedded derivatives



## ASC 815 – Derivatives & Hedging

- Types of hedges
  - The fair value of all FAS 133 Hedging derivatives will be reported on “Other assets” Line 1h or “Other liabilities” Line 4f.
  - For depository institutions, the two predominate types of hedges are
    - Fair Value
    - Cash Flow



## ASC 815 – Derivatives & Hedging

- Fair Value Hedges
  - The hedged items are reported at fair value for the portion of the risk being hedged
  - The mark-to-market gains and losses are reported in earnings along with those of the hedging contract
  - To the extent the hedging relationship is effective net earnings will be unaffected



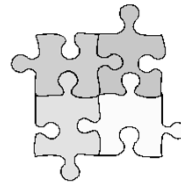
## ASC 815 – Derivatives & Hedging

- Cash Flow Hedges
  - Cash Flow Hedges apply to hedging the risk of changes in cash flows for variable rate assets and liabilities



## ASC 815 – Derivatives & Hedging

- The difference between a Cash Flow and Fair Value hedge
  - The hedged item is not reported at fair value under a cash flow hedge



## ASC 815 – Derivatives & Hedging

- Reporting on the FFIEC 002
  - The mark-to-market gains and losses from fair value and cash flow hedges should be reported in the institution's "Net unremitted profit/(loss)," Schedule M, Part I, Line 2.a



## ASC 815 – Derivatives & Hedging

- Intercompany transactions
  - Derivatives with the parent bank or another subsidiary of the reporting branch's or agency's parent bank may qualify for hedge accounting provided
    - The counterparty (e.g., the other member of the consolidated group) has entered into a contract with an unrelated party that offsets the inter-company derivative completely



## ASC 815-15-25, “Derivatives & Hedging: Embedded Derivatives: Recognition”

### Definition

- *Embedded derivatives* are implicit or explicit terms that effect the cash flows or value of other exchanges required by a contract in a manner similar to derivative
- The combination of the *host contract* and an embedded derivative is referred to as a *hybrid contract*
- Examples of hybrid contracts
  - Structured notes
  - Convertible securities



## ASC 815-15-25, “Derivatives & Hedging: Embedded Derivatives: Recognition”

### Structured Notes

- Hybrid securities that attempt to change their risk profile by including additional modifying structures.
  1. Host Contract - the debt obligation
  2. Embedded Derivative – Option (modifying structure)
  3. Example: A two year 100% principal protected bond tied together with an option contract linked to gold, available in US Dollars/Euros or Sterlings. At maturity, the investor receives 100% of the principal investment, and has the potential to get higher returns subject to the favorable movement in the price of gold over the two-year term.



## ASC 815-15-25, “Derivatives & Hedging: Embedded Derivatives: Recognition”

### Convertible Security (CV)

- A security that, at the option of the holder, may be exchanged for another asset, generally a fixed number of shares of common stock.
  1. Host Contract - Security (Bond)
  2. Embedded Derivative – Conversion Option
  3. Example: The holder of the CV exercises the conversion option and exchanges the bond into a predetermined amount of shares in the company.



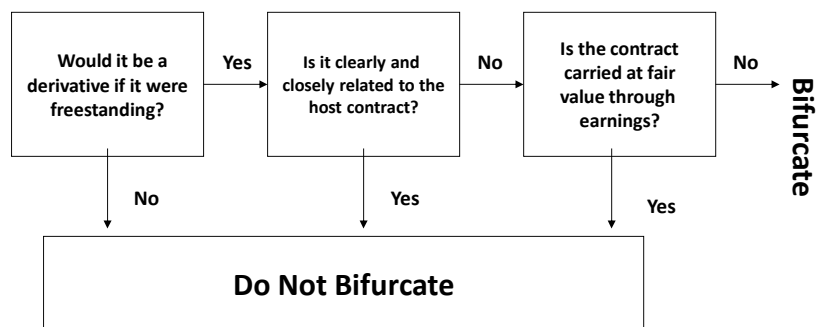
## ASC 815-15-25, “Derivatives & Hedging: Embedded Derivatives: Recognition”

### Embedded Derivatives - Bifurcate:

- Not “**clearly and closely related**” to host contract
- The hybrid instrument is not remeasured at fair value under otherwise applicable GAAP with changes in fair value reported in earnings
- A separate instrument with the same terms as the embedded derivative instrument would be a derivative instrument subject to the requirements of SFAS No. 133



## Embedded Derivatives When Does a Contract Have an Embedded Derivative Subject to Bifurcation?



**ASC 815-15-25, “Derivatives & Hedging:  
Embedded Derivatives: Recognition”**

▪ **Embedded Derivatives**  
**Clearly and Closely Related – General**

- Clearly and closely related refers to:
  - Economic characteristics
  - Risks
  
- Factors to be considered:
  - The type of host
  - The underlying



**ASC 815-15-25, “Derivatives & Hedging:  
Embedded Derivatives: Recognition”**

**Embedded Derivatives**  
**Clearly and Closely Related - Equity Host**

- An option to convert preferred stock (not mandatorily redeemable) to common is clearly and closely related to the equity host, and therefore is not subject to bifurcation.



## ASC 815-15-25, “Derivatives & Hedging: Embedded Derivatives: Recognition”

### Embedded Derivatives Debt Hosts - Embedded Derivatives That Are Not Clearly And Closely Related

The underlying is interest rates and *either*:

- The investor may not recover substantially all of its initial investment, or
- The investor’s yield may increase to twice the market rate or more and at least twice the initial rate



## Examples of Types of Derivatives

- Options
- Swaptions
- Swaps





## Options

- Options transfer the right but not the obligation to buy or sell an underlying asset, instrument, or index on or before the option's exercise date at a specified price (the strike price)



## Options

### Fair value

- For an exchange-traded option, the change in the price of the contract is the fair value
- For an over-the-counter option, the change in the price as determined by an option pricing model (e.g., Black-Sholes) is the fair value.



## Options

### Hedging Market Risk

#### Example

On January 1, 2004, GHI Company purchases equity securities in MBI and will hedge the market risk with an at-the-money put option

- Equity securities price: \$50 per share (100 shares)
- Premium of put option: \$600 (strike price \$65)



## Options

Option from inception to maturity

	<u>12/31/04</u>	<u>12/31/05</u>	<u>12/31/06</u>
MBI shares	<u>\$6500</u>	<u>\$6000</u>	<u>\$5700</u>
Put option			
Time value	600	350	0
Intrinsic value	<u>0</u>	<u>500</u>	<u>800</u>
	<u>\$600</u>	<u>\$850</u>	<u>\$800</u>

GHI Company exercises the option prior to the option's expiration on December 31, 2006



## Options

- **Time value** – The difference between the total premium for an option and the option's intrinsic value, effected by length of exercise period and volatility of the underlying.
- **Intrinsic value** – The amount of advantage, if any, that would be realized by exercising an option rather than buying or selling the underlying security in the cash market. Only in-the-money options have intrinsic value (exercise price - market price of the underlying security)



## Options

	<u>Debit</u>	<u>Credit</u>
<u>January 1, 2004</u>		
All other securities (Line 1.c(4))	\$5000	
Cash and balances due from depository inst. (Line 1.a) (To record purchase of MBI shares)		\$5000
<u>December 31, 2004</u>		
All other securities (Line 1.c(4))	\$1500	
Net due to/from Head Office (Schedule M, Part I, 2.a) (To record appreciation of MBI shares)		\$1500
Other assets (Line 1.h)	\$600	
Cash and balances due from depository inst. (Line 1.a) (To record the purchase of the put option)		\$600



## Options

	<u>Debit</u>	<u>Credit</u>
<u>December 31, 2005</u>		
Other assets (Line 1.h)	\$500	
Net due to/from Head Office (Sch. M, Part I, 2.a)		\$500
(To record the increase in the intrinsic value of the option)		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$500	
All other securities (Line 1.c(4))		\$500
(To record the decrease in the fair value of the MBI shares)		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$250	
Other assets (Line 1.h)		\$250
(To record the ineffective portion of the change in FV of the option)		

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## Options

	<u>Debit</u>	<u>Credit</u>
<u>December 31, 2006</u>		
Other assets (Line 1.h)	\$300	
Net due to/from Head Office (Sch. M, Part I, 2.a)		\$300
(To record the increase in the intrinsic value of the option)		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$300	
All other securities (Line 1.c(4))		\$300
(To record the decrease in the fair value of MBI shares)		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$350	
Other assets (Line 1.h)		\$350
(To record the ineffective portion of the change in FV of the option)		
Cash and balances due from depository inst. (Line 1.a)	\$6500	
Other assets (Line 1.h)		\$800
All other securities (Line 1.c(4))		\$5700
(To record the exercise of the option on 12/31/06 by delivering shares.)		

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## Swaptions

- An option that gives the holder the right, but not the obligation, to execute a swap contract at a future date
- Whether the option is exercised depends on some future event or time



## Swaps

### Fair Value

- The fair value of a swap contract is the net present value of the future cash flows (e.g., net settlement amount)
  - Only the change in the net settlement amount from quarter to quarter should be used as the fair value to calculate the revaluation gain or loss



## Swaps

### Swaps held for purposes other than trading (e.g., hedging contracts marked-to-market)

- The FV of hedging contracts should be reported on Schedule RAL, Line 1.h, "Other assets" or in Line 4.f, "Other liabilities" and on Schedule M, Part I, in Line 2.a
- These should only include those contracts meeting hedge effectiveness test under FAS 133
- All other contracts should be reported in trading



## Multiple Risk Contracts

- Derivative contracts that contain two or more risk characteristics
- Contracts should be classified on Schedule L, line 9, of the FFIEC 002 by their predominant risk characteristics at the origination of the derivative (i.e., interest rate, foreign exchange, equity or commodity).
- Example of this type of contract is a cross- currency interest rate swaps which contains both interest rate risk and FX risk. Whichever risk is more predominant, is where the contract will be classified.



## Reporting of Credit Derivatives

Reporting of credit derivatives is addressed in SR 96-17 (GEN) and ASC 815-10, "Derivatives and Hedging"

- Credit derivatives are off-balance sheet arrangements that allow one party (the "beneficiary") to transfer credit risk of a specific asset to another party (the "guarantor")
  - Allow the beneficiary to mitigate its credit risk concentration to a particular borrower
  - Guarantor assumes the credit risk associated with the asset without directly purchasing it and receives periodic payments in return.



## Reporting of Credit Derivatives

- Certain financial guarantees are subject to ASC 460-10, "Guarantees", if these provide for payments to the guaranteed party for a loss incurred because the debtor defaults on a payment when payment is due.
  - However, financial guarantees (e.g., credit derivatives) are subject to ASC 815-10 if the contract is indexed to the credit worthiness of the borrower



## Reporting of Credit Derivatives

- Credit derivatives subject to ASC 815, Derivatives and Hedging should be reported:
  - On the balance sheet in the same manner as any other derivative product (classify as trading or other assets or liabilities)
  - Schedule L, Line 6, breakout by:
    - Line 6a – Notional amount by type of contract (credit default swap, TROR swap, etc.)
    - Line 6b – Gross fair value, positive and negative
  - Schedule M, Part V, line 6



## Two Common Types of Credit Derivatives

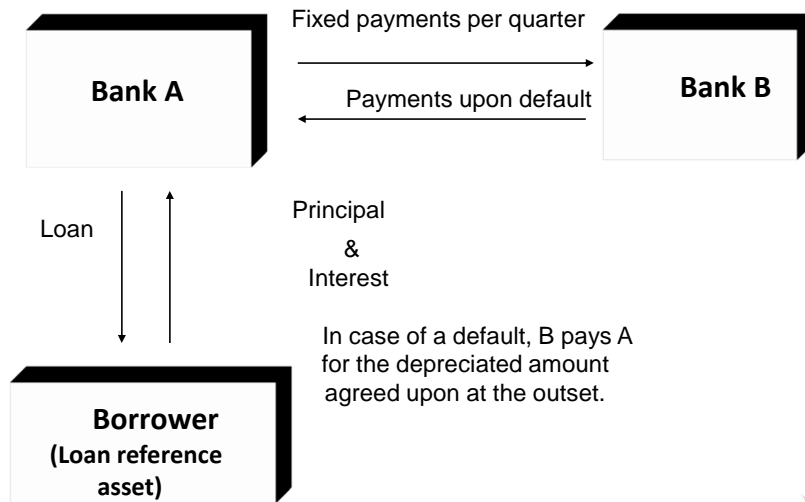
### (1) Credit Default Swaps

- The beneficiary agrees to pay guarantor a fixed payment (i.e., a certain number of basis points either quarterly or annually)
- In return the guarantor agrees to pay the beneficiary an agreed upon amount if there is a default





## Credit Default Swap Structure



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## Two Common Types of Credit Derivatives

### (2) Total Rate of Return Swaps (TROR)

- The beneficiary agrees to pay the guarantor the total return (e.g., principal and interest as well as any appreciation in the market value of the asset)
  - The guarantor agrees to pay spread over funding costs plus any depreciation in the value of the asset

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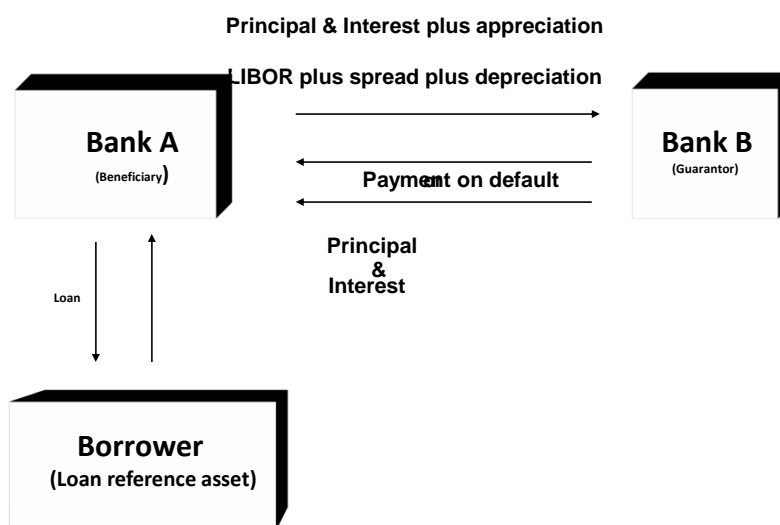
## Two Common Types of Credit Derivatives

- The guarantor in a TROR could be viewed as having “synthetic ownership” of the asset since it assumes the risk and rewards of the asset over the agreement period



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## Total Rate of Return Swaps Structure



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### Other Off-Balance Sheet Reporting Issues

- Commitments for Syndicated Loans or Participated Loans (line 1)
  1. Report only the branch or agency's proportional share of the commitment.
- Standby letters of Credit (LOCs) (Line 3(a))
  1. Report the total amount outstanding and unused as of report date.
  2. Include those standby LOCs that are collateralized by cash on deposit and those in which participations have been conveyed to others.



### Other Off-Balance Sheet Reporting Issues

- Contingent liabilities, Line 7
  - Commitments to accept and place deposits
  - Purchases of risk participations in acceptances of other banking institutions
  - Securities borrowed against collateral other than cash
  - Commitments to purchase when-issued securities that are excluded from ASC 815



## Other Off-Balance Sheet Reporting Issues

- Contingent Assets, Line 8
  - Securities lent against collateral other than cash
  - Sales of risk participation in loans
  - Commitments to sell when-issued securities that are excluded from ASC 815, Derivatives and Hedging



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FEDERAL RESERVE BANK of NEW YORK

**Securities**

Martin Milanovich

## Agenda

- FFIEC 002 report form changes
- Overview of ASC Topic 320-10-25, “Investments in Debt and Equity Securities: Overall: Recognition”
- Effect of the fair value option on securities (ASC 825-10-25)
- Reporting securities on Schedule RAL of the FFIEC 002
- Frequently asked questions relating to securities



## Reporting Form Changes (Effective June 30, 2012)

- Schedule RAL, Assets and Liabilities, was expanded to capture classification of other trading assets and securities
  - Other securities:
    - Securities issued by states and political subdivisions in the U.S; securities of foreign government and official institutions; and other bonds, notes and debentures (Line 1.f.4)
  - Other trading assets:
    - Certificates of deposits, commercial paper, bankers acceptances, loans, and derivatives with a positive fair value (Line 1.f.5)

f. Trading assets:						
(1) U.S. Treasury and Agency securities .....	K479			K479		1.f.(1)
(2) Mortgage-backed securities:						
(a) Issued or guaranteed by U.S. Government agencies .....	K298			K298		1.f.(2)(a)
(b) Other .....	3536			3536		1.f.(2)(b)
(3) Other asset-backed securities .....	K299			K299		1.f.(3)
<b>(4) Other securities .....</b>	L193			L193		1.f.(4)
(5) Other trading assets .....	K302			K302		1.f.(5)



## Securities

- ASC 320-10-25 “Investments in Debt and Equity Securities” (formerly FASB Statement No. 115, “Accounting for Certain Investments in Debt and Equity Securities”)
  - Held-to-maturity securities (HTM)
  - Available-for-sale securities (AFS)
  - Trading securities



## Securities

- Held-to-maturity securities
  - Debt securities
    - Positive intent and ability to hold to maturity
    - Definition of maturity (ASC 320-10-25-14)
    - Carried at amortized cost on Schedule RAL, Lines 1.b and 1.c
    - RAL Memoranda Line 1 (Fair value) and Line 2 (Amortized cost)

### Memoranda

1. Fair value of held-to-maturity securities .....	1771			1771			M.1.
2. Amortized cost of held-to-maturity securities .....	1754			1754			M.2.
3. Fair value of available-for-sale securities .....	1773			1773			M.3.
4. Amortized cost of available-for-sale securities .....	1772			1772			M.4.



## Securities

- Some circumstances when the sale or transfer from the held-to-maturity classification is considered consistent with ASC 320-10-25-6
  - Evidence of a significant deterioration in the issuer's creditworthiness
  - A change in tax law that eliminates or reduces the tax exempt status of interest on the debt security
  - A major business combination or major disposition
  - A change in statutory or regulatory requirements



## Securities

- Circumstances when the sale or transfer from the held-to-maturity classification is considered "inconsistent" with ASC 320-10-25-5
  - Changes in foreign currency risk
  - Changes in market interest rates
  - Changes in available alternative investments
  - Changes in funding sources and terms
  - Changes in the security's prepayment risk
  - Changes in the marginal tax rate
  - A liquidity need



## Securities

- Available-for-sale securities
  - Debt or equity securities
  - The institution does not have the intent and ability to hold to maturity
  - It does not intend to trade actively
  - Reported at fair value on Schedule RAL, Lines 1.b and 1.c
  - RAL Memoranda Line 3 (Fair Value) and Line 4 (Amortized cost)

Memoranda									
1. Fair value of held-to-maturity securities .....	1771				1771				M.1.
2. Amortized cost of held-to-maturity securities .....	1754				1754				M.2.
3. Fair value of available-for-sale securities .....	1773				1773				M.3.
4. Amortized cost of available-for-sale securities .....	1772				1772				M.4.



## Securities

- Trading securities
  - Debt or equity securities
  - The institution holds to capitalize on the short term movement
  - Securities elected at fair value option (ASC 825-10)
  - Revaluation gains/losses on derivatives contracts
  - Reported at fair value Schedule RAL, Lines 1.f

f. Trading assets:									
(1) U.S. Treasury and Agency securities .....	K479				K479				1.f.(1)
(2) Mortgage-backed securities:									
(a) Issued or guaranteed by U.S. Government agencies .....	K298				K298				1.f.(2)(a)
(b) Other .....	3536				3536				1.f.(2)(b)
(3) Other asset-backed securities .....	K299				K299				1.f.(3)
(4) Other securities .....	L193				L193				1.f.(4)
(5) Other trading assets .....	K302				K302				1.f.(5)





## Types of Securities

- U.S Treasuries Securities
  - Treasury Bills (T-Bills)
  - Treasury Notes (T-Notes)
  - Treasury Bonds (T-Bonds)
  
- U.S. Government Agency obligations (excluding mortgage-backed securities)
  - Export-Import Bank
  - Small Business Administration (SBA)
  - Federal Housing Administration (FHA)
  - Government National Mortgage Associations (GNMA)
  
- HTM and AFS reported on RAL Line 1.b.(1) and 1.b.(2)
- Trading reported on RAL Line 1.f.(1)



## Types of Securities

- Securities of foreign governments and official institutions (Excluding MBS)
  - International Bank for Reconstruction and Development (World Bank)
  - Inter-American Development Bank
  - Foreign Central Banks and Development Banks
  - Nationalized Banks
  
- HTM and AFS reported on RAL Line 1.c.(1)
- Trading reported on RAL Line 1.f.(4)



## Types of Securities

- Mortgage-Backed Securities issued or guaranteed by U.S. Government agencies
  - FNMA
  - FHLMC
  - GNMA
  - REMICs issued by the VA
  
- AFS and HTM reported on RAL Line 1.c.(2).(a)
- Trading reported on RAL Line 1.f.(2).(a)



## Types of Securities

- Other Mortgage-Backed Securities
  - Non-U.S.-government issuers
  - Other depository institutions
  - Insurance companies
  - State and local housing authorities in the U.S.
  
- AFS and HTM reported on RAL Line 1.c.(2).(b)
- Trading reported on RAL Line 1.f.(2).(b)



## Types of Securities

- Other Asset-Backed Securities (ABS)
  - Asset-backed commercial paper
  - ABS collateralized by credit card receivables, HELOCs, non-mortgage loans (consumer, auto, commercial and industrial, etc.)
  - SLM Corporation (after December 2004)
- AFS and HTM reported on RAL Line 1.c.(3)
- Trading reported on RAL Line 1.f.(3)



## Types of Securities

- All other securities
  - Commercial paper (non asset-backed)
  - Equity securities with readily determinable fair values (ASC 320-10-15-5)
  - Corporate obligations
  - Common stock of FNMA, FHLMC or SLMA
  - Municipal securities
  - All other bonds, notes and debentures
- HTM and AFS reported on RAL Line 1.c.(4)



## Types of Securities

- Other securities (trading)
  - Municipal securities
  - Securities of foreign governments and official institutions
  - All other bonds, notes and debentures
- Reported on RAL Line 1.f.(4)
  
- Other trading assets
  - Certificates of deposit
  - Commercial paper
  - Bankers acceptances
  - Loans and derivatives with a positive fair value
- Reported on RAL Line 1.f.(5)



## Securities - FAQ

- **Trade date/Settlement date accounting:**  
Preferred method is trade date accounting however settlement date accounting may be used if not materially different. Method should be used consistently



## Securities - FAQ

- **Securities Borrowed / Lent Against Collateral:**

Securities borrowed/lent against collateral other than cash should be reported as “Other assets” and “Other liabilities” on Schedule RAL and disclosed on Schedule L as “All other off-balance sheet contingent liabilities” and “All other off-balance sheet contingent claims”.



FEDERAL RESERVE BANK *of* NEW YORK

**Reporting of Securitization and  
Asset Sale Activities**

David Ignell

The slide features a decorative background with a repeating pattern of interlocking rings and arrows. The text is overlaid on a dark grey banner at the bottom. The banner contains the text 'FEDERAL RESERVE BANK of NEW YORK' in a serif font, followed by the title 'Reporting of Securitization and Asset Sale Activities' in a bold sans-serif font, and the name 'David Ignell' in a smaller sans-serif font.

## Objectives

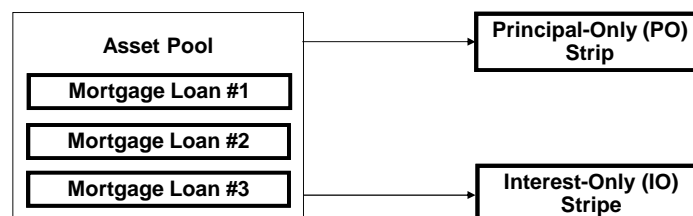
- What is a securitization?
- What are the major components in a securitization?
- What is reported on Schedule S?



## Definition

- Securitization – In general terms it is the process of converting financial assets into negotiable securities

### Example (Stripped Mortgage-Backed Security)



## Key Terms

- Credit Enhancement
  - An arrangement where the sponsoring institution retains in form or substance any risk of credit loss



## Key Terms

- Credit Enhancement
  - Common sources of Credit Enhancement
    - Excess Spread Accounts
    - Overcollateralization
    - Letter of Credit
    - Cash Collateral Account
    - Credit Derivatives
    - Senior-Subordinate Structure



## Key Terms

- Liquidity Facility
  - An arrangement in which the financial institution is obligated to provide funding to a securitization structure to ensure investors of timely payments



## Key Terms

- Credit Enhancement vs Liquidity Facility
  - Credit Enhancements act as buffers to absorb permanent losses
  - Liquidity Facilities act to smooth temporary timing difference from payments or market disruptions
    - Advances are repaid with subsequent collections
    - Advances that are NOT subordinated to other claims on the underlying assets are classified as a liquidity facility

Note: Advances that are subordinated to other claims on the underlying assets should be classified as a credit enhancement





## Key Terms

- Seller's Interest (retained interest)
  - The financial institutions ownership interest in assets that have been securitized
  - Reportable on Schedule RAL as well

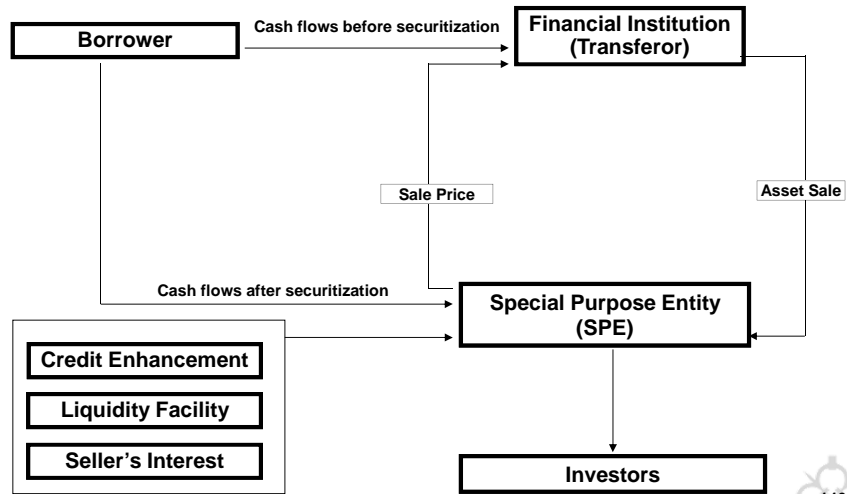


## Schedule S Securitization and Asset Sale Activities

- Securitization Activities by Reporting Institution
  - Line items 1. through 7.b
- Securitization Facilities Sponsored By Others
  - Credit exposure, Line 9
  - Unused commitments, Line 10
- Assets Sales
  - Line 11, and Line 12

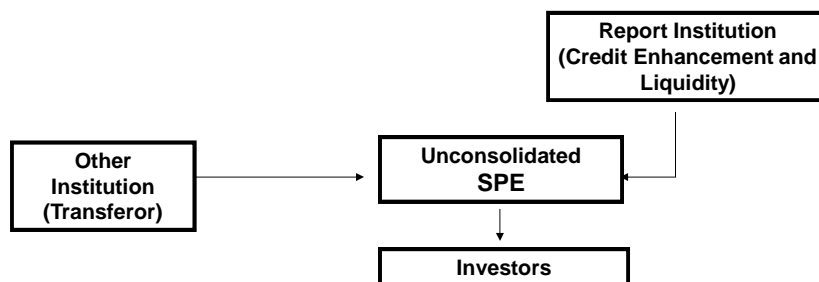


## Securitization Activities (Items 1-7)



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## Securitization Facilities Sponsored By Other Institutions (Items 9-10)



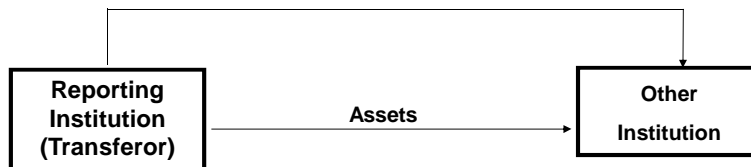
### 1. Reporting institution provides credit enhancements to SPE.

- The reporting institution reports the credit enhancement or liquidity on Schedule S items 9 -10 based on credit enhancement or liquidity is provided.
- Do not include credit enhancements or liquidity to asset-backed CP conduit.

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## Asset Sales (Items 11-12)

### Recourse and Credit Enhancements



- 1 . Reporting institution sells assets to another institution.
2. If the reporting institution retains recourse or provides credit enhancements, the amount of the outstanding principal balance is reported on Schedule S item 11.
3. The maximum amount of the credit exposure due to credit enhancements or recourse is reported on Schedule S item 12.

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## Asset Backed Commercial Paper

- An ABCP conduit is a SPE that issues commercial paper and uses the proceeds to purchase trade receivables, credit card receivables, auto and equipment leases, and other types of assets
- The payments that are collected from the purchased assets are used to redeem the commercial paper at maturity

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## Memorandum Item 1

### Asset-backed commercial paper conduits

- Maximum amount of credit exposure arising from credit enhancements provided to conduit structures
  - Report according to entity type sponsoring the conduit
- Unused commitments from liquidity facilities provided to conduit structures
  - Report according to entity type sponsoring the conduit



FEDERAL RESERVE BANK of NEW YORK

## Schedule T Fiduciary and Related Services

## Schedule T - Fiduciary and Related Services

- Determination of Fiduciary Powers (Items 1 - 3)
- Fiduciary and Related Assets Held (Items 4 - 10)
- Memoranda (Items 1 - 3)



## Items 1, 2 and 3

- Does the institution have trust powers?
- Does the institution exercise the fiduciary powers it has been granted?
- Does the institution have any fiduciary or related activity to report?
  - Exception: "No" if fiduciary services are limited to land trusts and custodial activities for MBSs



## **Fiduciary and Related Assets (Items 4 -10)**

- Report market values as of the report date:
  - Managed Assets - Column A
    - Accounts for which institution has investment discretion
  - Non-Managed Assets - Column B
    - Accounts for which the institution does not have investment discretion
  - Number of Managed Accounts - Column C
  - Number of Non-Managed Accounts - Column D



## **Memoranda Items**

- Managed assets held in personal trust and agency accounts – Memoranda Item 1
- Corporate trust and agency accounts– Memoranda Item 2
- Collective investment funds and common trust funds – Memoranda Item 3





FEDERAL RESERVE BANK *of* NEW YORK

## Reporting Issues

Susan Jessop

### Objectives

- Offsetting –balance sheet
- Resale and Repurchase Agreements
- Other assets and Other Liabilities
- Fair values
- Averages

## Offsetting

- Regulatory reports generally require reporting on a gross basis
- ASC 210-20, “Balance Sheet: Offsetting” (also known as FIN 39) & ASC 815-10-45, “Derivatives and Hedging: Overall: Other Presentation Matters”
  - Allows offsetting of certain contracts when a “right of setoff” exists



## Offsetting

### ASC 210-20-45 Offsetting Criteria

- There are two parties to the transaction, each owes the other determinable amounts
- Reporting party has the right to set off the amount owed by the other
- Reporting party intends to set off
- Right of setoff is enforceable by law





## Offsetting Under Master Netting Agreement

- Fair value of derivative contracts reported on the balance sheet that fall under a contractual agreement providing for the net settlement through a single payment can be reported net under ASC-210-20-45



## Offsetting

ASC 815-10-45, "Derivatives and Hedging: Overall: Other Presentation Matters", (FIN 39) Amendment

- Allows for netting of cash collateral from derivative contracts accounted for at fair value with the same counterparty under a master netting agreement



## Offsetting

### ASC 815-10-45 (FIN 39) Amendment

- A reporting entity's choice to offset fair value amounts or not must be applied consistently
  
- A reporting entity may not offset fair value amounts recognized for derivative instruments without offsetting fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral



## Offsetting

### ASC 815-10-45-7 - (FIN 39) Amendment

- Offsetting of amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against derivative positions is not allowed if:
  - Those amounts were not valued at fair value or,
  - Arose from instruments in a master netting agreement that are not eligible for offset



## Offsetting

- ASC 210-20-45-11, “Balance Sheet: Offsetting: Other Presentation Matters: Repurchase and Reverse Repurchase Agreements” (formerly FIN 41)
  - Allows netting of repurchase and reverse repurchase agreements that meet the legal right of setoff



## Offsetting

### ASC 210-20-45-11 (FIN 41) Offsetting Criteria

- The offsetting Agreements must be executed with the same counterparty
- The transaction must have the same explicit settlement date at the inception of agreement
- The offsetting must be executed in accordance with a Master Netting Agreement



## Offsetting

### ASC 210-20-45-11 (FIN 41) Offsetting Criteria

- The securities underlying the agreements must exist in “book entry” form
- The agreements must be settled on a securities transfer system



## Offsetting

### ASC 210-20-45-11 (FIN 41) Offsetting Criteria

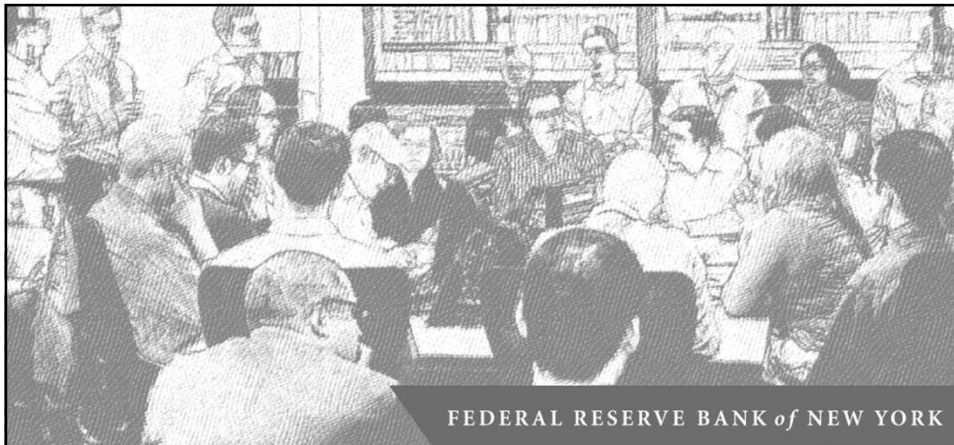
- Institutions intend to use same account at clearing bank for cash inflows and cash outflows resulting from settlement of these agreements
  - Netting of repurchase agreements under ASC 210-20 (FIN 41) should also be reflected in reporting of quarterly averages on Schedule K and related transactions on Schedule M



## Offsetting

### ASC 210-20-45-11 Offsetting Criteria

- Institution meeting the criteria for offsetting should have policies and procedures in place for reviewing the transactions and supporting documentation to ensure compliance with ASC 210-20-45-11 (FIN 39 and FIN 41)



FEDERAL RESERVE BANK *of* NEW YORK

## Reporting of Federal Funds and Resale and Repurchase Agreements

## Federal Funds

Federal funds sold/purchased are immediately available funds which may be secured by cash collateral (except by securities) or unsecured that mature in one business day or roll over under a continuing contract.

Exclude:

- Federal Home Loan Bank
- Federal Reserve Bank
- Balances due from - Schedule A
- Balances due to - Schedule P



## Term Federal Funds

- Term fed funds are loans of immediately available funds that mature in more than one business day.
  - Term federal funds sold
    - Schedule C
  - Term federal funds purchased
    - Schedule P



## Resale/Repurchase Agreements

Securities sold/purchased under agreement to repurchase/resell are immediately available funds which require the reporting institution to deliver the identical security (or a security that meets the definition of substantially the same) regardless of the maturity of the agreement

Exclude: FHLB & FRB other borrowings  
Assets other than securities



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## Resale/Repurchase Agreements

- Securities sold or purchased against cash collateral
  - Do not meet ASC 860-10-40, “Transfers and Servicing: Overall: Derecognition: Conditions for a Sale of Financial Assets”



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## Resale/Repurchase Agreements

- Financial assets (other than securities) purchased under agreements to resell if maturity is greater than one business day or is not in immediately available funds or without a continuing contract s
  - Loans
  - Borrowings



FEDERAL RESERVE BANK *of* NEW YORK

## Reporting of Other Assets and Other Liabilities



## Reporting of Other Assets

- Example

Bank A sells a security to a foreign central bank. Bank A uses trade date accounting to record its sales and purchases of securities. The transaction will be recorded as follows:

Dr     Accounts Receivable

Cr     Securities

- Accounts receivables generated from the sale are reported as “Other Assets”, Line 1.h



## Reporting of Other Assets

- If a right of setoff exists under ASC 210-20-45 (FIN 39) the receivable and payable from securities purchases and sales can be reported net



## Reporting of Other Assets

### Example A

- On settlement date, the receipt of funds is recorded as follows:

Dr    Cash

Cr        Accounts Receivable



## Reporting of Other Assets

- In-substance foreclosures (ISFs) should be reported as loans until the lender has taken possession (e.g., loan title or control) of the collateral
  - Once possession is taken, the FV of collateral should be reported as OREO
  - Until this occurs, ISFs should be reported as loans



## Reporting of Other Assets

- Income earned or accrued but not collected on loans, securities, and other interest-bearing assets should be reported in other assets
- Receivables from deferred payment for letter of credit



## Reporting of Other Assets

- Positive FV of derivative contracts designated as hedges under ASC 815-20, “Derivatives and Hedging: Hedging – General” (FAS 133)
  - If you choose to exclude accrued interest receivable from the fair value calculation, report as a separate accrual. Methodology should be applied consistently.



### **Reporting of Other Assets**

- Balances held in margin accounts should be reported as “Other Assets”.
- Credit balances with broker dealers should be reported as “Other liabilities”.
- Term Deposits offered through the Term Deposit Facility (TDF) should be excluded from “Other assets” and reported as “Cash and balances due from depository institutions” (Line 1.a)



### **Reporting of Other Liabilities**

- Accounts payable should be reported gross in other liabilities rather than netted against accounts receivable
- Interest accrued and unpaid on deposits



## Reporting of Other Liabilities

- Bank's liability for deferred payment letters of credit
- Negative FV of derivative contracts designated as hedges under ASC 815-20 (FAS 133)
  - If you choose to exclude accrued interest payable from the FV calculation, report as a separate accrual. Methodology should be applied consistently.



## Reporting of Other Liabilities

- Credit reserves allocated for losses on off-balance sheet credit commitments
- U.S income tax payable



## Reporting of Other Liabilities

### Exclude from Other Liabilities

- Short sales (Report on Schedule RAL, “Trading liabilities”)
- Reserves established for assets that are reported at fair value are included as part of the fair value of the asset



## Reporting of Other Liabilities

### Exclude from Other Liabilities

*These should be reported as “deposit liabilities” on Schedule E, as appropriate*

- Mortgage and escrow funds (funds received for payment of taxes, insurance, etc.)
- Proceeds from the sale of savings bonds
- Withheld taxes, social security taxes, sales taxes, and similar items



## Reporting of Suspense Accounts

- Suspense accounts

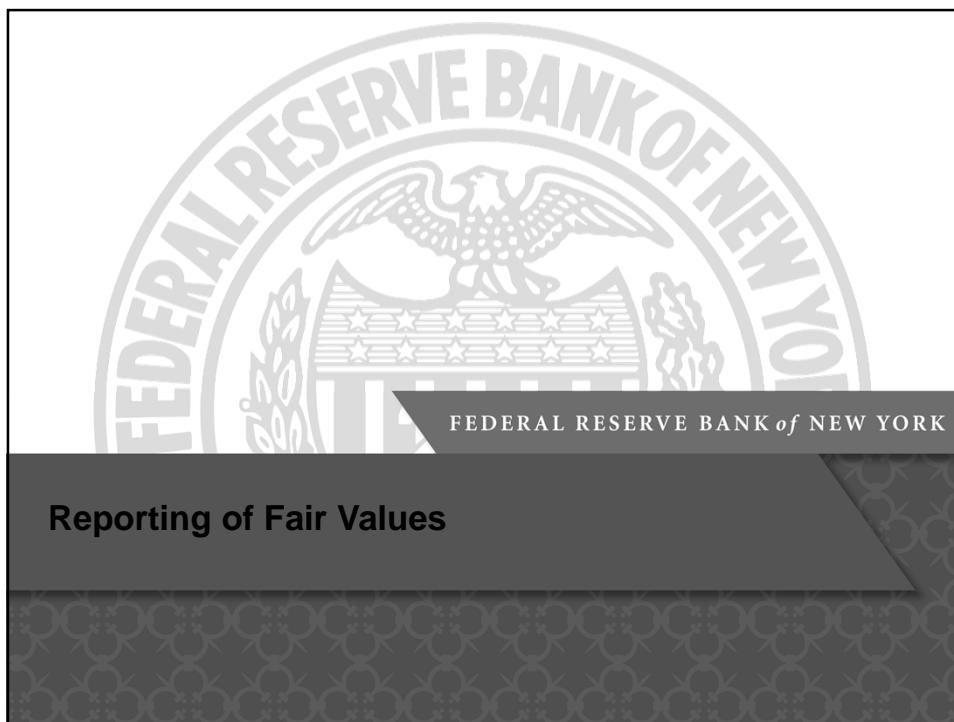
Temporary holding accounts where items are carried until they can be identified and posted to the proper account



## Reporting of Suspense Accounts

- Suspense accounts should be reviewed prior to the submission of the FFIEC 002 and reported in the appropriate account





## Fair Values

- Market valuation - readily determinable fair value
  - ASC 320-10-35-1a, Investments – Debt and Equity Securities: Overall: Subsequent Measurement: Trading Securities
  - ASC 320-10-35-1b, Investments – Debt and Equity Securities: Overall: Subsequent Measurement: Available-for-sale Securities
  - ASC 825-10-25 Financial Instruments: Overall: Recognition: Fair Value Option (formerly FAS 159)



## Fair Values

- For each classification of an asset or a liability only one fair value measurement can be applied.
  - Trading, available-for-sale, FVO
- Trading and FVO changes are reported in current earnings
  - Securities and loans
- Changes in market value for AFS securities are reported in OCI
  - Note: loans for investment are reported lower of cost or market (LOCOM)



## Objective

- Reporting Criteria
  - Quarterly
  - Annual
  - Exemption
- Common Reporting Errors
  - Reporting method
  - Related parties
  - Fair Value Option
  - Loans and Resale Agreements
  - Allowance for Loan and Lease Losses (ALLL)
  - Troubled Debt Restructurings (TDR)
  - Asset and Liability items
  - Off-Balance Sheet Items



## Quarterly Reporting

- Who is required to file?

Each top-tier foreign banking organization must file the FR Y-7N report on a quarterly basis for each of its U.S. nonbank subsidiaries that meets any one of the following criteria and are not regulated by a primary U.S. regulator other than the FRB:

- total assets equal to or greater than \$1 billion
- or
- total off-balance-sheet activities equal to or greater than \$5 billion



## Annual Reporting

- **Annual Reporting – Detailed**

Each top-tier foreign banking organization must file the FR Y-7N report on an annual basis for each of its U.S. nonbank subsidiaries that have total assets of \$250 million to < \$1 billion and are not regulated by a primary U.S. regulator other than the FRB.

- **Annual Reporting – Abbreviated**

Each top-tier foreign banking organization must file the FR Y-7NS report on an annual basis for each of its U.S. nonbank subsidiaries that have total assets of \$50 million to < \$250 million and are not regulated by a primary U.S. regulator other than the FRB.



## Filing Criteria – Frequency of Reporting

- Once a nonbank subsidiary satisfies the criteria to file the FR Y-7N report for any quarter during the calendar year, the nonbank subsidiary must continue to file the quarterly report for the remainder of the calendar year, even if it no longer satisfies the requirement for filing the quarterly report.

EXAMPLE:	Total Assets*	Report Filed
▪ March 31, 2012:	\$500 million	N/A
▪ June 30, 2012:	\$600 million	N/A
▪ September 30, 2012:	\$1.5 billion	Quarterly FR Y-7N
▪ December 31, 2012:	\$900 million	Quarterly FR Y-7N

*\*For purposes of this example, off-balance sheet activities is not applicable for this reporter and therefore that criteria is not met in any quarter*

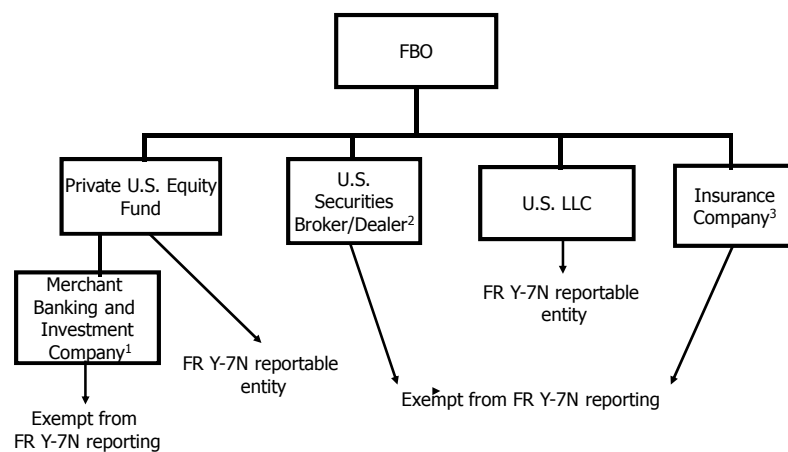


## Exemption

- Functionally Regulated in the U.S.
  - (ex. SEC, CFTC, State Insurance Commissioners, State Securities Departments)
- Subsidiaries organized outside the 50 states
  - (subs organized in U.S. territories are not required to file)
- Subsidiaries holding shares as a result of debts previously contracted (“DPC” assets)
- Merchant banking investment companies
  - Under section 4(k)4(H) of the BHC Act
- Subsidiaries of U.S. commercial banks



## Reporting Diagram



1 Under BHC Act Section 4(k)4(H)  
2 Regulated by SEC  
3 Regulated by the state insurance regulators



## Multiple FBO Ownership

- If the subsidiary is owned by multiple FBOs – majority owner FBO should submit the report
- If the subsidiary is owned equally by multiple FBOs – largest FBO, based on consolidated assets, should submit the report



## Reporting Details

- Calendar year reporting only
  - No fiscal year reporting
- Signatures
  - Reports must be signed by an officer of the FBO
  - If the top tier holding company is domiciled outside the U.S., the holding company may authorize an officer of the nonbank subsidiary to sign the report.



## Common Reporting Errors - Reporting Method

- No Consolidation
  - Separate report for each legal entity that is a subsidiary of the FBO (directly or indirectly owned) and that meets the reporting criteria
  - FBO should separately assess whether its VIEs meet the definition of a subsidiary and determine if any such entity meets the criteria for filing the report.
  - A subsidiary for purposes of this report is defined by Section 225.2 of Federal Reserve Regulation Y, which generally includes companies 25% or more owned or controlled by another company.



## Common Reporting Errors – Reporting Method Cont'd

- Equity method accounting for all subsidiaries of the reporting entity
  - Income Statement – net income of a subsidiary:  
“Equity in undistributed income” (Line 11)
  - Balance Sheet – net investment balance of a subsidiary:  
“Balances due from related institutions - gross” (Line 9) if positive  
“Balances due to related institutions – gross” (Line 16) if negative
- OCI including the cumulative translation adjustment pertaining to the subsidiaries of the reporting entity is included as part of the net income of the subsidiary, and is reported in Schedule IS, “Equity in undistributed income” (Line 11)
- Accumulated OCI of the reporter’s subsidiaries is reported on Schedule BS, “Balances due from related institutions” (Line 9)



## Common Reporting Errors - Related Parties

- Reported Gross on Schedule BS, Line 9 (Due From) and Line 16 (Due to) and Include:
  - Balances with the top tier FBO
  - Balances with subsidiary banks (or their branches)
  - Balances with other subsidiaries (including those of the parent and the reporting nonbank subsidiaries)
  - Investment in all subsidiaries and associated companies (whether consolidated or unconsolidated)



## Common Reporting Errors - Fair Value Option

- Nonbank subsidiaries that have elected to account for financial instruments or servicing assets and liabilities at fair value under a fair value option (FVO) with changes in fair value recognized in earnings
  - Assets and liabilities elected to report under the FVO are reported at fair value on Schedule BS
  - The total fair value of assets and liabilities (with third parties and related institutions) accounted for under the FVO are disclosed on Memoranda, Line 1.a and 1.b respectively.



## Common Reporting Errors - Fair Value Option

- Income Statement: Schedule IS, Memoranda Line 1 “Net change in fair values of financial instruments accounted for under a fair value option”
  - Revaluation adjustments to the carrying value of assets and liabilities reported at fair value under a FVO resulting from the periodic marking of such assets and liabilities can be reported in:
    - “Trading revenue”, Line 5.a(3) for assets/liabilities that were transferred to the trading account as a result of a reporting at fair value as a result of a FVO
    - “Net servicing fees”, Line 5.a(6) for servicing assets/liabilities reported at fair value under a FVO
    - “Other noninterest income”, Line 5.a(10) for all other assets/liabilities reported at fair value under a FVO



## Common Reporting Errors – Loans and Resale Agreements

- Resale agreements and Fed Funds Sold should be reported in “Loans and leases financing receivables” on Schedule BS, Line 3.a.
- If a loan cannot be classified into one of the categories defined on Schedule BS-A line 1 through 4, report in “All other loans and lease financing receivables” in Line 5.
  - Loans to unrelated VIEs
  - Loans to REITs and insurance companies
  - Loans to exchanges where securities are traded
  - Loans to entities that provide clearing and settlement services to its members (unless the clearing house is a depository institution, in which case, it should be reported as “Loans to depository institutions” (Schedule BS-A, Line 2))





## Common Reporting Errors - ALLL

- Allowance for Loan Losses (ALL) must be reported on a standalone basis for each legal entity
  - ALL cannot be reported at the parent bank level or at another subsidiary level
  - ALL should exclude reserves for credit risk on off balance sheet items. These should be reported in “Other liabilities”, Line 14 on Schedule BS and in “Noninterest expense”, Line 7 on Schedule IS
- Specific Reserves
  - Loans are to be reported net of specific reserves (exclude specific reserves from ALL)



## Common Reporting Errors – TDRs

- Troubled debt restructurings - include those loans that have been restructured or renegotiated to provide a reduction of either interest or principal because of a deterioration in the financial position of the borrower.
- Report on Schedule BS-A Line 7d.
  - Include loans to individuals for household, family, and other personal expenditures, and all loans secured by 1-4 family residential properties whose terms have been modified in troubled debt restructurings



## Common Reporting Errors – TDRs Cont'd

- A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not considered a TDR.
- Do not include leases
- Until a loan that is a TDR is paid in full or settled, sold, or charged off, the loan must be reported in the appropriate loan category in Schedule BS-A.
- For further information, see the FR Y-9C Glossary entry for “troubled debt restructurings.”



## Common Reporting Errors - Assets & Liabilities

- Goodwill
  - Goodwill is reported as “All other assets” on Schedule BS, Line 7
    - Impairments to goodwill are reported as “noninterest expense” on Schedule IS, Line 7
- Other Assets & Other Liabilities
  - Other assets reported on Schedule BS-M, Line 3 should be equal to or less than balances reported on Schedule BS “All other assets” Line 7
  - Other liabilities reported on Schedule BS-M, Line 6 must be equal to or less than balances reported on Schedule BS “Other liabilities” Line 14



### Common Reporting Errors - Off-Balance Sheet Items

- Derivatives and Off-balance Sheet items reported on Schedule BS, Lines 20 – 30 include transactions with related and nonrelated institutions.
- Transactions where foreign currencies are bought and sold against U.S. dollar (e.g. foreign exchange swaps or cross currency swaps), only the foreign exchange side of the transaction should be reported, according to type and risk exposure on Schedule BS.
- Performance guarantees, similar to standby letters of credit, represent an obligation of the creditor to pay the purchaser or beneficiary only when trigger event occurs, and therefore should be reported as “Standby letters of credit and foreign office guarantees” (Schedule BS, Line 22).



### Common Reporting Errors - Off-Balance Sheet Items

- Notional value of foreign exchange spot contracts is reported with foreign exchange futures and forwards on Schedule BS, Line 24.
- Notional value of interest rate swaption contracts purchased should be reported as “Purchase Options” (Line 26b) for the purchaser, because swaption contracts provide a purchaser the option to enter into a swap contract at a future date.



## Common Reporting Errors - Off-Balance Sheet Items

- Fair value of derivatives held for purposes other than trading
  - Derivatives held for purposes other than trading that do not qualify for hedge accounting under ASC 815-20, Derivatives and Hedging: Hedging - General, must be reported as held for trading
  - Derivatives that do qualify for hedge accounting are reported in “All other assets” (Line 7) if a positive fair value or “Other liabilities” (Line 14) if a negative fair value.
  - Cash collateral receivable or payable for derivatives transactions, can be included in the fair value of the derivative under ASC 815-10-45, “Derivatives and Hedging: Overall: Other Presentation Matters” (FIN 39 Amendment) if institution has polity to net. (Methodology should be applied consistently)



## Common Reporting Errors - Off-Balance Sheet Items

- Accrued interest receivable and payable from derivative contracts excluded from the calculation of fair value should be reported separately on Schedule BS, “All other assets” Line 7 and “All other Liabilities ” Line 14 respectively. (Methodology should be applied consistently)
- Unrealized gains and losses from derivative contracts held for trading with
  - nonrelated institutions are reported net on Schedule IS, “Trading Revenue” Line 5.a (3).
  - related institutions should be reported gross on Schedule BS as balances due from related institutions on line 9 and balances due to related institutions on line 16.



## Common Reporting Errors - Off-Balance Sheet Items

- “All Other Off Balance Sheet Liabilities” (Line 30)
  - ALL credit derivatives, including contracts where the reporter is the beneficiary
  - All securities borrowed/lent against collateral other than cash (i.e. against other securities)



## Questions & Answers