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KENNETH LAMAR
VICE PRESIDENT

December 30, 2003

To: The Individual Responsible for Preparing the Financial Statements for Large Bank Holding Companies (FR Y-9C) Located in the Second Federal Reserve District

Subject: Bank Holding Company (BHC) Reporting Requirements for December 31, 2003

Enclosed are two copies of the following report forms and instructions for the December 31, 2003 reporting date:

(1) Consolidated Financial Statements for Bank Holding Companies (FR Y-9C);
(2) Parent Company Only Financial Statements for Large Bank Holding Companies (FR Y-9LP);
(3) Financial Statements for Employee Stock Ownership Plan Bank Holding Companies (FR Y-9ES);
(4) Financial Statements of U.S. Nonbank Subsidiaries of U.S. Bank Holding Companies (FR Y-11/S); and
(5) Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies (FR Y-12).

There have been several clarifications to the FR Y-9ES and FR Y-11/S reporting instructions. Significant accounting updates and revisions to the instructions have been provided in this letter and in Attachment 1. There are no revisions to the FR Y-9C, FR Y-9LP and FR Y-12 for this quarter.

FR Y-9ES Reporting Criteria

The Financial Statements for Employee Stock Ownership Plan Bank Holding Companies (FR Y-9ES) is to be filed by all ESOPs that are also BHCs as of the last calendar day of the calendar year. No other FR Y-9 series form is required. BHCs that are subsidiaries of ESOP BHCs (i.e., a tiered bank holding company) must continue to submit the appropriate reports.

Reports Submission

All FR Y-9C, FR Y-9LP and FR Y-9ES filers are required to submit electronically. A signed and attested printout of the data submitted must be maintained in the BHCs files. The cover page of the Reserve Bank supplied report forms should be used to fulfill the signature and attestation requirements and this page should be attached to the printout placed in the bank holding company's files. For the FR Y-11/S and FR Y-12 that are not submitted electronically, an original and two copies (one-sided) of each completed report must be returned to this bank by mail or messenger by the dates listed below.

Under the Regulatory Reports Monitoring Program, the timeliness of receipt of these reports will be monitored. Earlier submission would aid this Bank in reviewing and processing the reports and is encouraged.

The submission deadline for the **FR Y-9C, FR Y-9LP, and FR Y-12** is Tuesday, February 17, 2004. Any FR Y-9C, FR Y-9LP, or FR Y-12 reports received after 5:00 p.m. on February 17 will be considered late unless postmarked by Thursday, February 12, 2004 or sent by overnight service on Monday, February 16, 2004. The submission deadline for the **FR Y-11/S** is Monday, March 1, 2004. Any reports received after 5:00 p.m. on March 1 will be considered late unless postmarked by Thursday, February 26, 2004 or sent by overnight service by Sunday, February 29, 2004.

The submission deadline for the **FR Y-9ES** is July 31, 2004. ESOPS that have filed Form 5558 with the IRS for an extension must submit a copy of the form by July 31, 2004 to receive an extension to October 15, 2004 to coincide with the extended IRS deadline.

Submission of initial data via facsimile, even if prior to this deadline does not constitute an official filing. In view of this, please be sure that completed reports are submitted on time to:

Federal Reserve Bank of New York
Statistics Function
Administrative Support Staff
33 Liberty Street, 4th Floor
New York, N.Y. 10045

Accounting for Indexed Retirement Plans

BHCs should account for indexed retirement plans in accordance with generally accepted accounting principles. BHCs that have agreements with individual employees to provide retirement benefits often fund the benefit obligation with the proceeds from bank-owned life insurance (BOLI). Some of these agreements are referred to as indexed retirement plans because retirement benefits are

based upon the difference between the actual earnings on the BOLI and a predefined index ("excess spread"). If the agreements with individual employees, taken together, are equivalent to a postretirement income plan, then FASB Statement No. 87, *Employers' Accounting for Pensions*, governs the accounting. Otherwise, each agreement should be accounted for individually on an accrual basis in accordance with the terms of the underlying contract as required by the provisions of Accounting Principles Board Opinion No. 12, *Omnibus Opinion*, addressing deferred compensation contracts.

Many employee agreements provide for future benefit payments from the excess spread that accrues before and after retirement on the related BOLI. Opinion No. 12, as amended by FASB Statement No.106, requires employer obligations under deferred compensation contracts to be accrued over the required service periods until the date the employee is fully eligible for the benefits ("full eligibility date"). However, some institutions have failed to record a liability for the estimated cost of benefit payments related to the excess spread that the employee will be entitled to receive after retirement. In addition, some institutions have failed to accrue the present value of the expected future benefit payments by the full eligibility date.

The failure to record a liability for the postretirement excess spread or to appropriately consider the impact of vesting provisions on the full eligibility date represents an accounting error. If an institution has made an error that is deemed material, it should make an adjustment to correct this accounting error and report the effect of the adjustment on retained earnings as of the beginning of the year in Schedule HI-A, item 2. The effect of the adjustment on earnings since the beginning of the year should be reflected in the appropriate income statement (Schedule HI) account on a year-to-date basis. The institution also should contact its Federal Reserve Bank contact to determine whether prior FR Y-9 reports should be amended.

Revisions to the estimated cost of future benefits because of changes in assumptions (e.g., changes in interest rates) should be accounted for as a change in accounting estimate and not as an accounting error.

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

FASB Statement No. 133 Implementation Issue No. C13 provides guidance on the circumstances in which a loan commitment must be accounted for as derivative. This guidance applies to commitments issued before July 1, 2003. **Commitments issued after June 30, 2003, are addressed by FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*.** BHCs must follow the guidance in Issue No. C13 and Statement No. 149 for FR Y-9 reporting purposes.

Issue No. C13, states that loan commitments that relate to the origination or purchase of mortgage loans that will be held for sale must be accounted for as derivative instruments in accordance with Statement No. 133. However, loan commitments that relate to the origination or purchase of mortgage loans that will be held for investment, i.e., loans for which the BHC or its subsidiaries has the intent and ability to hold for the foreseeable future or until maturity or payoff, are not considered

derivatives. In addition, commitments that relate to the origination of other types of loans (that is, other than mortgage loans) are not considered derivatives.

FASB Statement No. 149 differs from Issue No. C13. Under Statement No. 149, loan commitments that relate to the origination of mortgage loans that will be held-for-sale must be accounted for as derivatives by the issuer of the commitment. Commitments to originate mortgage loans that will be held for investment purposes and other types of loans are not derivatives. However, for commitments to purchase or sell existing loans, the definition of a derivative in Statement No. 133 (see page GL-20 of the Glossary section of the FR Y-9C instructions) should be applied to these commitments to determine whether they meet this definition and are subject to the provisions of Statement No. 133.

Mortgage loan commitments that must be accounted for as derivatives are considered over-the-counter written interest rate options. Therefore, because they are derivatives, these commitments should be excluded from item 1 of Schedule HC-L, Derivative and Off-Balance Sheet Items. Instead, mortgage loan commitments that are derivatives must be reported on the balance sheet (Schedule HC) at fair value. In addition, the par value of the mortgage loans to be acquired under these commitments must be reported in Schedule HC-L, item 11.d.(1), column A, and in Schedule HC-L, item 13, column A. The fair value of these mortgage loan commitments must be reported in the appropriate subitem of Schedule HC-L, item 14.b. As written options, mortgage loan commitments that are derivatives are not covered by the risk-based capital standards. However, if the fair value of these mortgage loan commitments is positive, the positive fair value is subject to the risk-based capital standards and must be risk weighted as an on-balance sheet asset.

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

FASB Interpretation No. 46

The FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*. This interpretation explains how to identify a "variable interest entity" (VIE) (previously referred to as a "special purpose entity") and how an organization should assess its interests in a VIE to decide whether to consolidate that entity. VIEs often are created for a single specified purpose, for example, to facilitate securitization, leasing, hedging, research and development, and reinsurance.

In general, a VIE is an entity in which either the controlling financial interests are not voting interests or the equity investors do not bear the entity's residual economic risks. A variable interest is a contractual or ownership interest in an entity that changes when the value of the entity's net assets changes. An organization that has a variable interest (or a combination of variable interests) that will absorb a majority of a VIE's expected losses if they occur, receive a majority of the entity's expected residual returns if they occur, or both, is the "primary beneficiary" of the variable interest entity and must

consolidate it.

For FR Y-9C and FR Y-11/S purposes, BHCs with variable interests in VIEs created after January 31, 2003, must apply the provisions of Interpretation No. 46 to those entities. A BHC that is a public company and has a variable interest in a VIE created before February 1, 2003, must apply the provisions of Interpretation No. 46 to that entity no later than the beginning of the first interim or annual reporting period beginning after December 15, 2003. A BHC that is not a public company but has a variable interest in a VIE created before February 15, 2003, must apply the provisions of Interpretation No. 46 to that entity no later than the end of the first annual reporting period beginning after June 15, 2003.

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

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

The banking agencies have issued an interim final rule that sets forth a temporary risk-based capital treatment for assets in asset-backed commercial paper conduits that sponsoring bank organizations are required to consolidate in accordance with Interpretation No. 46. This interim capital treatment allows sponsoring bank organizations to exclude the consolidated asset-backed commercial paper program assets from their risk-weighted asset bases when they calculate their risk-based capital ratios. However, sponsoring bank organizations must continue to hold risk-based capital against all exposures arising in connection with these programs, including direct credit substitutes, recourse obligations, residual interests, long-term liquidity facilities, and loans. Furthermore, any minority interests in consolidated asset-backed commercial paper programs are not eligible for inclusion in Tier 1 capital (or total risk-based capital).

This interim risk-based capital treatment will be in effect only for the December 31, 2003, and March 31, 2004, FR Y-9C report dates. In addition, the interim risk-based capital treatment does not alter the accounting rules for balance sheet consolidation under Interpretation No. 46, nor does it affect the denominator of the Tier 1 leverage capital ratio calculation, which continues to be based primarily on on-balance sheet assets as reported under generally accepted accounting principles. However, BHCs should continue to report in the appropriate items of Schedule HC-R any credit enhancements and liquidity facilities that they provide to the asset-backed commercial paper programs they sponsor.

Under the agencies' interim rule, bank organization sponsors of any consolidated asset-backed commercial paper programs should include the consolidated assets in the appropriate balance sheet asset

categories when completing items 34 through 43, column A, in Schedule HC-R, Regulatory Capital. The amounts of these consolidated assets should also be reported in items 34 through 43, column B, "Items not Subject to Risk-Weighting." However, sponsoring bank organizations must continue to hold risk-based capital against all exposures arising in connection with these programs, whether or not the programs are consolidated, including direct credit substitutes, recourse obligations, residual interests, long-term liquidity facilities, and loans. These exposures should be reported in the appropriate items of Schedule HC-R. Furthermore, any minority interests in consolidated asset-backed commercial paper programs are not eligible for inclusion in Tier 1 capital (or total risk-based capital).

For those asset-backed commercial paper programs that a BHC consolidates, any credit enhancements and liquidity facilities the bank provides to the conduit should not be reported in Schedule HC-L, Derivatives and Off-Balance Sheet Items. In contrast, for programs that are not consolidated, the bank should report the credit enhancements and liquidity facilities it provides to the programs in the appropriate items of Schedule HC-L.

Reporting of Trust Preferred Securities

The Federal Reserve is aware that FIN 46 may have implications for how trust preferred securities are reported on BHCs' financial statements. BHCs should continue to follow the pre-Fin 46 reporting of trust preferred securities.

Accordingly, on the FR Y-9C, BHCs should include these securities on Schedule HC-R, memoranda item 3.b., "Cumulative preferred stock (e.g., trust preferred securities) included and reported in 'Minority interest in consolidated subsidiaries and similar items,' on Schedule HC." Any common equity investment the organization has made in the trust issuing the preferred securities that is reported as an asset on the BHC's FR Y-9C balance sheet must be netted from the amount of trust preferred securities reported in item 3.b.

BHCs should continue to include the trust preferred securities reported in item 3.b. in their tier 1 capital for regulatory capital purposes, subject, together with other cumulative preferred stock, to the 25 percent of tier 1 capital limit. Accordingly, the amounts qualifying for inclusion in tier 1 capital should be reported in Schedule HC-R, item 6.

BHCs must disclose on the FR Y-9C "Notes to the Balance Sheet-Other", the amount of trust preferred securities that are reported as liabilities in their financial statements prepared according to generally accepted accounting principles (GAAP).

Reporting Gains and Losses from Extinguishments of Debt, Including Prepayment Penalties

Until it was rescinded by FASB Statement No. 145 in April 2002, FASB Statement No. 4 required gains and losses from the extinguishment (repayment or retirement) of debt to be aggregated and, if material, reported as extraordinary items. Under Statement No. 145, such gains and losses

should be classified as extraordinary items only if they meet the criteria in Accounting Principles Board Opinion No. 30. For FR Y-9C purposes, except for those unusual and infrequent gains and losses that qualify as extraordinary, BHCs should aggregate their gains and losses from the extinguishment of debt, including losses resulting from the payment of prepayment penalties on borrowings such as Federal Home Loan Bank advances, and consistently report the net amount in item 7.d, "Other noninterest expense," of the income statement (Schedule HI). Only if a bank holding company's debt extinguishments normally result in net gains over time should the BHC consistently report its net gains (losses) in Schedule HI, item 5.l, "Other noninterest income."

In addition, under FASB Emerging Issues Task Force (EITF) Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," the accounting for the gain or loss on the modification or exchange of debt depends on whether the original and the new debt instruments are substantially different. If they are substantially different, the transaction is treated as an extinguishment of debt and the gain or loss on the modification or exchange is reported immediately in earnings as discussed above. If the original and new debt instruments are not substantially different, the gain or loss on the modification or replacement of the debt is deferred and recognized over time as an adjustment to the interest expense on the new borrowing. EITF Issue No. 96-19 provides guidance on how to determine whether the original and the new debt instruments are substantially different.

Deposit Accounts on Which the Interest Rate Has Been Reduced to Zero

Many banking subsidiaries of BHCs offer deposit products, such as money market deposit accounts or NOW accounts, on which they periodically adjust the interest rate paid on the accounts in response to changes in market interest rates and other factors. If the adjustments on certain deposit accounts have reduced the interest rate to zero, but the interest rate paid on these accounts can be increased as market conditions change, the BHC should continue to report the deposits as interest-bearing accounts in item 13 of Schedule HC, Balance Sheet, and include them in the appropriate deposit items in Schedule HC-K, Quarterly Averages

FASB Interpretation No. 45

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This interpretation clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. Among the types of guarantee contracts to which the provisions of Interpretation No. 45 apply are:

- financial standby letters of credit, and
- performance standby letters of credit.

Commercial letters of credit and other loan commitments, and subordinated interests in securitizations, are not guarantees under Interpretation No. 45. BHCs should refer to Interpretation No.

45 for further information on the types of guarantee contracts to which the interpretation's initial recognition and measurement provisions do and do not apply.

For financial and performance standby letters of credit and other types of guarantees subject to the interpretation, when a BHC or its subsidiary issues the guarantee, it must recognize on its balance sheet a liability for that guarantee. In general, the initial measurement of the liability is the fair value of the guarantee at its inception. When a BHC or its subsidiary issues a guarantee in an arm's length transaction with a party outside the consolidated BHC, the liability recognized at the inception of the guarantee should be the premium or fee received or receivable by the guarantor. However, if the BHC or its subsidiary issues a guarantee for no consideration, the liability recognized at inception should be an estimate of the guarantee's fair value.

In the unusual circumstance where, at the inception of a guarantee, it is probable that a loss has been incurred and its amount can be reasonably estimated, the liability to be initially recognized for that guarantee should be the greater of the premium or fee received or receivable by the guarantor or the estimated loss from the loss contingency that must be accrued under FASB Statement No. 5, *Accounting for Contingencies*.

Interpretation No. 45 does not prescribe a specific account for the guarantor's offsetting entry when it recognizes the liability at the inception of a guarantee because that offsetting entry depends on the circumstances. If a BHC or its subsidiary issued a standby letter of credit or other guarantee in a standalone transaction for a premium or fee, the offsetting entry would reflect the consideration the BHC or its subsidiary received, such as cash, a receivable, or a reduction of a deposit liability. In contrast, if the BHC or its subsidiary received no consideration for issuing the guarantee, the offsetting entry would be to expense.

The interpretation does not describe in detail how a BHC's or its subsidiary's liability for its obligations under its guarantees should be measured subsequent to initial recognition. However, the accounting for fees received for issuing standby letters of credit has been, and should continue to be, governed by FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. Under Statement No. 91, such fees are termed "commitment fees."

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures

It has come to our attention that some inconsistent treatment was being applied for certain allowance accounts. The *Audit and Accounting Guide – Banks and Savings Institutions*, published by the American Institute of Certified Public Accountants, has stated that credit losses related to off-balance sheet financial instruments should be accrued and reported separately as liabilities "if the conditions of FASB Statement No. 5 are met." Consistent with this accounting guidance, each BHC should also maintain, as a separate liability account, an allowance sufficient to absorb estimated credit losses associated with off-balance sheet credit instruments. Off-balance sheet credit instruments include

off-balance sheet loan commitments, standby letters of credit, and guarantees.

On the FR Y-9C, a BHC must report its "Allowance for credit losses on off-balance sheet credit exposures" in item 3 of Schedule HC-G, Other Liabilities, *not* as part of its "Allowance for loan and lease losses" in Schedule HC, item 4.c. However, for risk-based capital purposes, the "Allowance for credit losses on off-balance sheet credit exposures" is combined with the "Allowance for loan and lease losses" and the total of these two allowances is included in Tier 2 capital up to a limit of 1.25 percent of a BHC's gross risk-weighted assets. For further information on the inclusion of these allowances in Tier 2 capital, please refer to the instructions for FR Y-9C Schedule HC-R, item 14.

Accelerated Filing Deadline

The acceleration of the filing deadline for top-tier FR Y-9C filers has been approved and will follow the SEC's phased-in approach by implementing a 40-day deadline in June 2004 and a 35-day deadline in June 2005. The new filing deadlines apply for the March, June, and September report dates. The December filing deadline for top-tier FR Y-9C filers will remain at 45 days after the report date.

The 35-day deadline is defined as "5 business days after the 30th day after the report date" to allow time for integration of bank data in the event that the 30th day falls on a weekend.

The FR Y-9LP, FR Y-9SP, FR Y-9ES and all lower-tier BHCs that file the FR Y-9C are not subject to the accelerated deadline. The deadline for these reports will remain at 45 days after the report date.

Edit Checklist

The staff of this Bank will monitor whether banking organizations are meeting their basic reporting requirements through the use of "validity edits". Enclosed are the updates to the monitoring edits. Please note these updates to ensure your institution meets these edit tests. Also, to avoid common reporting errors, we are now providing a list of edit checks which we perform between the FR Y-9LP and FR Y-9C reports.

In addition to the validity edits, we also perform quality edit checks. These quality edit checks are available on the Federal Reserve Banks website at www.federalreserve.gov under "Reporting Instructions".

Electronic Submission Option

This Bank offers BHCs the option of submitting their FR Y-11/S and FR Y-12 reports electronically. Any BHC interested in submitting these reports electronically should contact Carolyn Polite at (212) 720-5415 for information concerning the procedures for electronic transmission. BHCs

choosing to submit these reports electronically must maintain in their files a signed printout of the data submitted.

In addition, we now offer distribution of this letter, report forms, and instructions via e-mail. If you are interested in receiving this electronically, please fax the attached form to Hilda Hyman at (212) 720-2364.

Website

Report forms and instructions for the FR Y-9C, FR Y-9LP, FR Y-9ES, FR Y-11/S and FR Y-12 are also available on the Federal Reserve Board's web site at ***www.federalreserve.gov*** under "Reporting Forms".

Questions regarding these reports should be addressed to Monica Posen at (212) 720-8239. Questions regarding the capital adequacy guidelines should be directed to Dianne Dobbeck in the Policy and Analysis Department at (212) 720-2610.

Sincerely,

Signed by Kenneth P. Lamar

Kenneth P. Lamar
Vice President
Financial Reports Department

ATTACHMENT 1

<u>Significant Revisions to the FR Y-9ES for December 2003:</u>

Instructions

1. The General Instructions section was reorganized into four main topics. In addition, the electronic submission requirement was updated.
2. Reporting instructions for leveraged ESOPS were clarified in Schedules SC, general schedule instructions, Schedule SB, item 15, and the Glossary.
3. In the Glossary, the entry for "Suspense Shares" was clarified regarding the reporting of allocated and unallocated suspense shares.

<u>Significant Revisions to the FR Y-11/S for December 2003</u>

Instructions

1. The General Instructions were clarified to state that insurance companies are functionally regulated and exempt from filing this report.
2. The instructions for Schedule IS, item 2(b), Schedule IS-A, item 4, and BS, item 18(a) were clarified to state that a special purpose subsidiary (trust) should report trust preferred securities as stock and that the distributions from that special purpose subsidiary (trust) to the trust preferred stockholders should be reported as dividends.