

# FFIEC 002 Seminar

Doug Herold  
Monica Posen  
Mike Tursi  
Patricia Maone  
Henry Castillo  
Rich Molloy  
Vadim Tovshsteyn

5/19/06

August 1, 2006

## Securities

Doug Herold

## Securities

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

## Securities

- Held-to-maturity securities
  - Management must have both the positive intent and ability to hold to maturity
  - Carried at amortized cost on Schedule RAL, Lines 1.b and 1.c

## Securities

- Available-for-sale securities

- Securities for which the institution does not have the intent and ability to hold to maturity, yet does not intend to trade actively

- Trading Securities

## Securities

- Some circumstances when the sale or transfer from the held-to-maturity classification is considered consistent with FAS 115

- 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 FAS 115
  - 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

## **Types of Securities**

- U.S Treasuries Securities
  - Treasury Bills (T-Bills)
  - Treasury Notes (T-Notes)
  - Treasury Bonds (T-Bonds)
  - Separate Trading of Registered Interest and Principal of Securities (STRIPS)
  - Treasury Inflation-Indexed Securities (TIIS)

## **Types of Securities**

- U.S Government Agency obligations (excluding mortgage-backed securities)
  - Export-Import Bank
  - FHA
  - GNMA
  - Maritime Administration
  - SBA
  - FAMC (Farmer Mac)
  - TVA
  - U.S. Postal Service
  - Federal Farm Credit Banks
  - FHLBs
  - FHLMC (Freddie Mac)
  - FLBs
  - FNMA (Fannie Mae)
  - FICO
  - REFCORP
  - SLMA (Sallie Mae)

## **Types of Securities**

- Securities of foreign governments and official institutions
  - International Bank for Reconstructions and Development (World Bank)
  - Inter-American Development Bank
  - Foreign Central Banks and Development Bank
  - Nationalized Bank

## **Types of Securities**

- Mortgage-Backed Securities (MBS)
  - Pass-throughs
  - CMOs
  - REMICs
  - IOs
  - POs

## **Types of Securities**

- Mortgage-Backed Securities issued or guaranteed by U.S. Government agencies
  - FNMA
  - FHLMC
  - GNMA
  - REMICs issued by the VA

## **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.

## **Types of Securities**

---

- Other Asset-Backed Securities (ABS)
  - Asset-backed commercial paper
  - ABS backed by credit card receivables, HELOCs, non-mortgage loans (consumer, auto, commercial and industrial, etc.)

## **Types of Securities**

---

- All other securities
  - Bonds, notes and debentures
  - Commercial paper (non asset-backed)
  - Equity securities
  - Municipal securities
  - Corporate Stock
  - Common stock of FNMA, FHLMC or SLMA

## **Types of Securities**

---

- All other securities
  - Brady Bonds
  - Industrial Development Bonds



## **Types of Securities**

---

### ■ Other issues

- Certificates of Deposit (CDs) are not to be reported as securities for regulatory reporting purposes unless held for trading
- Trade date/Settlement date accounting

## **Deposits**

---

Monica Posen

## Objectives

---

- Definition of Deposit
- Deposits versus Borrowings
- Definitional Differences between  
FFIEC 002 and FR 2900
- Overdrafts
- Sweep Arrangements
- Credit Balances and Cash Collateral

## Definition of a Deposit

---

- Defined:
  - 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, either conditionally or unconditionally, to an account, including interest credited, or which is evidenced by an instrument on which the depository institution is primarily liable.

## Definition of a Deposit

- 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 for a special or specific purpose...including escrow funds, funds held as security for securities loaned by the depository institution, funds deposited as advance payment on subscriptions to U.S. government securities, and funds held to meet its acceptances.

## Definition of a Deposit

### ■ Transaction Account

#### – Demand Deposits

- ❖ Deposits payable immediately on demand,  
or
- ❖ issued with an original maturity of less than  
seven days

## Definition of a Deposit

### ■ Transaction Account

#### – “Other” transaction accounts are:

- ❖ Deposit accounts (other than savings) where the DI reserves the right to require 7 days written notice prior to withdrawal/transfer of funds in the account
  - ❖ Subject to unlimited withdrawal by check, draft, negotiable order of withdrawal, electronic transfer, or other similar items
- Provided the depositor is eligible to hold a NOW account

## Definition of a Deposit

### ■ Nontransaction Account

#### – Time deposits

- ❖ A deposit account with an original maturity date of at least seven days
- ❖ The depositor is not permitted to make withdrawals from within six days after the date of deposit unless the deposit is subject to an early withdrawal penalty of at least seven days' simple interest

## Definition of a Deposit

### ■ Nontransaction Account

#### – Savings deposits

- ❖ An account which the depository institution reserves the right to require at least seven days written notice prior to a withdrawal
- ❖ An account with no specified maturity
- ❖ The depositor is not permitted to make more than six withdrawals per calendar month or statement cycle

## Deposits vs. Borrowings

- In economic terms, deposits and borrowings are similar. However, they are different transactions from a legal and regulatory perspective.
- 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 between FFIEC 002 and FR 2900

- Preparers should be aware of all definitional differences between FFIEC 002 and FR 2900 which include:
  - Consolidation
  - Definition of United States
  - Suspense Accounts
  - Primary Obligations
  - Reciprocal Balances
  - Vault Cash
  - Assets Sold with Recourse
  - Credit Balances

## **Definitional Differences Related Parties**

---

- FFIEC 002
  - Accounts of U.S. and non-U.S. banking affiliates are excluded from Schedule E. Such accounts are reported on Schedule M (Due From/Due To Related Institutions in the U.S. and in Foreign Countries).
  - Nonbanking subsidiaries are treated as unrelated or third parties
- FR 2900
  - Accounts of U.S. and non-U.S. affiliates and subsidiaries are included on the FR 2900.

## **Definitional Differences Suspense Accounts**

---

- On the FR 2900, suspense account items are reported in other demand deposits
- On the FFIEC 002, suspense account items are reported in the appropriate accounts

## Overdrafts

- Customers Overdrafts
- Reporting Institutions Overdrafts

## Customers Overdrafts

- Should be raised to zero and reported as loans
- Should NOT be netted against “good deposit” balances
- Customers overdrafts can be
  - Unplanned
  - Planned



## Customers Overdrafts

- An unplanned overdraft occurs when
  - A depository institution honors a check or draft drawn against a deposit account when insufficient funds are on deposit, and
  - There is no advance contractual agreement to honor the check or draft
- Reported as “All other loans” on Schedule C (Line 8) EXCEPT
  - Overdrafts of depository institutions, foreign governments , and foreign official institutions are reported according to counterparty.

## Customers Overdrafts

- A planned overdraft occurs when
  - A contractual agreement has been made in advance to allow credit extensions
- Reported as loans on Schedule C according to counterparty

## Reporting Institutions Overdrafts

- Overdrafts on deposit accounts held with other banks (e.g., “due from” accounts)
- Reported as borrowings on Schedule P, according to counterparty

## Reporting of Overdrafts

Type of Overdraft	Reporting Treatment
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)
Planned	Loans on Schedule C, according to counterparty
Reporting Institutions Overdrafts	Borrowings on Schedule P, according to counterparty

## Reporting of Sweep Accounts

- Sweep accounts are agreements:
  - Where funds in excess of a predetermined balance are “swept” into a higher-yielding investment or another deposit account
  - The “swept” balances should be reported based on the nature of the investment and counterparty
  - The balance swept is only reported on the FFIEC 002 if the investment remains on the bank’s balance sheet (e.g., repurchase agreements)

## Reporting of Sweep Accounts

- Funds that are swept from a transaction account into a non-transaction account (subject to third party limitations)
  - Report the amount of the “swept” balance on Schedule E, Column C, according to the counterparty
- The transfer of the swept funds back to the transaction account are considered third party transfers, subject to the six transfer rule as stated in Regulation D

## Credit Balances

- Only reported by U.S. agencies
  - According to Regulation K, U.S. agencies are NOT allowed to accept deposits from U.S. citizens or residents; credit balances ARE permitted
- Reported as a transaction account on Schedule E, Lines 1-5, Column A

## Credit Balances

- An obligation is a credit balance if:
  - It is generated by the exercise of other lawful banking powers
  - It serves a specific purpose
  - It is not solicited from the general public
  - It is NOT used to pay routine expenses in the U.S.
  - It is withdrawn within a reasonable period of time after the specific purpose for its placement has been accomplished
  - It must generally be drawn upon in a manner reasonable in relation to the size and nature of the account

## Credit Balances

### ■ Example

– A U.S. agency of a foreign bank issues a letter of credit to a U.S. domiciled counterparty for \$90,000 and accepts \$50,000 as collateral

❖ The \$50,000 would be reported as a credit balance on Schedule E, Column A

## Definitional Differences Credit Balances

■ On the FFIEC 002, U.S. agencies report credit balances as transaction accounts.

■ On the FR 2900, credit balances may be reported as either transaction, savings, or time deposits, depending on the criteria they meet

## Cash Collateral

- Cash collateral received (e.g., in connection with loans or letters of credit) should be reported as a deposit
  - Can be reported as a transaction or non-transaction 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 commercial letter of credit can be fully or partially collateralized by cash
    - ❖ For 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

# Reporting of Off-Balance Sheet Items

Michael Tursi



## Reporting of Off-Balance Balance Sheet Items

- Reporting of derivative contracts
- FASB Statement No. 133, “Accounting for Derivatives Instruments and Hedging Activities” (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 principal amount 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 multiplied by 10 has an effective notional amount of \$10,000,000

## **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 swaps contracts, as appropriate based on the predominant risk characteristic

## **Reporting of Fair Values**

- The definition of “fair value” for the FFIEC 002 purposes is based on FASB Statement No. 107, “Disclosures About Fair Value of Financial Instruments” (FAS 107)

## Reporting of Fair Values

- FAS 107 defines fair value as “the amount at which the instrument could be exchanged in a current transaction between willing parties, other than a forced liquidation or sale”. Report the fair value as follows:
  - If a quoted market price is available for a contract, use closing market price as quoted by the exchange

## Reporting of Fair Values

- If a quoted market price is not available, report the bank's best estimate of fair value based on the quoted market price of a similar contract
- When external prices are not available, valuation techniques such as discounted cash flows may be used to establish market values

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

- Report in Line 12 gross positive and negative fair values of derivative contracts held for trading and for purposes other than trading.

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

- The FV of derivative contracts held for trading should be reported **gross** (unless FIN 39 applies) on Schedule RAL, Line 1.f, "Trading assets" or in Line 4.e, "Trading liabilities"
- The gain/loss should be reported as a part of the calculation of unremitted profit/loss on Schedule M, Part I, Line 2.a

## **FAS 133**

### ■ FAS 133

- Accounting and reporting standards for derivative instruments and hedging activities
- Cash flow hedging/Fair value hedging

## **FAS 133**

### ■ Types of hedges

- The fair value of all non-trading derivatives will be reported on “Other assets” or “Other liabilities”
- For depository institutions, the two predominate types of hedges are
  - >> Fair Value
  - >> Cash Flow

## FAS 133

### ■ Fair Value Hedges

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

## FAS 133

### ■ Cash Flow Hedges

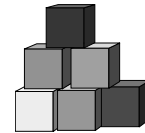
- Cash Flow Hedges apply to hedging the risk of changes in cash flows for variable rate assets and liabilities



## FAS 133

---

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



## FAS 133

---

- 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



## FAS 133

- Intercompany transactions
  - Derivatives with the parent bank or another office 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

## 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 from the inception 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)

## Options

### Hedging Market Risk

#### Example

GHI Company purchases equity securities 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

	<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)		\$5000
(To record purchase of MBI shares)		
 <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)		\$1500
(To record appreciation of MBI shares)		
 Other assets (Line 1.h)		
	\$600	
Cash and balances due from depository inst. (Line 1.a)		\$600
(To record the purchase of the put option)		

## 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)		

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

## Swaptions

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

## Swaptions

### Hedging Interest Rate Risk

- RST Bank plans borrows from another bank and will hedge the interest rate risk exposure using a swaption.
- Borrows \$10 million for 2 years at market rate
- Purchases swaption for a premium of \$20 thousand for option to receive-variable, pay-fixed interest rate swap.

## Swaptions

	<u>Debit</u>	<u>Credit</u>
<u>January 1, 2003</u>		
Other assets (Line 1.h)	\$20,000	
Cash and balances due from depository inst. (Line 1.a)		\$20,000
(To record the purchase of the swaption)		
 <u>December 31, 2003</u>		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$20,000	
Other assets (Line 1.h)		\$20,000
(To record the change in the time value of the swaption)		
Other assets (Line 1.h)	\$347,000	
Net due to/from Head Office (Sch. M, Part I, 2.a)		\$347,000
(To record the change in the fair value (gain) of the swaption)		

## Swaptions

	<u>Debit</u>	<u>Credit</u>
<u>January 1, 2004</u>		
Cash and balances due from depository inst. (Line 1.a)	\$347,000	
Other assets (Line 1.h)		\$347,000
(To record the settlement of the swaption)		
Cash and balances due from depository inst. (Line 1.a)	\$10MM	
Other borrowed money (Line 4.c)		\$10MM
(To record the issuance of the fixed-rate debt)		
<u>December 31, 2004</u>		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$1MM	
Cash and balances due from depository inst. (Line 1.a)		\$1MM
(To record the interest payment on the debt)		

## Swaptions

	<u>Debit</u>	<u>Credit</u>
<u>December 31, 2005</u>		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$1MM	
Cash and balances due from depository inst. (Line 1.a)		\$1MM
(To record the interest payment on the debt)		
Other borrowed money (Line 4.c)	\$10MM	
Cash and balances due from depository inst. (Line 1.a)		\$10MM
(To record the repayment of the fixed-rate debt)		

## 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 net settlement amount should be included in the fair value used to calculate the revaluation gain or loss

## Swaps

### Swaps held for trading

- The FV of these contracts should be reported on Schedule RAL, Line 1.f, “Trading assets” or in Line 4.e, “Trading liabilities”
- The the gain/loss should be reported as part of the calculation of unremitted profit/loss reported on Schedule M, Part I, in Line 2.a



## 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

## Swaps

- Hedging Interest Rate Risk
- Bank A borrows \$10MM of 3-year 7.5% fixed - rate debt
- Bank A enters into an interest rate swap to convert the fixed rate into a variable rate
- Fair value hedge

## Swaps

The six month U.S. LIBOR rates and the swap and debt fair values are assumed to be as follows for the first year of the swap and debt agreements:

<u>Date</u>	Six-Month U.S. LIBOR <u>Rate</u>	Swap Fair Value <u>Asset</u>	Debt Fair Value
06/30/04	6.0%	0	(\$10,000,000)
12/31/04	7.0%	(\$323,000)	(\$9,667,000)
06/30/05	5.5%	\$55,000	(\$10,055,000)

Amounts in parenthesis represent liabilities, not negative amounts.

## Swaps

	<u>Debit</u>	<u>Credit</u>
<u>June 30, 2004</u>		
Cash and due from depository instit. (Line 1.a)	\$10MM	
Other borrowed money (Line 4.c) (To record the issuance of the debt.)		\$10MM

## Swaps

	<u>Debit</u>	<u>Credit</u>
<u>December 31, 2004</u>		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$375,000	
Other liabilities (Line 4.f)		\$375,000
(To accrue semiannual interest on the debt – 7.5%)		
Other liabilities (Line 4.f)	\$375,000	
Cash and due from depository instit. (Line 1.a)		\$375,000
(To record semiannual debt interest payment)		
Cash and due from depository instit. (Line 1.a)	\$75,000	
Net due to/from Head Office (Sch. M, Part I, 2.a)		\$75,000
(To record settlement of the semiannual swap amount)		
Other borrowed money (Line 4.c)	\$323,000	
Net due to/from Head Office (Sch. M, Part I, 2.a)		\$323,000
(To record change in the debt's fair value)		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$323,000	
Other assets (Line 1.h)		\$323,000
(To record the change in the fair value of the swap)		

## Swaps

	<u>Debit</u>	<u>Credit</u>
<u>June 30, 2005</u>		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$375,000	
Other liabilities (Line 4.f)		\$375,000
(To accrue semiannual interest on the debt-7.5%)		
Other liabilities (Line 4.f)	\$375,000	
Cash and due from depository instit. (Line 1.a)		\$375,000
(To record semiannual debt interest payment)		
Cash and due from depository instit. (Line 1.a)	\$25,000	
Net due to/from Head Office (Sch. M, Part I, 2.a)		\$25,000
(To record settlement of the semiannual swap amount)		
Net due to/from Head Office (Sch. M, Part I, 2.a)	\$378,000	
Other borrowed money (Line 4.c)		\$378,000
(To record change in the debt's fair value)		
Other assets (Line 1.h)	\$378,000	
Net due to/from Head Office (Sch. M, Part I, 2.a)		\$378,000
(To record the change in the fair value of the swap)		

## **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 characteristic (i.e., interest rate, foreign exchange, equity or commodity)
- Example of this type of contract is a cross-currency interest rate swaps.

## **Reporting of Credit Derivatives**

Reporting of credit derivatives is addressed in SR 96-17 (GEN) and FAS 133

- 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

## **Reporting of Credit Derivatives**

- Certain financial guarantees are not subject to this statement if these provide for payments to the guaranteed party for a loss incurred because the debtor defaults on a payment when payment is due (§ 10, FAS 133)
  - However, financial guarantees (e.g., credit derivatives) are subject to FAS 133 if the contract is indexed to the credit worthiness of the borrower

## **Reporting of Credit Derivatives**

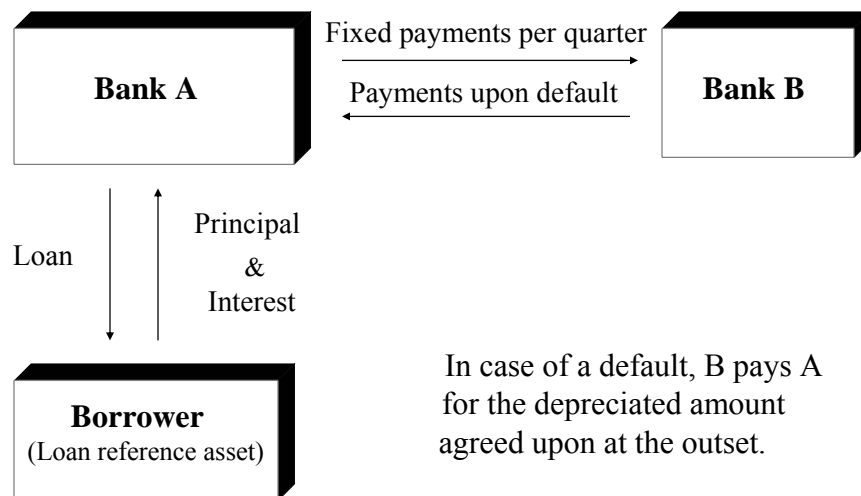
- Credit derivatives subject to FAS 133 should be reported:
  - On the balance sheet in the same manner as any other derivative product
  - Schedule L, Memoranda Section 1 or 2 (Notional amount and fair value disclosures)

## 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



## Two Common Types of Credit Derivatives

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

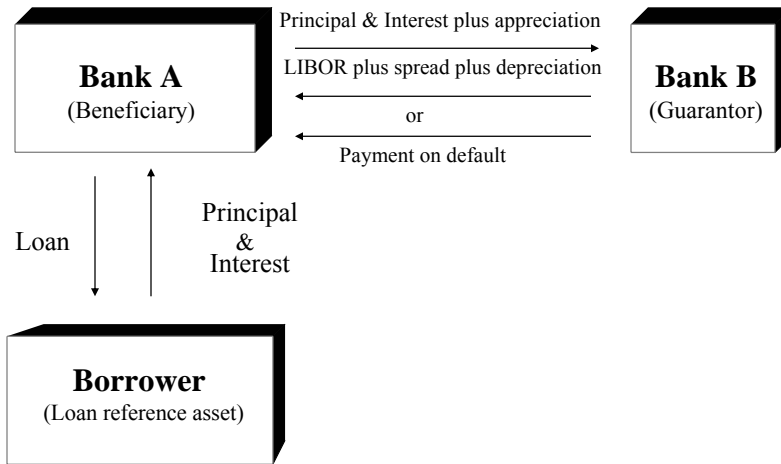
- The beneficiary agrees to pay the guarantor the total return (e.g., principal and interest as well as any appreciation in the market value of the asset)
  - The guarantor agrees to pay spread over funding costs plus an depreciation in the value of the asset

## 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 risks and rewards of the asset over the agreement period



## Total Rate of Return Swaps Structure



## Other Off-Balance Sheet Reporting Issues

- Contingent liabilities, Line 7
  - Commitments to accept and place deposits
  - Purchases and sales of risk participation in loans
  - Securities borrowed
  - Commitments to purchase when-issued securities that are excluded from FAS 133



## Other Off-Balance Sheet Reporting Issues

---

- Contingent Assets, Line 8
  - Securities lent
  - Commitments to sell when-issued securities that are excluded from FAS 133



## FASB Interpretation No. 46

---

## FASB Interpretation No. 46

- Requires consolidation of variable interest entities (“VIEs”) by enterprises that have controlling financial interest.
- VIEs are special purpose entities (“SPEs”) where either of the following conditions exist:
  - Total equity at risk is not sufficient to cover expected losses
  - Holders of equity at risk:
    - >> Lack ability to make decisions about the entity’s activities
    - >> Lack obligation to absorb expected losses or receive residual gains.

## FASB Interpretation No. 46

- Enterprise that has a variable interest or combination of variable interests that will absorb a majority of the VIE’s expected losses or receive a majority of the VIE’s expected residual returns is the VIE’s **primary beneficiary**.
- The **primary beneficiary** is the equivalent of the accounting parent and thus consolidates the VIE.

## **FASB Interpretation No. 46**

---

- Variable interests are contractual, ownership, or other financial interests in a VIE that changes with the VIE's net asset value (e.g., equity interest, loans or debt securities, guarantees)
- An equity investment of less than 10% is presumed to be insufficient to finance a VIE's activities.

## **FIN 46(R) - Mutual Funds/Trust Arrangements**

---

- Exception provided to mutual funds in the form of trusts and trusts of a bank's trust department unless used by the enterprise to circumvent FIN 46(R).

### **FIN 46(R) - Design of Ownership Changes**

---

- Whenever the design of an entity or ownership interests change, the determination of VIE status must be reconsidered.

### **FIN 46(R) - Recognition of Goodwill**

---

- Requires that an enterprise recognize goodwill if it becomes the primary beneficiary of a VIE that is a business.

## **Definition of a Subsidiary**

- For the purposes of defining the nonbank subsidiary reports the Regulation Y definition of subsidiary is used.
- As defined by 225.2 of Regulation Y, a subsidiary generally includes:
  - Companies 25% or more owned or controlled by another company
  - Companies that control in any manner the election of a majority of the Board of Directors of another company
  - Companies that have a controlling interest over another company.
- Controlling interest used in FIN 46 is defined in terms of non-voting interest, which is not covered in Reg Y’s definition of a subsidiary.

	<h3><b>FFIEC 002 Reporting Instructions Initial Measurement</b></h3>
	<ul style="list-style-type: none"><li>■ The primary beneficiary should follow the guidance specified in paragraphs 43, 44 and 45 of FAS 141, Business Combinations, when consolidating the VIE, as if the initial consolidation had resulted from a business combination.</li></ul>

	<p style="text-align: center;"><b>FFIEC 002 Reporting Instructions Initial Measurement</b></p> <hr/>
--	--

- Excess of the fair value of newly consolidated assets over consideration paid should be reported as a pro rata adjustment to amounts assigned to newly consolidated long-term assets. If any excess remains after reducing the long-term assets to zero, it should be reported as an extraordinary item.

	<p style="text-align: center;"><b>FFIEC 002 Reporting Instructions Initial Measurement</b></p> <hr/>
--	--

- Excess of the consideration paid and other factors over the fair value of the newly consolidated assets is to be reported as goodwill in the period in which the enterprise becomes a primary beneficiary.

## **FFIEC 002 Reporting Instructions**

---

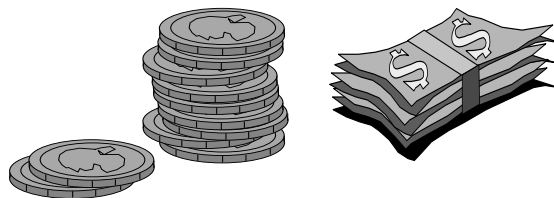
- Line-by-line consolidation (asset and liabilities accounts are reported as part of the bank in the same manner if the conduit was reported as a separate entity, equity and intercompany accounts are eliminated in consolidation).

## **Loans**

### **Allowances for Loans, Leases and Credit Losses**

---

Patricia Maone



## Loans

### Objectives

- Unamortized loan fees
- Loans held for sale
- Specific and General Reserves
- Charge-offs and Recoveries
- Allowance for credit losses

## Loans

- Report the amortized cost of all loans and leases (unless they are being hedged using FV hedge accounting or are held for sale) before deducting the allowance for loan and lease losses on Schedule C
- Loans should be reported net of:
  1. Unearned income
  2. Specific reserves
  3. Unamortized loan fees





## Loans

- Loans and leases held for trading purposes are reported as “Trading assets” at **fair value** on Schedule RAL in Line 1.f
- Loans held for sale should be reported **at the lower of cost or fair value** on Schedule C (SR Letter 01-12)

2

## Fees on Loans

- Net unamortized fees on loans are reported in the same manner as unearned income on loans (e.g., deducted)
- Net unamortized direct loan origination costs are added to the related loan balances and reported in each line as appropriate



3

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

- Branches and agencies are not required to hold general reserves at the branch or agency level (SR Letter 95-4)
- Loans are reported on Schedule C (and throughout the report) at their **book value** and may not be reduced by the amount of general reserves

4

## General Reserves

- General reserves may still be maintained by an institution as part of its internal credit policy
  - General allowance for loan losses represents reserves that are maintained against the loan portfolio in order to absorb probable losses

5

## General Reserves

---

### Accounting Entries

**Dr** Provision for Loan Losses  
(Expense)

**Cr** Allowance for Loan Losses  
(Contra-asset)



6

## General Reserves

---

- Report **gross** on **Schedule M, Part I**, Line 2.a, Column B, as “**due to**” and not netted against loans reported on Schedule C
- Also report on the **Schedule M, Part IV**, Line 1

7

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

- 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

8

## Specific Reserves

- A full or partial write-down of a loan through a direct charge off, cannot be reversed at a later date (e.g., the cost basis cannot be "written-up")

9

## Specific Reserves

### Accounting Entries

**Dr** Provision for Loan Losses  
(Expense)

**Cr** Specific Reserve for Loan Losses  
(Contra-asset)



10

## Specific Reserves

- The provision for specific loan loss reserve is reported on the FFIEC 002 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 identified losses on Schedule C (and throughout the report)

11

## General vs Specific Reserves

### Accounting Entries

#### General Reserves

**Dr** Provision for Loan Losses (*M, Part I, Line 2.a, Col A*)  
     **Cr** Allowance for Loan Losses  
           (*M, Part I, 2.a, Col B; M, Part IV, Line 1*)

---

#### Specific Reserves

**Dr** Provision for Loan Losses (*M, Part I, Line 2.a, Col A*)  
     **Cr** Specific Reserves for Loan Losses  
           (*Deducted from a specific loan on Schedule C*)

12

### Charge-Off of a Loan for Which a General Reserve was Established

#### “Allowance Method”

#### ■ When a Loan is Deemed Uncollectible

##### 1. Reduce the amount of loan

**Dr** Allowance for Loan Losses (Contra-asset)  
     **Cr** Loan (Asset)

---

##### 2. Record uncollectible amount

**Dr** Uncollectible Accounts (Expense)  
     **Cr** Provision for Loan Losses  
           (Expense)

13

	<p><b>Recovery of a Loan for Which a General Reserve was Established</b></p> <hr/> <p><b>“Allowance Method”</b></p> <p>■ <b>When a Loan Previously Charged-off is Collected</b> (e.g., partially or fully)</p> <p>1. <u>Record the Recovery</u></p> <p><b>Dr</b> Cash (Amount recovered)  <b>Cr</b> Uncollectible Accounts (Expense)</p> <hr style="width: 20%; margin-left: auto; margin-right: auto;"/> <p>2. <u>Reverse the Allowance</u></p> <p><b>Dr</b> Provision for Loan Losses (To replenish reserve)  <b>Cr</b> Allowance for Loan Losses  (To replenish allowance)</p>
	14

	<p><b>Direct Charge-Off Method</b></p> <hr/> <p>■ If a depository institution identifies a loss amount for a particular loan and wishes to <u>charge the loan off directly</u> in lieu of a specific reserve it may do so via the following entry:</p> <p style="padding-left: 40px;">Dr Expense  Cr Loan</p> <p>■ The loss is <u>charged against income</u> (reduction to unremitted profit) on Schedule M, Part I, Line 2.a. The individual loan balance is reduced by the amount of the charge-off on Schedule C.</p>
	15

## Recovery

### “Direct Charge-Off Method”

- A recovery for a loan that was **charged-off directly** should be accounted for as follows:

Dr Cash (Amount recovered)

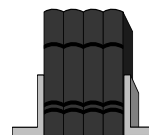
Cr Expense (Amount recovered)

- The recovered amount is reflected in the cash account and the expense incurred by the direct write-off is reversed

16

## Allowances 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



17



## Allowances for Credit Losses

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

18

## Allowance for Credit Losses

- Allowance for credit losses is created 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.

19

## Key Points

---

- ✍ Loans should be reported at:
  - Amortized cost, except under FV hedge accounting or if held-for-sale
  - Net of specific reserves
  - Gross of general allowance
  - Net of unearned income
  - Net of unamortized loan fees
- ✍ Yield-adjustment fees vs loan servicing fees

20

## Key Points

---

- ✍ Loans held for sale
- ✍ Specific reserves
- ✍ “Allowance” vs direct “charge-off” method
- ✍ Allowance for off-balance sheet items

21

# Lunch Break!



## The Capital and Asset Report for Foreign Banking Organizations (FR Y-7Q)

Rich Molloy

<b>The Capital and Asset Report for Foreign Banking Organizations (FR Y-7Q)</b>	
	<ul style="list-style-type: none"><li>■ Who is required to file?<ul style="list-style-type: none"><li>– FBOs that have not elected to become FHCs report capital information for the top-tier FBO on the Part 1 of the FR Y-7Q <i>annually</i>.</li><li>– FBOs that have been granted FHC status will report <i>quarterly</i> and will complete Part 1 for the top-tier FBO and Part 2 for lower-tier FBOs operating a branch, agency, Edge, Agreement Corp. or commercial lending company in the U.S.</li></ul></li></ul>

<b>The Capital and Asset Report for Foreign Banking Organizations (FR Y-7Q)</b>	
	<ul style="list-style-type: none"><li>■ What data are collected?<ul style="list-style-type: none"><li>– Tier 1 capital</li><li>– Total risk based capital</li><li>– Risk weighted assets</li><li>– Total assets at end of period</li></ul></li></ul>

	<b>The Capital and Asset Report for Foreign Banking Organizations (FR Y-7Q)</b>
--	---

---

- What date should the data be based on?
  - Preferably the calendar year ending 12/31  
(and calendar quarters ending March 31,  
June 30, September 30 for quarterly filers).

	<b>The Capital and Asset Report for Foreign Banking Organizations (FR Y-7Q)</b>
--	---

---

- What date should the data be based on?
  - Annual filers can base their data on the  
most recent fiscal year end. The fiscal  
year end should be reported in Item 6.  
If an entity's FYE is 3/31, the report for  
12/31/2006 would have 03 31 2005 in  
item 6.

<b>The Capital and Asset Report for Foreign Banking Organizations (FR Y-7Q)</b>	
	<ul style="list-style-type: none"> <li>■ Quarterly filers can report based on different periods if its fiscal year is not 12/31. Report the quarter the data is based on in Part 1 item 6 and Part 2 item 6.</li> <li>■ NOTE: The reports must be submitted for each quarter ending March 31, June 30, September 30, and December 31st.</li> <li>■ For example, if the entities 2<sup>nd</sup> quarter fiscal end is 4/30, the 6/30/2006 filing would have 04 30 2006 in item 6.</li> </ul>

<b>Due Dates - FR Y-7Q (2006 – 2007)</b>	
<b><u>Report Date</u></b>	<b><u>Due to FRB**</u></b>
<ul style="list-style-type: none"> <li>■ September 30, 2006</li> <li>■ December 31, 2006</li> <li>■ March 31, 2007</li> <li>■ June 30, 2007</li> <li>■ September 30, 2007</li> <li>■ December 31, 2007</li> </ul>	<ul style="list-style-type: none"> <li>■ December 29, 2006</li> <li>■ April 2, 2007</li> <li>■ June 29, 2007</li> <li>■ September 28, 2007</li> <li>■ December 31, 2007</li> <li>■ March 31, 2008</li> </ul>
<p>**Reports are due to the FRB 90 days after the report date (if this date falls on a weekend it is moved to the next business day).</p>	

	<b>Financial Statements of U.S. Nonbank Subsidiaries Held by Foreign Banking Organizations (FR Y-7N/NS)</b>

	<b>Quarterly Reporting - FR Y-7N</b>
	<ul style="list-style-type: none"><li>■ Who is required to file? Quarterly Reporting: Each top-tier foreign banking organization must file the FR Y-7N report on a <b>quarterly</b> basis for each of its U.S. nonbank subsidiaries that meets <b>any one</b> of the following criteria and are not regulated by a primary U.S. regulator other than the FRB:<ul style="list-style-type: none"><li>(a) total assets equal to or greater than \$1 billion; or</li><li>(b) total off-balance-sheet activities equal to or greater than \$5 billion</li></ul></li></ul>

## Annual Reporting - FR Y-7N/NS

### ■ 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.

## FR Y-7N/NS

### ■ What data are collected?

- Quarterly and Annual Detailed Reports (FR Y-7N)
  - ✦ Balance Sheet and Income Statements
    - Loan Schedule
    - Changes in Equity Capital
    - Changes in ALLL
- Annual Abbreviated Reports (FR Y-7NS)
  - ✦ Net Income
  - ✦ Total Assets
  - ✦ Total Equity Capital
  - ✦ Total Off-Balance-Sheet Items



## FR Y-7N/NS

- Separate report for each legal entity
  - No consolidation
- Reports are consistent with nonbank reports filed by subsidiaries owned by domestic entities.

## Due Dates - FR Y-7N (2006 – 2007)

<u>Report Date</u>	<u>Due to FRB**</u>
■ September 30, 2006	■ November 29, 2006
■ December 31, 2006	■ March 1, 2007
■ March 31, 2007	■ May 30, 2007
■ June 30, 2007	■ August 29, 2007
■ September 30, 2007	■ November 29, 2007
■ December 31, 2007	■ February 29, 2008 <sup>24</sup>

\*\*Reports are due to the FRB 60 days after the report date (if this date falls on a weekend it is moved to the next business day).

## Question Received

- Should the FR Y-7N/NS report be signed by an officer of the entity (subsidiary) or the FBO?

Answer: 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.

## Question Received

- Should a subsidiary chartered by the state and regulated by the State Insurance Commissioner file the FR Y-7N/NS?

Answer: Subsidiaries (Insurance companies) that are functionally regulated by a primary U.S. regulator other than the FRB (i.e., State Insurance Commissioner) are exempt for filing the FR Y-7N/NS.

## Question Received

- If a subsidiary is over the \$1 billion threshold on Dec. 31, but on March 31 the subsidiary was under \$1 billion, would the subsidiary be required to file the FR Y-7N on a quarterly basis in March?

Answer: If a nonbank subsidiary meets the criteria for filing quarterly as of December 31, the subsidiary does not have to continue to file quarterly if it does not meet the criteria in March. However, if the subsidiary meets the criteria in March, but not in June it must continue to file quarterly for the remainder of the calendar year.

## Question Received

- Can nonbank subsidiaries file the FR Y-7N/NS according to the fiscal year end?

Answer: The FR Y-7N/NS must be filed as of the quarter/calendar year end and not the subsidiary's fiscal year end.

## Question Received

---

- We received an extension for filing the FR Y-7 (Annual Report of Foreign Banking Organizations) does this apply to the FR Y-7Q and/or the FR Y-7N/NS?

Answer: Each of these reports are separate data collections. Therefore, extensions granted for the FR Y-7 do not apply to the FR Y-7Q and FR Y-7N/NS

## Questions

---

**Doug Herold (212) 720-8591**

# Reporting Issues

Henry Castillo



## Offsetting

- Regulatory reports generally require reporting on a gross basis
- Financial Interpretation No. 39 (FIN 39)
  - Allows offsetting of certain contracts when a “right of setoff” exists

## **Offsetting**

### FIN 39 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 FIN 39

## Offsetting

### ■ Financial Interpretation No. 41 (FIN 41)

- Allows netting of repurchase and reverse repurchase agreements that meet the legal right of setoff

## Offsetting

### 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**

### 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**

### 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 FIN 41 should also be reflected in reporting of quarterly averages on Schedule K



## Offsetting

### FIN 39 and FIN 41 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 FIN 39 and FIN 41.

## Reporting of

## Repurchase & Reverse Repurchase Agreements



## **Reporting of Repurchase & Reverse Repurchase Agreements**

- FASB Statement No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (FAS 140)

Defines a transfer of an asset as:

- Transferred assets must be isolated from the transferors and creditors even in bankruptcy
- Transferee (purchaser) must be able to repledge or exchange the asset
- Transferor is not obligated to repurchase or redeem the transferred asset

## **Reporting of Repurchase & Reverse Repurchase Agreements**

- If a repurchase agreement does not meet the sale criteria in ¶ 9 of FAS 140, the transaction qualifies as a financing transaction and there is no change in reporting:
  - Repurchase agreements are reported on Schedule RAL, Line 4.b (2)
  - Reverse repurchase agreements are reported on Schedule RAL, Line 1.d (2)

## **Reporting of Repurchase & Reverse Repurchase Agreements**

- The reporting of repurchase agreements and reverse repurchase agreements depends on whether:
  - The transferor has the right and ability to redeem the securities on short notice
  - The transferee has the right to sell or repledge the security

## **Reporting of Repurchase & Reverse Repurchase Agreements**

- If the control of the collateral is transferred in accordance with ¶ 15 of FAS 140:
  - Except as provided in ¶ 15.c, the debtor or transferor of securities shall continue to carry the collateral as its asset; the secured party or transferee shall not recognize the pledged asset

## **Reporting of Repurchase & Reverse Repurchase Agreements**

### Borrower's accounting entries

Dr Cash

Cr Repurchase Agreements



## **Reporting of Repurchase & Reverse Repurchase Agreements**

### Lender's accounting entries

Dr Reverse Repurchase Agreements

Cr Cash



## Repurchase Agreements vs. Fed Funds

- All securities purchased/sold under agreement to repurchase/resell, that mature overnight or have longer term maturity, should be reported separately rather than included with Fed Funds purchased/sold.

## Reporting of

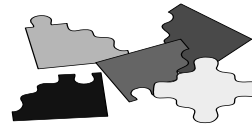
## Equity Investments



## Reporting of Equity Investments

---

- The amount of influence an institution has over the operations of the entity whose stock it owns determines the accounting method to be applied in reporting the investment



## Reporting of Equity Investments

---

- **Methods of Accounting of Long-Term Investments**
  - Cost Method
  - Equity Method
  - Consolidation Method



	<b>Reporting of Equity Investments</b>
	<u>Cost Method</u> <ul style="list-style-type: none"><li>■ <u>Equity Investments that Represent less than 20% Ownership in a Company</u><ul style="list-style-type: none"><li>– Subject to FAS 115</li><li>– If Available-for-sale, report at fair value on Schedule RAL, Line 1.c</li><li>– If Trading, report at fair value on Schedule RAL, Line 1.f</li></ul></li></ul>



	<b>Reporting of Equity Investments</b>
	<u>Equity Method</u> <ul style="list-style-type: none"><li>■ <u>Equity Investments that Represent 20 - 50% Ownership in a Company</u><ul style="list-style-type: none"><li>– Not subject to FAS 115</li></ul></li></ul>

## Reporting of Equity Investments

### Equity Method

- The carrying value of the bank's investment in a company is originally recorded at cost but is adjusted periodically
  - To record share of institution's earnings or losses in income
  - To record any cash dividends received

## Reporting of Equity Investments

### Equity Method

#### *Original Entry*

Dr Investment in ABC Sub (Other assets)

Cr Cash





## Reporting of Equity Investments

### Equity Method

*To Record Net Income Received from Sub*

Dr Investment in ABC Sub (Other Assets)  
Cr Income

---

*To record Receipt of Dividends*

Dr Cash  
Cr Investment in ABC Sub

## Reporting of Equity Investments

### Consolidation Method

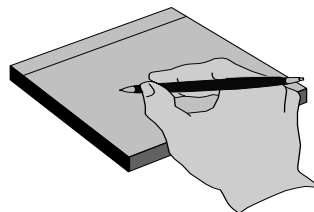
- Equity securities that represent more than 50% ownership in a company
  - Not subject to FAS 115
  - Consolidated on a line-by-line basis
    - >> Must consolidate the entire entity rather than only the percentage owned

## Summary Chart

Level of Control	Indication	Recording Investment at Purchase	Method of Recording Subsequent to Purchase	FAS 115
Investor can exert absolute control over the activities of the entity	<b>Over 50%</b> ownership	Recorded at Original Cost	<b>Consolidation</b>	Does not Apply
Investor can exercise significant influence but not absolute control, in general	<b>20% - 50%</b> ownership	Recorded at Original Cost	<b>Equity Method</b>	Does Not Apply
Investor cannot exercise control or significant influence	<b>Less than 20%</b> ownership	Recorded at Fair Value	<b>Cost Method</b>	Applies

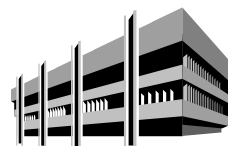
## Reporting of

## Other Assets and Other Liabilities



## Reporting of Other Assets

- All fixed assets should be reported at book value (i.e., original cost less accumulated depreciation)
- Precious metals inventories



## 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 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.
- Customers' liability for deferred payment letter of credit

## Reporting of Other Assets

- Positive FV of derivative contracts designated as hedges under 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 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 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

## Reporting of Other Liabilities

### Exclude from Other Liabilities

- Example

Bank A borrows gold bullion from a foreign bank. The transaction will be recorded as follows:

Dr            Other Assets  
                 Cr        Other Borrowed Money

- Borrowing of precious metals is reported on Schedule P, "Other Borrowed Money", based on counterparty

## Reporting of Other Liabilities

### Exclude from Other Liabilities

- U.S. income taxes payable
- Due bills - securities sold but not yet delivered to customers (Report on Schedule P, "Other borrowed money")



## 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

## **Website**

The FFIEC 002 form, presentations and transmittal letters are available at:

[http://www.newyorkfed.org/banking/reportingforms/FFIEC\\_002.html](http://www.newyorkfed.org/banking/reportingforms/FFIEC_002.html)



## **Subscription Service**

A subscription service was created to notify of reporting changes and seminar announcements as they are added to the Federal Reserve website.

To subscribe, please register at the link below:

[http://service.govdelivery.com/service/subscribe.html?code=USFRBNEWYORK\\_8](http://service.govdelivery.com/service/subscribe.html?code=USFRBNEWYORK_8)

# Reporting of Securitization and Asset Sale Activities

Rich Molloy



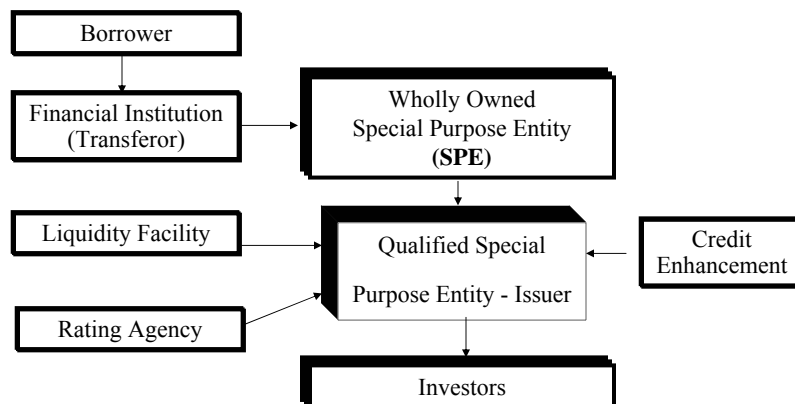
## Objectives

- 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.

## Major Components



## Major Components

### ■ Offered Notes

Senior Notes

Subordinated Notes

Retained Interest

## Key Terms

### ■ Credit Enhancement

- An arrangement where the financial institution retains in form or substance any risk of credit loss, directly or indirectly associated with a transferred asset that exceeds its pro rata claim of the asset.

## Key Terms

### ■ Credit Enhancement

#### – Purpose

- ✦ Protect investors against unwanted risk.

## Key Terms

### ■ Credit Enhancement

#### – Sample Contractual Language

- ✦ The credit enhancement for the benefit of the notes consists of:
- ✦ *Excess Interest*. There is expected to be excess interest because more interest is expected to be paid by the borrowers than is necessary to pay the interest on the notes and the related servicing fee each month. Excess interest may be used to protect the notes against some losses, by making an additional payment of principal up to the amount of the losses.

## Key Terms

### ■ Credit Enhancement

#### – Sample Contractual Language

- ❖ *Overcollateralization.* Although the aggregate principal balance of the home equity loans as of the cut-off date is \$900,000,000, the trust is issuing only \$800,000,000 aggregate principal amount of notes.
- ❖ The excess principal balance of the home equity loans represents overcollateralization, which may absorb some losses on the home equity loans, to the extent such losses are not otherwise covered by excess interest. The targeted overcollateralization amount will initially be set at 11.00% of the aggregate principal balance of the home equity loans as of the cut-off date.

## Key Terms

### ■ Credit Enhancement

#### – Sample Contractual Language

- ❖ The credit enhancement for the benefit of the notes consists of:
- ❖ *Subordination.* Distribution of interest on the Class M Notes is subordinate to distribution of interest on the Class A Notes. Other than amounts distributed in connection with attaining the required overcollateralization amount, distribution of principal on the Class M Notes is subordinate to distribution of principal on the Class A Notes.



## Key Terms

- Credit Enhancement
  - Sample Contractual Language
    - ✦ Common sources of Credit Enhancement
      - Excess Spread Accounts
      - Overcollateralization
      - Subordinated Interest
      - Cash Collateral Accounts
      - Recourse Obligations
      - Derivatives

## 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.
    - ✦ For example: By smoothing timing differences in the receipt of interest and principal payments on securitized assets, or to ensure investors of payments in the event of market disruptions.

## Key Terms

---

- Credit Enhancement vs. Liquidity Facility
  - Advances made under liquidity facilities are NOT subordinated to other claims on the underlying assets.

## Key Terms

---

- Seller's Interest (retained interest)
  - The financial institutions ownership interest in assets that have been securitized.

	<b>Schedule S</b> <b>Securitization and Asset Sale Activities</b>
--	--

	<ul style="list-style-type: none"><li>■ Overview</li></ul>
--	--

- |  |  |
|--|--|
|  | <ul style="list-style-type: none"><li>– Credit exposure and liquidity for assets SOLD and SECURITIZED by the reporting institution.</li><li>– Credit exposure and liquidity to securitization structures sponsored by others.</li><li>– Credit exposure to assets sold by the reporting institution but not securitized.</li></ul> |
|--|--|

	<b>Schedule S</b> <b>Securitization and Asset Sale Activities</b>
--	--

	<ul style="list-style-type: none"><li>■ Assets sold and securitized by reporting institution</li></ul>
--	--

- |  |  |
|--|--|
|  | <ul style="list-style-type: none"><li><ul style="list-style-type: none"><li>– Line items 1. through 7.b.</li></ul></li></ul> |
|--|--|

	<ul style="list-style-type: none"><li>■ Credit Exposure to Securitizations Sponsored by Others</li></ul>
--	--

- |  |   |
|--|---|
|  | <ul style="list-style-type: none"><li><ul style="list-style-type: none"><li>– Credit exposure, Line 9.</li><li>– Unused commitments, Line 10.</li></ul></li></ul> |
|--|---|

**Schedule S**  
**Securitization and Asset Sale Activities**

---

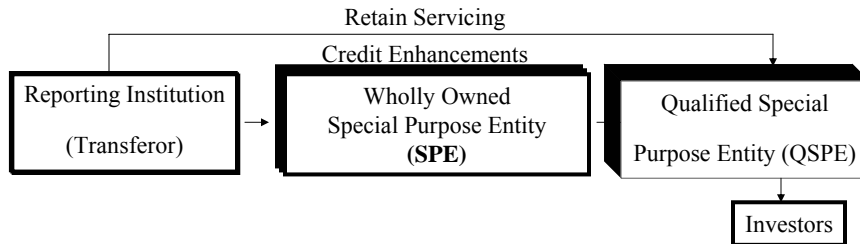
- Assets sold and not securitized by the reporting institution
  - Line 11. and Line 12.

**Schedule S**  
**Securitization and Asset Sale Activities**

---

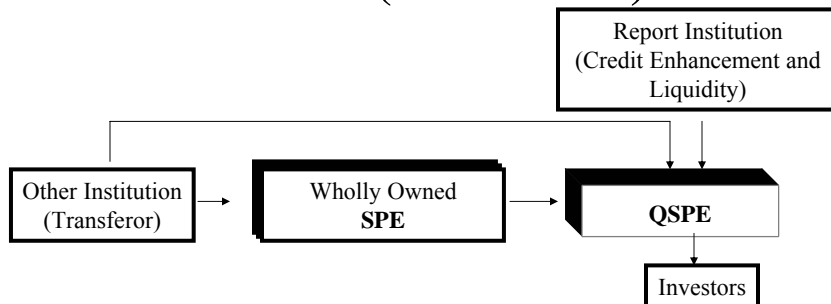
- Data will be collected on the following loans in a column format:
  - Residential Mortgages                      Column A
  - Home Equity Loans                            Column B
  - Credit Card Receivables                      Column C
  - Auto Loans                                      Column D
  - Other Consumer Loans                        Column E
  - Commercial and Industrial Loans            Column F
  - All Other Loans and All Leases              Column G

## Assets Sold and Securitized (Items 1-7)



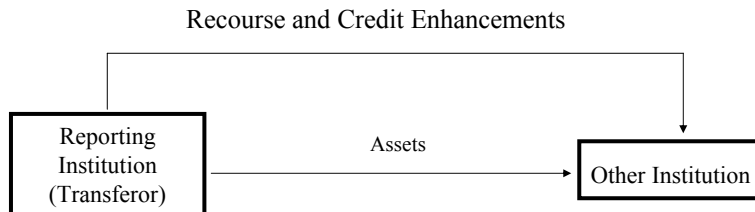
1. Reporting institution transfers assets to a bankruptcy remote entity (Legal Sale)
2. The SPE transfers the Qualified Special Purpose Entity (QSPE) (Accounting Sale)
3. QSPE obtains credit enhancements and issues asset-backed securities to investors
  - If reporting institution retains only servicing, report on Schedule S item 1
  - If reporting institution provides credit enhancements or liquidity to the securitization structure, report on Schedule S item 1 and items 2-7 based on the type of credit enhancement or liquidity provided.

## Credit Enhancement/Liquidity to Others (Items 9-10)



1. Reporting institution provides credit enhancements to QSPE.
  - 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.

## Asset Sales (Items 11-12)



- 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.

## Asset Backed Commercial Paper

- Is an application of the concept of securitization to funding of trade receivables. Several originators wanting liquidity against their trade receivables sell these receivables to a conduit which then issues commercial paper, that is, short term paper of typically 90 days to 180 days maturity corresponding to the present value of such receivables.

Definition from: <http://www.vinodkothari.com/glossary/abcp1.htm>

## **Asset Backed Commercial Paper**

---

- On maturity, the originator is supposed to collect the receivables and pass them over to the holders of the paper through the conduit. At times, the conduit is sponsored by a major bank which also provides liquidity support to the conduit to ensure timely redemption of the paper.

Definition from: <http://www.vinodkothari.com/glossary/abcp1.htm>

## **Asset Backed Commercial Paper**

---

- ABCP Sponsor
  - Initiates the creation of the program
  - ✦ Refers and determines eligibility of assets included in the program.

## **Asset Backed Commercial Paper**

---

- Memoranda - Asset-backed Commercial Paper Conduits

- Memorandum

- ➤ Line Items M 1.a.(1) and M 1.b.(1)

- ➤ Line items M 1.a.(2), M 1.b.(2)

## **Memorandum Item 1**

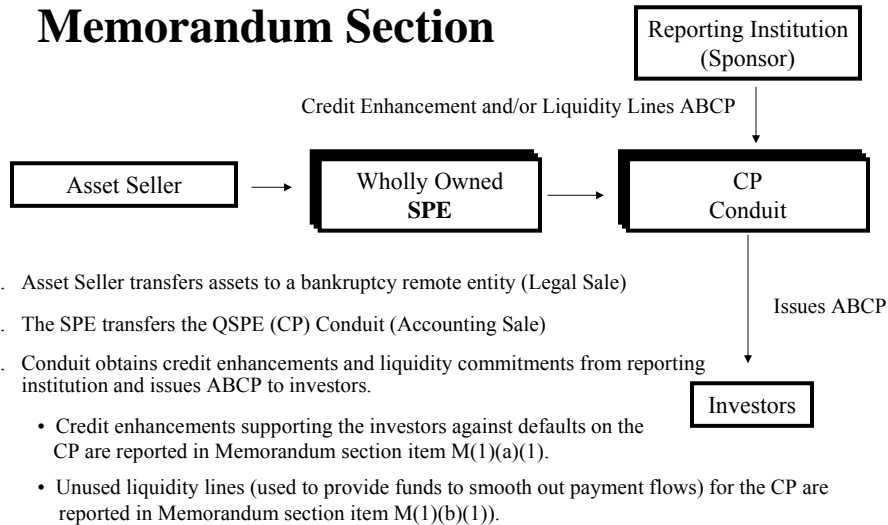
---

### **Asset-backed commercial paper conduits**

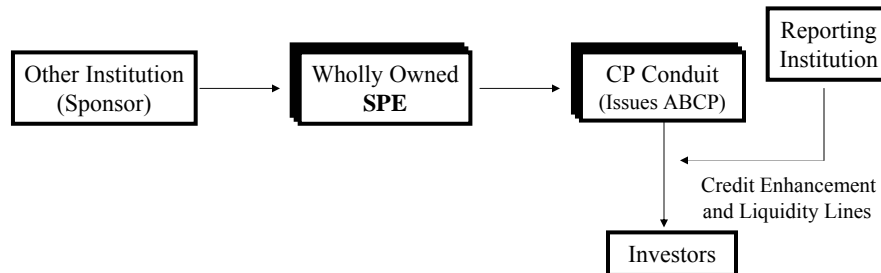
- Maximum amount of credit exposure arising from credit enhancements provided to conduit structures in the forms of standby letters of credit, subordinated securities and other credit enhancements.
- Unused commitments provided to conduit structures
- Report according to entity type sponsoring the conduit



## Commercial Paper Conduits - Memorandum Section



## Commercial Paper Conduits - Memorandum Section



Conduit obtains credit enhancements and/or liquidity commitments from reporting institution and issues asset-backed CP to investors.

- Credit enhancements supporting the investors against defaults on the commercial paper are reported in Memorandum section item M(1)(a)(2).
- Unused liquidity lines (ex. used to provide funds to smooth out payment flows) for the CP are reported in Memorandum section item M(1)(b)(2).

# Income Statement

## Reporting Issues

Vadim TovshTEyn



## Income Statement Issues

- FFIEC 002 Report does not contain income statement
- However, unremitted profits/losses are reported on Schedule M, Part I, Line 2.a
- How to report the income statement and other similar items on the FFIEC 002?

## **Income Statement**

- + Interest income
- Interest expense
- = **Net Interest Income**
- Provision for Loan Losses
- = **Net Interest Income** (net of provision)
- + Non Interest Income (includes net gain/(loss) on FX and trading account)
- Non Interest Expense
- + Extraordinary Items
- = **Net Profit or Loss**

## **Income Statement Issues**

- Valuation Allowance
  - A valuation account is created with the intend of absorbing some element of estimated loss. Such allowance is created by charges to expense account and should be reported as part of an institution’s unremitted profit/(loss) calculation.

## **Income Statement Issues**

- **Provision**

- The provision for both specific and general reserves is an expense and should be reported on Schedule M, Part I, Line 2.a as part of the profit/(loss) calculation

## **Income Statement Issues**

- Net unrealized gains or losses on the available-for-sale securities should be reported as part of unremitted profit (loss) on Schedule M, Part I, Line 2.a
- Foreign Currency translation adjustments should be included as part of calculation of unremitted profit /(loss)

## Income Statement Issues

- Fees earned for fiduciary activities should be included as part of unremitted profits calculation
- U.S. income tax expense and income tax payable should be **excluded** from the FFIEC 002

## Income Statement Issues

- The IBF's net profit or loss
  - Report in Part II, Line 1.b (1)  
(When maintained as a separate account)
  - In addition, consolidate with the bank's profit or loss and report on Schedule M, Part I, Line 2.a

## Income Statement Issues

- The mark-to-market gains and losses from fair value and cash flow hedges should be reported as components of the “Net unremitted profit/(loss),” Schedule M, Part I, Line 2.a

### Example 1 - Problem

- Capital Contribution = **15 mil**
- Net Profit - Branch = **5 mil**
- *Net Loss - IBF* = **(30 mil)**
- What is reported in Line 2. A?

### Example 1 - Solution

- **Line 2. A?**
- Column A - “Due from” = **(10 mil)**
- Column B - “Due to” = **0 mil**

Example 2 - Problem

- Capital Contribution = **5 mil**
- Net Loss - IBF = **(30 mil)**
- Net Profit/(Loss) - Branch = **0**
- *Mark-to-market gains from FV hedges* = **10 mil**
- What is reported in Line 2. A?

Example 2 - Solution

- **Line 2. A?**
- Column A - “Due from” = **(15 mil)**
- Column B - “Due to” = **0**

Example 3 - Problem

- Capital Contribution = **5 mil**
- Net Profit - Branch = **5 mil**
- Net Loss - IBF = **(30 mil)**
- *Net Unrealized Gain on AFS Sec* = **10 mil**
- What is reported in Line 2. A?

Example 3 - Solution

- **Line 2. A?**
- Column A - “Due from” = **(10 mil)**
- Column B - “Due to” = **0 mil**

## Key Points

---

- Net unrealized gains and losses on the available-for-sale securities
- Provision for loan losses
- IBF's net income
- Gains/(losses) from FV and cash flow hedges (Schedule M, Part I, Line 2.a)
- Net income should be reported GROSS of U.S. income taxes on Schedule M

## Schedule T

### Fiduciary and Related Services

---





	<b>Schedule T</b> <b>Fiduciary and Related Services</b>
--	--

	<u>Three sections</u>
--	-----------------------

- |  |  |
|--|--|
|  | <ul style="list-style-type: none"><li>■ Fiduciary Powers (Items 1 - 3)</li><li>■ Fiduciary and Related Assets Held (Items 4 - 10)</li><li>■ Memoranda (Items 1 - 3)<ul style="list-style-type: none"><li>– Managed Assets Held in Personal Trust and Agency Accounts</li><li>– Corporate Trust and Agency Accounts</li><li>– Collective Investment Funds</li></ul></li></ul> |
|--|--|

	<b>Items 1, 2 and 3</b>
--	-------------------------

- |  |  |
|--|--|
|  | <ul style="list-style-type: none"><li>■ Does the institution have trust powers?</li><li>■ Does the institution exercise the fiduciary powers it has been granted?</li><li>■ Does the institution have any fiduciary or related activity to report?</li></ul> |
|--|--|

## 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 Item 1

### Managed assets held in personal trust and agency accounts

- Breakout of Item 4 above according to asset type
- Used to monitor household investments

## **Memoranda Item 2**

### Corporate trust and agency accounts

- Number of issues - Column A
- Principal amount outstanding - Column B
- Corporate and municipal trusteeships
- Transfer agent, registrar, paying agent, and other corporate agency

## **Memoranda Item 3**

### Collective investment funds and common trust funds

- Number of funds - Column A
- Market value of fund assets - Column B
- Breakout according to type of asset

**Thank You!**

