

FFIEC

Federal Financial Institutions Examination Council

Washington, D.C. 20006

CALL REPORT DATE: September 30, 2002

THIRD 2002 CALL, NUMBER 221

SUPPLEMENTAL INSTRUCTIONS

September 2002 Call Report Materials

A sample set of the September 30, 2002, report form applicable to your bank is enclosed. Banks with domestic offices only must file the FFIEC 041 report form. Banks with domestic and foreign offices must file the FFIEC 031 report form.

Please retain the enclosed sample report form for reference. Sample forms also are available on both the FFIEC's Web site (www.ffiec.gov) and the FDIC's Web site (www.fdic.gov). A paper copy of the Call Report forms, including the cover (signature) page, can be printed from the Web sites. In addition, banks that use Call Report software generally can print paper copies of blank forms from their software.

Submission of Completed Reports

All banks must submit their Call Reports electronically to the banking agencies' electronic collection agent, Electronic Data Systems Corporation (EDS), using one of the two methods described in the agencies' cover letter for the September 30, 2002, report date. For assistance in submitting Call Reports to EDS, contact EDS toll free at (800) 255-1571.

Banks are required to maintain in their files a signed and attested record of the completed Call Report that has been submitted to EDS showing at least the title of each Call Report item and the reported amount. Either the cover page of the enclosed sample set of report forms, a photocopy of the cover page, or a copy of the cover page printed from Call Report software or from the FFIEC's or the FDIC's Web site should be used to fulfill the signature and attestation requirement. The signed cover page should be attached to the Call Report that is placed in the bank's files.

Currently, Call Report preparation software products marketed by DBI Financial Systems, Inc.; Financial Architects US; FRS, an S1 Corporation Business; IDOM, Inc., Information Technology, Inc.; The InterCept Group; Jack Henry & Associates, Inc. (Banker-II Data Center); Milas LLC; and Sheshunoff Information Services have been certified for electronic submission by EDS. The addresses and telephone numbers of the vendors with EDS-certified Call Report software are listed at the end of these Supplemental Instructions.

Amending Previously Submitted Reports

Should your bank find that it needs to revise certain Call Report information in a previously submitted report, an amended Call Report data file may be electronically submitted to EDS. Otherwise, contact your Call Report analyst at the FDIC (for national and FDIC-supervised banks) or at your Federal Reserve District Bank (for state member banks) and arrange to provide the amended data by telephone, fax, or electronic mail.

FFIEC Instruction Books

The most recent update to your Call Report instruction book was distributed with the June 2002 Call Report materials. Copies of the Call Report instructions may be obtained from the FDIC's Reports Analysis and Quality Control Section (telephone toll free at 800-688-FDIC) or from your Federal Reserve District Bank. The Call Report instructions are also available on both the FFIEC's and the FDIC's Web sites.

Reporting Estimated Uninsured Deposits

Beginning with the March 2002 Call Report, all banks were required to report the estimated amount of their uninsured deposits in Schedule RC-O, Memorandum item 2. Banks should note that they are not expected to modify their information systems or acquire new systems solely for purposes of making this estimate. Rather, to limit reporting burden, the instructions for Memorandum item 2 indicate that a bank should base its estimate of the uninsured portion of its deposits on data that are readily available from the information systems and other records the bank has in place, particularly for fiduciary deposit accounts and employee benefit and deferred compensation plan accounts with balances of \$100,000 or more that are insured on a "pass-through" basis. Furthermore, a bank with brokered deposits must use the information it develops for reporting its "Fully insured brokered deposits" in Schedule RC-E, Memorandum item 1.c, to determine its best estimate of the uninsured portion of its brokered deposits. A bank must also include the entire amount of any benefit-responsive "Depository Institution Investment Contracts," which must be reported in Schedule RC-O, item 10, in its estimated uninsured deposits.

For those segments of a bank's deposits for which the data needed to estimate the uninsured deposits within the segment are not readily available from in-place information systems, the bank may use nonautomated information such as paper files or less formal knowledge of its depositors if such information provides reasonable estimates of the uninsured portions of these deposits. For any remaining segments of its deposits, the bank would need to consider the number and amount of deposit accounts in these segments that have balances of more than \$100,000 in order to estimate the uninsured portion of these deposits. However, as indicated above, this latter approach may not be used for brokered deposits and "Depository Institution Investment Contracts."

Loan Commitments That Must Be Accounted for as Derivatives

FASB Statement No. 133 Implementation Issue No. C13 describes the circumstances in which a loan commitment must be accounted for as derivative. According to Issue No. C13, 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, *Accounting for Derivative Instruments and Hedging Activities*. 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 bank 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.

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 not be reported as unused commitments in item 1 of Schedule RC-L, Derivative and Off-Balance Sheet Items. Instead, mortgage loan commitments that are derivatives must be reported on the balance sheet (Schedule RC) at fair value. In addition, the par value of the mortgage loans to be acquired under these commitments must be reported in Schedule RC-L, item 12.d.(1), column A, and in Schedule RC-L, item 14, column A. Banks with foreign offices or with \$100 million or more in total assets must also report the fair value of these mortgage loan commitments in the appropriate subitem of Schedule RC-L, item 15.b. As written options, mortgage loan commitments that are derivatives are not covered by the agencies' risk-based capital standards.

The unused portion of loan commitments that are not considered derivatives should continue to be reported in Schedule RC-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 RC-R, item 53.

Embedded Derivatives

As discussed in the Glossary entry for "Derivative Contracts" in the Call Report instructions (pages A-27 and A-28), FASB Statement No. 133 requires an embedded derivative instrument to be separated from the host contract in which it is embedded and accounted for as a derivative contract at fair value if

certain conditions are met. In this situation, the carrying value of the host contract and the fair value of the embedded derivative on the report date may be combined and presented together on the balance sheet in the asset or liability category appropriate to the host contract. Regardless of whether an embedded derivative that must be accounted for as a derivative is combined with its host contract or reported separately for balance sheet presentation purposes, the notional amounts of these embedded derivatives must be reported by risk exposure in Schedule RC-L, first by type of contract in item 12, and then as contracts held for purposes other than trading in item 14. The fair values of these embedded derivatives, both positive and negative, must be reported by risk exposure in Schedule RC-L, item 15.b, by banks with foreign offices or with \$100 million or more in total assets.

In addition, when an embedded derivative must be separated from its host contract and accounted for as a derivative under Statement No. 133, the embedded derivative and the host contract must be treated separately for risk-based capital purposes. Please refer to the instructions for Schedule RC-R, Memorandum item 1, for information on the types of derivatives, including embedded derivatives, that are not covered by the risk-based capital standards.

Equity-Indexed Certificates of Deposit

Under FASB Statement No. 133, a certificate of deposit (CD) that pays "interest" based on changes in an equity securities index is a hybrid instrument with an embedded derivative that must be accounted for separately from the host contract, i.e., the CD. One such equity-indexed CD is a trademarked product called the "Index Powered CD," which is sponsored by the Federal Home Loan Banks for issuance by their member depository institutions.

At the maturity date of a typical equity-indexed CD, the holder of the CD receives the original amount invested in the CD plus some or all of the appreciation, if any, in an index of stock prices over the term of the CD. Thus, the equity-indexed CD contains an embedded equity call option. To manage the market risk of its equity-indexed CDs, a bank that issues these CDs normally enters into one or more separate freestanding equity derivative contracts with an overall term that matches the term of the CDs. At maturity, these separate derivatives are expected to provide the bank with a cash payment in an amount equal to the amount of appreciation, if any, in the same stock price index that is embedded in the CDs, thereby providing the bank with the funds to pay the "interest" on the equity-indexed CDs. During the term of the separate freestanding equity derivative contracts, the bank will periodically make either fixed or variable payments to the counterparty on these contracts.

When a bank issues an equity-indexed CD, it must account for the written equity call option embedded in the CD separately from the CD host contract. The fair value of this embedded derivative on the date the CD is issued must be deducted from the amount the purchaser invested in the CD, creating a discount on the CD that must be amortized to interest expense over the term of the CD using the effective interest method. This interest expense should be reported in the income statement in the appropriate subitem of Schedule RI, item 2.a, "Interest on deposits." The equity call option must be "marked to market" at least quarterly with any changes in the fair value of the option recognized in earnings. On the balance sheet, the carrying value of the CD host contract and the fair value of the embedded equity derivative may be combined and reported together as deposit liabilities on the balance sheet (Schedule RC) and in the deposit schedule (Schedule RC-E). As for the separate freestanding derivative contracts the bank enters into to manage its market risk, these derivatives must be carried on the balance sheet as assets or liabilities at fair value and "marked to market" at least quarterly with changes in their fair value recognized in earnings. The periodic payments to the counterparty on these freestanding derivatives must be accrued with the expense reported in earnings along with the change in the derivative's fair value. In the Call Report income statement (Schedule RI), the changes in the fair value of the embedded and freestanding derivatives, including the effect of the accruals for the payments to the counterparty on the freestanding derivatives, should be netted and reported consistently in either "Other noninterest income" (item 5.l) or "Other noninterest expense" (item 7.d).

The notional amounts of the embedded and freestanding equity derivatives must be reported in column C of Schedule RC-L, items 12.d.(1) and 12.e, respectively. The notional amounts of both derivatives must also be included in Schedule RC-L, item 14, column C. For banks with foreign offices or with more

than \$100 million in assets, the fair values of these two derivative contracts must be included in the appropriate subitems of Schedule RC-L, item 15.b, column C. The equity derivative embedded in the indexed CD is a written option, which is not covered by the agencies' risk-based capital standards. However, the freestanding equity derivative is covered by these standards.

A bank that purchases an equity-indexed CD for investment purposes must account for the embedded purchased equity call option separately from the CD host contract. The fair value of this embedded derivative on the date of purchase must be deducted from the purchase price of the CD, creating a discount on the CD that must be accreted into income over the term of the CD using the effective interest method. This accretion should be reported in the Call Report income statement in Schedule RI, item 1.c. The embedded equity derivative must be "marked to market" at least quarterly with any changes in its fair value recognized in earnings. These fair value changes should be reported consistently in either "Other noninterest income" (item 5.l) or "Other noninterest expense" (item 7.d). The carrying value of the CD host contract and the fair value of the embedded equity derivative may be combined and reported together as interest-bearing balances due from other depository institutions on the balance sheet in Schedule RC, item 1.b. The notional amount of the embedded derivative must be reported in Schedule RC-L, item 12.d.(2), column C, and item 14, column C, and, if appropriate, its fair value (which will always be positive or zero, but not negative) must be reported in Schedule RC-L, item 15.b.(1), column C. The embedded equity derivative in the indexed CD is a purchased option, which is subject to the agencies' risk-based capital standards.

Final Rule on Recourse and Direct Credit Substitutes

On November 29, 2001, the agencies published a final rule revising the regulatory capital treatment of recourse arrangements and direct credit substitutes, including residual interests and credit-enhancing interest-only strips, as well as asset-backed and mortgage-backed securities. This final rule took effect on January 1, 2002. Any transactions settled on or after that date are subject to the rule. However, for transactions settled before January 1, 2002, that result in increased capital requirements under the final rule, banks may delay the application of the final rule to those transactions until December 31, 2002.

Revised instructions for Schedule RC-R, Regulatory Capital, and a revised Glossary entry for "Sales of Assets for Risk-Based Capital Purposes," which incorporate the provisions of this final rule, were included in the March and June 2002 instruction book updates. For transactions settled before January 1, 2002, that would be subject to higher capital requirements under the final rule, each bank should decide whether to apply the revised instructions or the previous reporting requirements to these transactions during the transition period that runs until December 31, 2002.

For further information, please refer to the revised instructions and to the agencies' final capital rule.

Reporting of Funds Invested Through Bentley Financial Services, Inc.

On October 30, 2001, the agencies issued a joint release advising depository institutions that the Securities and Exchange Commission (SEC) had filed suit against Robert L. Bentley, Entrust Group, and Bentley Financial Services, Inc. Specifically, the SEC alleged that the defendants were representing to investors that they were selling federally-insured certificates of deposit when, in fact, they were selling uninsured securities issued by the defendants. In addition, a temporary restraining order was issued against the defendants, freezing the defendants' accounts and appointing a receiver to exercise control over the defendants' assets.

In light of these events and other developments, banks that have invested funds through Bentley Financial Services should report these funds as "Other" assets in Schedule RC-F, item 5, *not* as "Interest-bearing balances" due from depository institutions in Schedule RC, item 1.b. In addition, these Bentley-related assets should be placed in nonaccrual status and reported as nonaccrual assets in Schedule RC-N, item 9, column C. Previously accrued but uncollected interest on these assets should be reversed through a charge to interest income (for any amounts accrued in 2002) and a charge to other noninterest expense (for amounts accrued prior to 2002) in Schedule RI, Income Statement. Any

write-downs of Bentley-related assets and charges to establish valuation allowances against these assets should be reported as other noninterest expense. In addition, these assets should be risk-weighted at 100 percent in item 42, column F, in Schedule RC-R, Regulatory Capital.

FASB Statements Nos. 141 and 142

In July 2001, the FASB issued Statement No. 141, *Business Combinations*, and Statement No. 142, *Goodwill and Other Intangible Assets*. Statement No. 141 supersedes the previous accounting standard on business combinations (i.e., mergers and acquisitions), Accounting Principles Board (APB) Opinion No. 16, and requires that all business combinations initiated after June 30, 2001, (except for combinations between two or more mutual enterprises) must be accounted for by the purchase method. The use of the pooling-of-interests method for those business combinations is prohibited. Statement No. 141 also changes the requirements for recognizing intangible assets as assets apart from goodwill in business combinations accounted for by the purchase method for which the date of acquisition is July 1, 2001, or later. The statement specifically identifies core deposit intangibles as one type of intangible that must be recognized as an asset separate from goodwill.

Statement No. 142 supersedes the previous accounting standard on intangible assets, APB Opinion No. 17. This new standard addresses how intangible assets that are acquired individually or with a group of other assets (but not in a business combination) should be accounted for upon their acquisition. It also explains how goodwill and other intangible assets should be accounted for after they have been acquired.

Under Statement No. 142, goodwill acquired in a business combination for which the acquisition date is after June 30, 2001, should not be amortized, but should be tested for impairment in accordance with the provisions of this accounting standard. Goodwill acquired in a business combination for which the acquisition date is before July 1, 2001, should continue to be amortized until an institution first applies all of the provisions of Statement No. 142 in accordance with the effective date of the standard. Statement No. 142 is effective for fiscal years beginning after December 15, 2001. For banks with a calendar year fiscal year, Statement No. 142 took effect January 1, 2002.

Banks must adopt FASB Statements No. 141 and 142 for Call Report purposes in accordance with the effective dates of these standards based on their fiscal years. The Call Report instruction book update distributed with the March 2002 Call Report materials included revised instructions that incorporated relevant provisions of these new standards. For a bank that is a subsidiary of a holding company or other company, this includes applying the provisions of Statement No. 142 on goodwill impairment testing by a subsidiary. These provisions require all goodwill recognized by such a bank on its Call Report balance sheet to be accounted for in accordance with Statement No. 142 and to be tested for impairment at the bank level.

Banks should also note that any unidentifiable intangible assets recorded in accordance with FASB Statement No. 72 should not be reported as "Goodwill" on the Call Report balance sheet (Schedule RC). Rather, these unidentifiable intangible assets should be reported in Schedule RC, item 10.b, "Other intangible assets," and must continue to be amortized. The amortization expense should be reported in item 7.c.(2) of the Call Report income statement (Schedule RI).

Upon the adoption of Statement No. 142, banks should report any impairment losses on goodwill and other intangible assets that must be recognized as a result of the standard's required transitional impairment testing as the effect of a change in accounting principle. The effect of the accounting change and related income tax effects should be reported in the Call Report income statement, Schedule RI, item 11, "Extraordinary items and other adjustments, net of income taxes," and disclosed in Schedule RI-E, item 3.

Although the accounting rules for goodwill and other intangible assets have changed, there has been no change in the regulatory capital treatment of these assets. The existing regulatory capital limits on servicing assets and purchased credit card relationships remain in effect, and goodwill and other intangible assets continue to be deducted from capital and assets in determining a bank's capital ratios.

Questions about the application of Statement Nos. 141 and 142 for Call Report purposes should be directed to your primary federal regulator. Banks also are encouraged to consult with their outside accountants concerning their implementation of these two new accounting standards.

Optional Tax Worksheet

For assistance in calculating year-to-date applicable income taxes in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, an **optional** worksheet geared toward smaller banks is available upon request. For a copy of this worksheet, state member banks should contact their Federal Reserve District Bank. National and FDIC-supervised banks should telephone the FDIC's Reports Analysis and Quality Control Section in Washington, D.C., toll free at (800) 688-FDIC or call (202) 898-6607. The optional tax worksheet for September 30, 2002, also is expected to be available on the FDIC's Web site by that date.

Call Report Software Vendors

For information on available Call Report software, banks should contact:

DBI Financial Systems, Inc.
P.O. Box 90360
Santa Barbara, California 93190
Telephone: (800) 774-3279
www.e-dbi.com

Financial Architects US
80 Slocum Avenue
Bronxville, New York 10708
Telephone: (914) 376-5405
www.finarch.com

FRS, an S1 Corporation Business
2815 Coliseum Centre Drive,
Suite 300
Charlotte, North Carolina 28217
Telephone: (704) 423-0394
frs.s1.com

IDOM, Inc.
One Gateway Center, Third Floor
Newark, New Jersey 07102
Telephone: (973) 648-0900
www.idomusa.com

Information Technology, Inc.
1345 Old Cheney Road
Lincoln, Nebraska 68512
Telephone: (402) 423-2682
www.itiwnet.com

The InterCept Group
27200 Agoura Road, Suite 100
Calabasas Hills, California 91301
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2405 Schneider Avenue, Suite A
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