SUPPLEMENTAL INSTRUCTIONS

March 2003 Call Report Materials

A sample set of the March 31, 2003, 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 March 31, 2003, 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

Enclosed with this quarter’s Call Report materials is an update to your Call Report instruction book. Please follow the filing instructions on the inside of the cover page of the update package.

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.
FASB Interpretation No. 45

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

- financial standby letters of credit, which are irrevocable undertakings, typically by a financial institution, to guarantee payment of a specified financial obligation, and
- performance standby letters of credit, which are irrevocable undertakings by a guarantor to make payments in the event a specified third party fails to perform under a nonfinancial contractual obligation.

Commercial letters of credit and other loan commitments, as well as subordinated interests in securitizations, are not considered guarantees under Interpretation No. 45 and, therefore, are not subject to the interpretation. Banks should refer to Interpretation No. 45 for further information on the types of guarantee contracts to which the interpretation’s initial recognition and measurement provisions do and do not apply.

For financial and performance standby letters of credit and other types of guarantees subject to the interpretation, when a bank issues the guarantee, it must recognize on its balance sheet a liability for that guarantee. In general, the initial measurement of the liability is the fair value of the guarantee at its inception. When a bank issues a guarantee in a standalone arm’s length transaction with a party outside the consolidated bank, which would typically be the case for a standby letter of credit, the liability recognized at the inception of the guarantee should be the premium or fee received or receivable by the guarantor. However, if the bank issues a guarantee for no consideration on a standalone basis, the liability recognized at inception should be an estimate of the guarantee’s fair value. In the unusual circumstance where, at the inception of a guarantee, it is probable that a loss has been incurred and its amount can be reasonably estimated, the liability to be initially recognized for that guarantee should be the greater of the premium or fee received or receivable by the guarantor or the estimated loss from the loss contingency that must be accrued under FASB Statement No. 5, *Accounting for Contingencies*.

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

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

For Call Report purposes, banks should apply the initial recognition and measurement provisions of Interpretation No. 45 on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the bank’s fiscal year-end. A bank’s previous accounting for guarantees issued prior to January 1, 2003, should not be revised.

FASB Interpretation No. 46

The FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*, in January 2003. This interpretation explains how to identify a “variable interest entity” (previously referred to as a “special purpose entity”) and how an institution should assess its interests in a variable interest entity to decide whether to
consolidate that entity. Variable interest entities often are created for a single specified purpose, for example, to facilitate securitization, leasing, hedging, research and development, and reinsurance. Most small banks are unlikely to have any “variable interests” in variable interest entities.

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

For Call Report purposes, banks with variable interests in variable interest entities created after January 31, 2003, must apply the provisions of Interpretation No. 46 to those entities immediately. A bank that is a public company, or a subsidiary of a public company, and has a variable interest in a variable interest entity created before February 1, 2003, must apply the provisions of Interpretation No. 46 to that entity no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003. A bank that is neither a public company nor a subsidiary of a public company, but has a variable interest in a variable interest entity created before February 15, 2003, must apply the provisions of Interpretation No. 46 to that entity no later than the end of the first annual reporting period beginning after June 15, 2003.

**Allocated Transfer Risk Reserves**

For banks that have allocated transfer risk reserves (ATRRs) related to loans and leases held for investment, the way in which the ATRR and related provisions should be reported on the Call Report balance sheet and income statement has changed this quarter. Any ATRRs related to loans and leases held for investment should be included on the balance sheet in Schedule RC, item 4.c, “Allowance for loan and lease losses.” This means that these ATRRs should no longer be deducted directly from the individual loans to which they relate in the Call Report loan schedule (Schedule RC-C, part I). The amount of any ATRRs related to loans and leases held for investment should be disclosed in new Memorandum item 1 of Schedule RI-B, part II. In addition, provisions for allocated transfer risk related to loans and leases should be included in Schedule RI, item 4, “Provision for loan and lease losses.” Any ATRRs for assets other than loans and leases held for investment should continue to be deducted directly from the individual assets for Call Report balance sheet purposes.

ATRRs are not eligible for inclusion in either Tier 1 or Tier 2 capital. Therefore, because the allowance for loan and lease losses will include any ATRRs related to loans and leases held for investment, banks should ensure that they deduct these ATRRs from the amount of the loan loss allowance reported on the Call Report balance sheet when determining the “Allowance for loan and lease losses includible in Tier 2 capital” and the “Excess allowance for loan and lease losses” to be reported in Schedule RC-R, items 14 and 60, respectively. The entire amount of a bank’s ATRR should be reported in Schedule RC-R, item 61.

**Loan Commitments That Must Be Accounted for as Derivatives**

Until an amendment to FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, is issued and takes effect, Statement No. 133 Implementation Issue No. C13 provides guidance on 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. 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 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 outside the scope of the credit conversion process that applies to derivatives under the agencies' risk-based capital standards. However, if the fair value of these mortgage loan commitments is positive and therefore reported as an asset, this positive fair value is subject to the risk-based capital standards and must be risk weighted as an on-balance sheet asset.

The unused portion of loan commitments that are not 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.

**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 fair value of the freestanding derivatives should not be netted against the fair value of the embedded equity derivatives for Call Report balance sheet purposes because these two derivatives have different counterparties. 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. 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 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.

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*. In October 2002, the FASB issued a related accounting standard, Statement No. 147, *Acquisitions of Certain Financial Institutions*, which is discussed in the following section. Banks must follow each of these three accounting standards for Call Report purposes.

Statement No. 141 requires all business combinations (i.e., mergers and acquisitions), except for combinations between two or more mutual enterprises, to be accounted for by the purchase method. The use of the pooling-of-interests method 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. 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 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. In this regard, under Statement No. 142, goodwill should not be amortized, but should be tested for impairment in accordance with the provisions of this accounting standard.

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.

FASB Statement No. 147

FASB Statement No. 147 clarifies that acquisitions of financial institutions (except transactions between two or more mutual enterprises), including branch acquisitions that meet the definition of a business combination, should be accounted for by the purchase method under FASB Statement No. 141. Statement No. 147 also clarifies that branch acquisitions that do not meet the definition of a business combination because the transferred net assets and activities do not constitute a business represent acquisitions of net assets and do not give rise to goodwill. An institution should refer to FASB Emerging Issues Task Force Issue No. 98-3, “Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business,” for guidance in determining whether a branch acquisition meets the definition of a business combination. An institution should consider all facts and circumstances when evaluating whether the
transferred net assets and activities in a particular branch acquisition constitute a business under Issue No. 98-3. Statement No. 147 took effect October 1, 2002.

Banks must adopt FASB Statement No. 147 for Call Report purposes. This accounting standard includes transition provisions that apply to unidentifiable intangible assets previously accounted for in accordance with FASB Statement No. 72. If the transaction (such as a branch acquisition) in which an unidentifiable intangible asset arose does not meet the definition of a business combination, this intangible asset should not be reported as "Goodwill" on the Call Report balance sheet (Schedule RC). Rather, this unidentifiable intangible asset 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).

In contrast, if the transaction (such as a branch acquisition) that gave rise to an unidentifiable intangible asset under FASB Statement No. 72 meets the definition of a business combination, this asset should be reclassified to goodwill for balance sheet purposes and should no longer be amortized. This reclassified goodwill should be recorded on the balance sheet at its carrying amount as of the date FASB Statement No. 142 was initially applied in its entirety (January 1, 2002, for most banks) or the date of acquisition of this intangible asset, whichever is later (subject to the results of the transitional impairment testing provisions of Statement No. 147).

Questions about the application of Statement No. 147 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 this new accounting standard.

**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 "All 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. 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.
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
Telephone: (800) 825-3772
www.intercept.net

Jack Henry & Associates, Inc.
Banker-II Data Center
2405 Schneider Avenue, Suite A
Menomonie, Wisconsin 54751
Telephone: (715) 235-8420

Milas LLC
1317 26th Street, Suite 1
Santa Monica, California 90404
Telephone: (888) 862-7610
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Sheshunoff Information Services
P.O. Box 13203 Capitol Station
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