Supporting Statement for
the Reports of Condition and Income
(FFIEC 031 and 041; OMB No. 7100-0036)

Summary

The Board of Governors of the Federal Reserve System (Board) requests approval from the Office of Management and Budget (OMB) to revise, with extension, the Federal Financial Institutions Examination Council (FFIEC) Consolidated Reports of Condition and Income (Call Reports) (FFIEC 031-034; OMB No. 7100-0036). These reports are required of state member banks and are filed on a quarterly basis. The revisions to the Call Reports that are the subject of this request have been approved by the FFIEC. The Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) have also submitted a similar request for OMB review in order to request this information from banks under their supervision.

The Federal Reserve requires information collected on the Call Reports to fulfill its statutory obligation to supervise state member banks. State member banks are required to file both detailed schedules of assets, liabilities, and capital accounts in the form of a condition report and summary statement as well as detailed schedules of operating income and expense, sources and disposition of income, and changes in equity capital. The current annual burden for the Call Reports is estimated to be 193,104 hours; the proposed revisions are estimated to increase the annual burden to 193,177 hours.

First, the agencies proposed revisions on the reporting requirements related to certain U.S. Government-guaranteed or –insured residential mortgage loans backing Government National Mortgage Association (GNMA) securities that meet certain delinquency criteria and are subject to seller buy-back provisions. Second, the agencies proposed revisions to make the content of the report more consistent with American Institute of Certified Public Accountants (AICPA) Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3). Finally, the agencies proposed to clarify the report with respect to when-issued securities, risk-based capital, and USA PATRIOT Act contact information.

Background and Justification

Banks that are members of the Federal Reserve System are required by law to file reports of condition with the Federal Reserve System. Section 9(6) of the Federal Reserve Act (12 U.S.C. 324) states:

> ... banks ... shall be required to make reports of condition and of the payment of dividends to the Federal Reserve bank of which they become a member. Not less than three of such reports shall be made annually on call of the Federal Reserve bank on dates to be fixed by the Board of Governors of the Federal Reserve System.... Such reports of condition shall be in such form and shall contain such information as the Board of Governors of the Federal Reserve System may require and shall be published by the reporting banks in such manner and in accordance with such regulations as the said Board may prescribe.

In discharging this statutory responsibility, the Board of Governors, acting in concert with the other federal banking supervisory agencies since 1979 through the FFIEC, requires banks to submit on the quarterly Reports of Condition and Income such financial data as are needed by the Federal Reserve System to: (1) supervise and regulate banks through monitoring of their financial condition, ensuring the continued safety of the public's monies and the overall soundness of the nation's financial structure, and (2) contribute information needed for background for the proper discharge of the Board's monetary policy responsibilities. The use of the data is not limited to the federal government, but extends to state and local governments, the banking industry, securities analysts, and the academic community.

Description of Information Collection

The Call Reports collect basic financial data from commercial banks in the form of a balance sheet, income statement, and supporting schedules. The Report of Condition contains supporting schedules that provide detail on assets, liabilities, and capital accounts. The Report of Income contains supporting schedules that provide detail on income and expenses.

Within the Call Report information collection system as a whole, there are two forms that apply to different categories of banks: (1) all banks that have domestic and foreign offices (FFIEC 031), and (2) banks with domestic offices only (FFIEC 041). Prior to March 2001, there were four categories of banks and four reporting forms. The FFIEC 031 was filed by banks with domestic and foreign offices and the FFIEC 032, 033, and 034 were filed by banks with domestic offices only and were filed according to the asset size of the bank.

There is no other report or series of reports that collects from all commercial and savings banks the information gathered through the Reports of Condition and Income taken as a whole. There are other information collection systems that tend to duplicate certain parts of the Call Reports; however, the information they provide would be of limited value as a replacement for the Call Report. For example, the Federal Reserve collects various reports in connection with its measurement of monetary aggregates, of bank credit, and of flow of funds. Reporting banks supply the Federal Reserve with detailed information relating to such balance sheet accounts as balances due from depository institutions, loans, and deposit liabilities. The Federal Reserve also collects financial data from bank holding companies on a regular basis. Such data are presented for the holding company on a consolidated basis, including its banking and nonbanking subsidiaries, and on a parent company only basis.

However, Federal Reserve reports from banks are frequently obtained on a sample basis rather than from all insured banks. Moreover, these reports are often prepared as of dates other than the last business day of each quarter, which would seriously limit their comparability. Institutions below a certain size are exempt entirely from some Federal Reserve reporting requirements. Data collected from bank holding companies on a consolidated basis reflect an aggregate amount for all subsidiaries within the organization, including banking and nonbanking subsidiaries, so that the actual dollar amounts applicable to any bank subsidiary are not determinable from the holding company reports. Hence, these reports could not be a viable replacement for even a significant portion of the Call Reports since the Federal Reserve, in its role as supervisor of insured state member banks, would be lacking the data necessary to assess the financial condition of individual insured banks to determine whether there had been any deterioration in their condition.

Beginning March 1998, all banks were required to transmit their Call Report data electronically to the federal banking agencies' private sector collection agent (currently Electronic Data Systems, Inc.), using software that has been certified for this purpose by the collecting agent. Banks do not have to submit hard copy Call Reports to any federal bank supervisory agency unless specifically requested to do so.

Proposed Revisions

GNMA Buy-Back Options

Under the GNMA Mortgage-Backed Securities Guide, the issuer of GNMA securities has the option to repurchase individual Federal Housing Administration (FHA), Department of Veterans Affairs/Veterans Administration (VA), and Farmers Home Administration (FmHA) mortgage loans backing the securities when these GNMA loans meet certain delinquency criteria. Because of this option, if and when individual loans that have been accounted for as sold in accordance with Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140), later meet GNMA's specified delinquency criteria and are eligible for repurchase, FAS 140 requires these individual delinquent GNMA loans to be brought back onto the issuer's books as assets, along with an offsetting liability. This rebooking of the GNMA loans is required regardless of whether the issuer intends to exercise the buy-back option.

The agencies proposed that all delinquent rebooked GNMA loans (including those for which the institution is taking steps to foreclose on the real estate collateral at the time of repurchase, but for which the sheriff's sale has not yet taken place) should be reported as past due on Call Report Schedule RC-N – Past Due and Nonaccrual Loans, Leases, and Other Assets, in accordance with their contractual terms. As part of this change, the agencies proposed to eliminate an existing provision in the Call Report instructions that permits institutions not to report delinquent GNMA loans that are repurchased when they are "in foreclosure status" at the time of repurchase as past due loans in Schedule RC-N, provided the government reimbursement process is proceeding normally. In proposing this reporting change, the agencies noted that delinquent rebooked GNMA loans would also be reported in supplemental items 10 and 10.a of Schedule RC-N, which disclose amounts for past due loans wholly or partially guaranteed or insured by the U.S. Government. These items supplement the main body of the past due loans schedule by providing information that enables users of the Call Report to determine the amount of an institution's total delinquent loans that are not protected by a U.S. Government guarantee or insurance.

The agencies have decided to proceed with their original proposal that would require rebooked GNMA loans that are past due to be reported in the main body of Call Report Schedule RC-N and in supplemental item 10, "Loans and leases reported in items 1 through 8 above which are wholly or partially guaranteed by the U.S. Government." However, based on suggestions from commenters, the agencies will add a new supplemental item 10.b to Schedule RC-N effective June 30, 2005, in which banks would report "Rebooked 'GNMA loans' that have been repurchased or are eligible for repurchase included in item 10 above."[1]

In this regard, the agencies note that banks that originate and hold FHA, VA, and FmHA mortgage loans in their loan portfolios, rather than securitizing and selling them in the form of GNMA securities, currently report these loans as past due in the main body of Call Report Schedule RC-N if and when these loans become delinquent. These past due loans are also reported in existing supplemental items 10 and 10.a for past due loans wholly or partially guaranteed or insured by the U.S. Government in Call Report Schedule RC-N. The reporting treatment of these guaranteed and insured loans in Schedule RC-N will not change.

In addition, the agencies proposed that, when an institution forecloses on real estate backing a delinquent GNMA loan that it has rebooked as an asset, it should report the property as "other real estate owned" and not as an "other asset" on the Call Report balance sheet. The foreclosed property should be reported in this manner beginning at the time of foreclosure until it has been sold, transferred to HUD, or otherwise disposed of.

Commenters objected to the proposed balance sheet classification of foreclosed real estate collateral backing delinquent GNMA loans as "other real estate owned." Commenters recommended that institutions report such real estate as "other assets" because they do not believe that institutions are exposed to the underlying risk of the real estate, despite the foreclosure, due to the insurance or guarantee by the U.S. Government. They also observed that, in contrast to foreclosed real estate arising from other types of loans, institutions do not intend to sell foreclosed properties resulting from GNMA loans in order to recover the value of these assets. Instead, institutions look to their claim on the U.S. Government for recovery.

The agencies have reviewed and considered these comments. As stated in the April 2004 proposal, the U.S. Department of Housing and Urban Development (HUD), the federal entity that administers the GNMA program, cannot accept a foreclosed property nor can the government guarantee or insurance be honored until all legal actions related to the foreclosure process have been completed. Commenters confirmed that certain conditions must be met before a property can be conveyed to HUD. While these conditions normally will be met, whether they will ultimately be met for an individual property is not known at the time of foreclosure. For example, the servicing guide for VA loans indicates the circumstances in which foreclosed property would not be conveyed, including when the VA issues "no-bid" advice (because the VA's cost of paying its guarantee is less than its estimated cost of taking possession of the property and selling it) and when there has been a failure to follow the regulations upon which the VA's guarantee is based.

Although the existence of insurance or a guarantee from the U.S. Government on a particular foreclosed loan will aid in determining whether the carrying value of the asset is

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1 In addition, if a bank services but did not originate mortgage loans backing a GNMA security, i.e., where the bank was not the transferor of the loans that have been securitized, the servicing bank should also include any government-guaranteed or -insured mortgage loans that it has purchased out of the securitization in Schedule RC-R, items 10 and 10.b, even if the bank was not required to record the delinquent loans as assets prior to purchasing the loans.

recoverable, it does not determine the classification of the asset upon foreclosure. Because an institution's claim against the U.S. Government is effectively conditional until all the conditions have been met for the conveyance of a foreclosed property to HUD, the asset resulting from an institution's foreclosure on a delinquent GNMA loan has more of the characteristics of real estate than a receivable from the U.S. Government. Accordingly, the agencies believe that, for Call Report balance sheet purposes, it is more appropriate to view this asset as other real estate owned than as a receivable at foreclosure.

The agencies recognize that the more common practice is for institutions that foreclose on delinquent GNMA loans to report the resulting asset as an "other asset" rather than "other real estate owned" on the Call Report balance sheet. In this regard, some commenters recommended that if the agencies concluded that these assets should not be reported as "other assets," there should be separate disclosure of these assets in the Call Report because of the difference in their risk profile compared to other types of foreclosed real estate. The agencies see merit in enabling institutions with foreclosed properties from GNMA loans to distinguish the amount of these properties from other foreclosed properties. Therefore, the agencies will delay the implementation date for institutions to report foreclosed real estate from GNMA loans as "other real estate owned" on the balance sheet until the March 31, 2006, report date. The agencies will also add a new subitem to Schedule RC-M, item 3.b, "All other real estate owned," to enable institutions to disclose the amount of such real estate in the March 2006 Call Report. Until then, i.e., through the December 31, 2005, report date, institutions should continue to report these foreclosed properties in their Call Reports in accordance with their existing reporting policies for such properties.

Accounting for Certain Loans or Debt Securities Acquired in a Transfer

The agencies proposed revisions in response to SOP 03-3, which was issued by the AICPA and is effective for loans acquired in fiscal years beginning after December 15, 2004.

In December 2003, the AICPA issued SOP 03-3. In general, this SOP applies to "purchased impaired loans," i.e., loans that a bank has purchased, including those acquired in a purchase business combination, when there is evidence of deterioration of credit quality since the origination of the loan and it is probable, at the purchase date, that the bank will be unable to collect all contractually required payments receivable. The SOP applies to loans acquired in fiscal years beginning after December 15, 2004, with early adoption permitted. Banks must follow SOP 03-3 for Call Report purposes in accordance with its effective date based on their fiscal years. The SOP does not apply to the loans that a bank has originated. SOP 03-3 also excludes certain acquired loans from its scope.

Under SOP 03-3, a purchased impaired loan is initially recorded at its purchase price (in a purchase business combination, the present value of amounts to be received). The SOP limits the yield that may be accreted on the loan (the accretable yield) to the excess of the bank's estimate of the undiscounted principal, interest, and other cash flows expected at acquisition to be collected on the loan over the bank's initial investment in the loan. The excess of contractually required cash flows over the cash flows expected to be collected on the loan, which is referred to as the nonaccretable difference, must not be recognized as an adjustment of yield, loss accrual, or valuation allowance. Neither the accretable yield nor the nonaccretable difference may be shown on the balance sheet. After acquisition, increases in the cash flows expected to be collected generally should be recognized prospectively as an adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected should be recognized as an impairment through an addition to the loan loss allowance.

The SOP prohibits a bank from "carrying over" or creating valuation allowances (loan loss allowances) in the initial accounting for purchased impaired loans. This prohibition applies to the purchase of an individual impaired loan, a pool or group of impaired loans, and impaired loans acquired in a purchase business combination. As a consequence, SOP 03-3 provides that valuation allowances should reflect only those losses incurred after acquisition, that is, the present value of all cash flows expected at acquisition that ultimately are not to be received. Thus, because of the accounting model set forth in SOP 03-3, banks will need to segregate their purchased impaired loans, if any, from the remainder of their loan portfolio for purposes of determining their overall allowance for loan and lease losses.

According to the Basis for Conclusions of SOP 03-3, the AICPA's Accounting Standards Executive Committee "believes that the accounting for acquired loans within the scope of this SOP is sufficiently different from the accounting for originated loans, particularly with respect to provisions for impairment, such that the amount of loans accounted for in accordance with this SOP should be disclosed separately in the notes to financial statements." The agencies agree with this assessment and have considered the disclosures required by SOP 03-3. Therefore, to assist the agencies in understanding the relationship between the allowance for loan and lease losses and the carrying amount of the loan portfolios of those banks whose portfolios include purchased impaired loans, the agencies are proposing to add several items to the Call Report. The first three of these items represent information included in the disclosures required by SOP 03-3.

The agencies would add two Memorandum items to Schedule RC-C, part I, Loans and Leases: (1) the outstanding balance[2] and (2) the carrying amount (before any loan loss allowances) as of the report date of the purchased impaired loans held for investment[3] that are included in Schedule RC-C. In addition, the agencies would add a Memorandum item to Schedule RI-B, part II, Changes in Allowance for Loan and Lease Losses, in which banks would report the amount of loan loss allowances for purchased impaired loans held for investment that is included in the total amount of the allowance for loan and lease losses as of the report date. The agencies also plan to revise the instructions to Schedule RC-N, Past Due and Nonaccrual Loans, Leases, and Other Assets, to explain how purchased impaired loans should be reported in this schedule. SOP 03-3 does not prohibit placing loans on nonaccrual status and any nonaccrual purchased impaired loans should be reported accordingly in Schedule RC-N. For those purchased impaired loans that are not on nonaccrual status, banks should determine their delinquency status in accordance with the contractual repayment terms of the loans without regard to the purchase price of (initial investment in) these loans or the amount and timing of the cash flows expected at acquisition.

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2 The outstanding balance is the undiscounted sum of all amounts, including amounts deemed principal, interest, fees, penalties, and other under the loan, owed to the bank at the report date, whether or not currently due and whether or not any such amounts have been charged off by the bank. The outstanding balance does not include amounts that would be accrued under the contract as interest, fees, penalties, and other after the report date.

3 Loans held for investment are those loans that the bank has the intent and ability to hold for the foreseeable future or until maturity or payoff. Thus, the outstanding balance and carrying amount of any purchased impaired loans that are held for sale would not be reported in these proposed Memorandum items.

Other Clarifications

When-Issued Securities

The agencies proposed to revise the Call Report Glossary entry for "When-Issued Securities Transactions," which currently indicates that institutions should follow settlement date accounting for when-issued securities, by replacing it with one that calls for trade date accounting for such securities. In addition, the agencies proposed to remove the references to commitments to purchase and sell when-issued securities from the instructions for Schedule RC-L, item 9, "All other off-balance sheet liabilities," and item 10, "All other off-balance sheet assets," respectively. Furthermore, the agencies proposed to revise the Call Report Glossary entry for "Trade Date and Settlement Date Accounting" to clarify that institutions should follow trade date accounting for all securities, including when-issued securities.

Several commenters noted that, under paragraph 59(a) of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (FAS 133), when-issued securities that meet certain criteria should be accounted for as derivatives rather than securities and, therefore, this derivatives accounting treatment should be followed in the Call Report.

The agencies have reviewed relevant portions of FAS 133 and agree that, in appropriate circumstances, banks should report when-issued securities as derivatives and not as securities. Accordingly, the FFIEC and the agencies have concluded that they should not proceed with the elements of their proposal related to when-issued securities. However, the agencies will clarify the Call Report instructions addressing when-issued securities, where necessary, to ensure that they are in conformity with FAS 133.

Risk-Based Capital

Call Report Schedule RC-R – Regulatory Capital, does not currently allow a bank to report an amount in column B, "Items Not Subject to Risk-Weighting," of item 34, "Cash and balances due from depository institutions," because such items were not expected to exist within this asset category when this schedule was originally designed. However, when amounts are included in column A, "Totals (from Schedule RC4)," of item 34 for certain embedded derivatives, these embedded derivatives should be risk-weighted under the rules for derivatives rather than the rules that apply to the cash and due from asset account. As a result, banks contacted the agencies upon finding that they could not properly report the carrying amount of these derivatives in column B when allocating the total carrying amount of their "Cash and balances due from depository institutions" across the columns of item 34. In response to banks' comments about this reporting difficulty, the agencies are revising Schedule RC-R to permit the use of column B of item 34.

USA PATRIOT Act Contact

4 Schedule RC of the Call Report is the balance sheet.

A number of banks have requested that they be permitted to provide USA PATRIOT Act Section 314(a) Anti-Money Laundering contact information for more than two contact persons at their institutions. The agencies are adding text fields for two additional contact persons that will enable a bank, at its option, to supply information for a third and fourth anti-money laundering contact person. This contact information is not released to the public.

Time Schedule for Information Collection

The Call Reports are collected quarterly as of the end of the last calendar day of March, June, September, and December. Less frequent collection of Call Reports would reduce the Federal Reserve's ability to identify on a timely basis those banks that are experiencing adverse changes in their condition so that appropriate corrective measures can be implemented to restore their safety and soundness. State member banks must submit the Call Reports to the appropriate Federal Reserve Bank within thirty calendar days following the as-of date; a fifteen-day extension may be given to banks with more than one foreign office.

Aggregate data are published in the *Federal Reserve Bulletin* and the *Annual Statistical Digest*. Additionally, data are used in the *Uniform Bank Performance Report (UBPR)* and the *Annual Report of the FFIEC*. Individual respondent data, excluding confidential information, are available to the public from the National Technical Information Service in Springfield, Virginia, upon request approximately twelve weeks after the report date. The information is provided in the form of magnetic tapes or hard copy facsimiles of the material on file.

Legal Status

The Board's Legal Division has determined that Section 9(6) of the Federal Reserve Act [12 U.S.C. 324] authorizes the Board to require these reports from all banks admitted to membership in the Federal Reserve System. The Board's Legal Division has also determined that the individual respondent information contained in the trust schedule, RC-T are exempt from disclosure pursuant to the Freedom of Information Act [5 U.S.C. 552(b)(4) and (8)]. Finally, Column A and Memorandum item 1 to Schedule RC-N, "Past Due and Nonaccrual Loans, Leases, and Other Assets," are exempt from disclosure pursuant to the Freedom of Information Act [5 U.S.C. 552(b)(4) and (8)] for periods prior to March 31, 2001.

Consultation Outside the Agency

On April 29, 2004, the agencies jointly published for comment a *Federal Register* notice soliciting comments on proposed revisions to the currently approved Call Report information collection. On March 11, 2005, the agencies jointly published for comment a *Federal Register* notice soliciting comments on additional proposed revisions to the currently approved Call Report information collection.

Estimate of Respondent Burden

The Federal Reserve estimates that the proposed revisions would increase the estimated annual burden by 73 hours. The slight increase in burden is related to the proposed new items for GNMA buyback options and SOP-03-3. The estimated average hours per response did not change significantly because most of the items (1) are required for other financial reporting purposes and (2) apply to a limited number of institutions. The Federal Reserve estimates the total proposed annual reporting burden for state member banks to be 193,177 hours, as shown below. This burden represents less than 1 percent of the total Federal Reserve paperwork burden.

	Number of Respondents	*Annual Frequency*	*Estimated Average Hours Per Response*	*Estimated Annual Burden Hours*
Current	922	4	52.36	193,104
Proposed	922	4	52.38	193,177
Change				73

Based on an average hourly cost of $30, the total cost to state member banks is estimated to be $5,795,310 annually. This estimate represents costs associated with recurring salary and employee benefits, and expenses associated with software, data processing, and bank records that are not used internally for management purposes but are necessary to complete the Call Reports.

With respect to the changes that are the subject of this submission, banks would incur a capital and start-up cost component, but the amount would vary from bank to bank depending upon its individual circumstances and the extent of its involvement, if any, with the particular type of activity or product about which information would begin to be collected. An estimate of this cost component cannot be determined at this time.

Sensitive Questions

This collection of information contains no questions of a sensitive nature, as defined by OMB guidelines.

Estimate of Cost to the Federal Reserve System

Current costs to the Federal Reserve System for collecting and processing the Call Report are estimated to be $2,750,243 per year. This amount includes the routine annual costs of personnel, printing, and computer processing, as well as internal software development costs for maintaining and modifying existing operating programs used to edit and validate reported data. The annual costs would remain unchanged and the one-time costs to implement the revised reports are estimated to be $30,000.