

STATE OF CALIFORNIA

DEPARTMENT OF BUSINESS OVERSIGHT

INSTRUCTIONS FOR FOREIGN BANK REPORT OF INCOME

A1 The amounts of ordinary and recurring income for either 6 months (June) or 1 year (December)

Nonaccrual of interest.

No interest or discount should be accrued on (a) any asset maintained on a cash basis, or (b) any asset upon which a default of principal or interest has existed for 90 days or more, unless it is both well secured and in process of collection. When accrual of interest or discount has been discontinued on any asset, all previously accrued and uncollected interest must be reversed against the appropriate income and asset accounts. When interest is received during the nonaccrual status period, it should be applied against the principal balance of the loan. A nonaccrual asset may be restored to an accrual status when none of its principal and interest is due and unpaid or it otherwise becomes well secured and in process of collection, and when prospects for future contractual payments are no longer in doubt.

A1a Interest and fees on loans and leases

Interest and accrued discount, both current and past due, and fees and similar charges levied against all assets classified as loans and leases in the Report of Condition, including interest on:

Acceptances of other banks and commercial paper purchased in the open market

Acceptances executed by or for the account of the reporting bank and subsequently acquired by it through purchase or discount

Drafts and bills of exchange that have been accepted by the reporting bank or by other banks for its account and that are owned or held by the reporting bank

Customer's liability to the reporting bank on drafts paid under letters of credit for which the bank has not been reimbursed

Commodity or bill-of-lading drafts payable upon arrival of goods against which drawn, for which the reporting bank has given deposit credit to customers

Paper rediscounted with the Federal Reserve or other banks

Paper pledged as collateral to secure bills payable, as marginal collateral to secure bills rediscounted, or for any other purpose

Purchases, under resale agreements of commercial paper, mortgages, or acceptances

Profits (or losses) from the sale of acceptances and commercial paper at discount rates other than those at which such paper was purchased

Discounts received or points charged on real estate mortgage loan transactions

Investigation and service charges on loans

Renewal and past-due charges on loans

Net income received from the leasing of personal property acquired for that purpose

Commitment fees (regardless of whether the loan has been made)

Fees charged for the execution of mortgages or agreements securing the bank's loans

Bank-owned credit card income (any yield-related fee income when items are included in Schedule A)

- *Deduct* interest rebated to customers on loans paid before maturity.
- *Deduct* amortization of premiums on real estate mortgages or other loans.

A1b Income on Federal funds sold

Report on this line Federal funds transactions involving the lending of immediately available funds for one business day or under a continuing contract, regardless of the nature of the contract or of the collateral, if any. Income on term Federal funds should be reported in item A1a.

A1c Interest on interbank placements and CDs purchased

Gross interest income received or accrued on balances with banks in the United States and in foreign countries.

Exclude interest income from H/O, branches & wholly-owned subsidiaries which should be reported in item A1h.

A1d Income on securities purchased under resale agreement

A1e Interest and dividends on investments (excluding trading account income)

Income on all assets reported in the Report of Condition at items 1b and 1c exclusive of income from securities held in dealer trading accounts

Interest and dividends on securities which the bank has:

Loaned

Sold under repurchase agreements

Pledged as security for deposits, bills payable, or otherwise

Interest received at sale of securities, if such interest has not been accrued on the bank's books.

- Amortization of premium on securities purchased above par or face value is required of all banks. Premiums should be amortized to maturity or the first call date with the current period amortization deducted from the appropriate category
- Do not include income from trading account securities which should be reported in item A1i.

Interest on U.S. Treasury securities

Income from securities issued by the United States Treasury Department: bills, bonds, certificates of indebtedness, and notes

Discount received or accumulated on U.S. Treasury bills

Interest on obligations of other U.S. Government agencies and corporations

Income from bonds, notes, and debentures of United States Government agencies and corporations including:

Banks for Cooperatives
D.C. Stadium and Armory
Department of Housing and Urban Development
Department of Transportation
Export-Import Bank
Federal Home Loan Banks
Federal Home Loan Mortgage Corporation
Federal Housing Administration
Federal Housing Authority
Federal Intermediate Credit Banks
Federal Land Banks
Federal National Mortgage Association
General Services Administration
Government National Mortgage Association
Merchant Marine
Small Business Administration
Tennessee Valley Authority
United States Postal Service

Income from participation certificates issued by:

Commodity Credit Corporation
Export-Import Bank
Federal Home Loan Mortgage Association
Federal National Mortgage Association
Government National Mortgage Association

Income from securities purchased under the Government National Mortgage Association's mortgage-backed securities program

Income from Government National Mortgage Association guaranteed securities secured by pooled mortgages

Income from Farmers Home Administration insured *notes*

- Income from Farmers Home Administration *loans* should be included *in item A1a*.

Interest on obligations of States and political subdivisions in the U.S.

Income from all obligations, including loans, warrants, and tax anticipation notes, issued by:
Municipalities
School, irrigation, drainage, and reclamation districts
Local housing authorities including those backed by a U.S. Government agency

Income from obligations issued by other instrumentalities of one or more States and by territorial or insular possessions of the United States

Income from Farmers Home Administration guaranteed loans that are made for rural community water supply systems, waste disposal systems, and outdoor recreation centers

Interest on other bonds, notes, and debentures

Income from all bonds, notes, and debentures not reported in items A1d and A1f including but not limited to:

Asian Development Bank
Foreign governmental units
Inter-American Development Bank
International Bank for Reconstruction and Development (World Bank)
Savings and loan associations
Credit unions

Dividends on stock

Dividends from all domestic and foreign corporate stocks

A1f Service charges, commissions & fees

Amounts charged depositors for maintaining accounts with the bank or for failing to maintain specified minimum deposit balances

Charges based on the number of checks drawn on and deposits made in deposit accounts

Charges for checks drawn on so-called "no minimum balance" deposit accounts

Include income not applicable to items A1a through A1e:

Commissions on the sale of insurance policies and the collection of premiums

Charges for the collection of checks, notes, and bills of exchange

Collection of bills for public utilities and other firms

Sale of bank drafts

Acceptance of bills of exchange

Purchase and sale of securities, acceptances, and commercial paper for banks and other customers

Negotiation of loans for customers or correspondents

Underwriting and sale of securities permitted by statute

Lending of securities owned by the bank

Percentage charges to merchants for handling credit card or charge sales when the bank does not carry the related loan accounts on its books (Expenses associated with credit card or charge sales that are clearly identifiable should be netted against income)

Equipment leasing and rental fees

Data processing services

Reimbursements, received for services in redeeming United States savings bonds

Service charges on deposit accounts in foreign offices

Escrow fees

- A single monthly charge for multiple services should, whenever possible, be shown in this line item. When that is impractical, the amount should be placed in item A1i

A1g Net profit/loss on foreign exchange trading

Report the net gain or loss from trading in foreign exchange recognized during the calendar year-to-date. Include unrealized gains or losses related to open forward contracts held for trading. Include incidental fee income and expense related to such transactions.

Exclude gains and losses on swap transactions (report as adjustments to the income or expense of the related asset or liability).

If the amount to be reported in this item is a loss, enclose it in parentheses.

A1h Income from H/O, branches & wholly-owned subsidiaries

A1i Other operating income: From Section C, item 4

Report all operating income and recurring operating credits of the bank not required to be reported separately in Section A.

SECTION C - OTHER OPERATING INCOME	Mil.	Thou.
1. Trading account, net		
2. All other (Itemize amount over 25% of item 3):		
3. TOTAL (must equal Section A, item 1i)		

C1 Trading account income, Net

Interest, profits and losses on trading account securities

Revaluation adjustments

Incidental income and expenses related to the purchase and sale of such securities

Net profit/loss on foreign exchange trading should be reported in item A1g

C2 All Other

All other operating income not reported elsewhere including:

Gross rentals from other real estate and safe deposit boxes

Net tellers' or cash overages

Forgery recoveries

Recoveries on payment of checks over stop payment orders

Recoveries on securities previously charged-off

Gain on sale of other real estate

Gross revenue from available balances sold and securities purchased under agreements to resell in foreign offices

- Itemize:

Any amounts that represent 25 percent or more of the total of this section

- Show totals of itemizations in box

C3 Total: (Sum of Items C1 and C2)

- Must equal Section A, item 1i.

Section A - Continued

A2 Operating Expenses

The amounts of ordinary and recurring expenses of operating during the period.

A2a Salaries and employee benefits

Report salaries and benefits of all officers and employees including guards and contracted guards, temporary office help, dining room and cafeteria employees, and building department officers and employees (including maintenance personnel).

Include as salaries and employee benefits:

- Gross salaries, wages, overtime, bonuses, incentive compensation, and extra compensation.
- Social security taxes and state and federal unemployment taxes paid by the bank.
- Contributions to the bank's retirement plan, pension fund, profit-sharing plan, employee stock ownership plan, employee stock purchase plan, and employee savings plan.

A2b Interest on time CDs of \$100,000 and over

Interest paid or accrued during the current period on time certificates of deposit issued by domestic offices in denominations of \$100,000 or more

A2c Interest on all other deposits or credit balances

Interest paid or accrued on all deposits classified as time and savings deposits in Schedule E of the Report of Condition except those included in A2b above.

A2d Interest expense - Federal funds purchased

Show gross expenses in connection with Federal funds purchased. Interest on term Federal funds should be reported in A2f or A2g.

A2e Interest expense - securities sold under repurchase agreements

Show gross expenses in connection with Securities sold under agreements to repurchase

A2f Interest on borrowings (other than H/O, branches, & wholly-owned subsidiaries)

- Interest and discount on:
 - Promissory notes
 - Term Federal funds
 - Notes and bills rediscounted
 - Participation sales in pools of loans
 - Other instrument given for the purpose of borrowing money

A2g Interest on borrowings from H/O, branches, & wholly-owned subsidiaries

- Interest and discount on:
 - Promissory notes
 - Term Federal funds
 - Notes and bills rediscounted
 - Participation sales in pools of loans
 - Other instruments given for the purpose of borrowing money

A2h Other operating expenses: From Section D, item 3.

SECTION D - OTHER OPERATING EXPENSES	Mil.	Thou.
1. Other expenses paid to H/O, branches & wholly owned subsidiaries.		
2. All Other (itemize amounts over 25% of item 3)		
3. TOTAL (must equal Section A, item 2h)		

SECTION D - OTHER OPERATING EXPENSES

In Section D report all operating expenses and recurring debits of the bank that are not required to be reported separately in Section A.

D1 Other expenses paid to H/O, branches & wholly owned subsidiaries

Other expenses paid to head offices, branches and wholly owned subsidiaries not reported in Section A, items 2a through 2g.

D2 Other

Net occupancy expense of bank premises

Furniture and equipment expense

Normal and recurring depreciation charges applicable to the current period (whether representing direct reductions in the carrying value of the assets or additions to depreciation reserves)

Rental costs of office machines and data processing equipment

Ordinary repairs including servicing costs to furniture and office machines

Taxes on furniture and equipment

Premiums on fidelity insurance

Operating expenses (except salaries) connected with holdings of real estate owned other than bank premises

Interest paid on liens and normal or recurring depreciation charges on real estate owned other than bank premises

Office supplies

Telephone and telegraph

Cost of examinations by supervisory authorities

Retainer fees

Expenses related to the use of automobiles for bank business

Costs of data processing performed by others

Losses from counterfeit money, forged checks, net cash shortages, payment of checks over stop-payment orders, and similar recurring losses

Sales taxes and other taxes not reported against other items

Net deposit insurance assessment expense (All assessment credits during the period should be applied against the assessment expense.)

Premiums on mortgages written off in a lump sum rather than amortized over the life of the mortgage

Losses on securities charged off prior to sale or redemption

Gross expenses related to available balances purchased and securities sold under agreements to repurchase of foreign offices

- Itemize any amounts that represent 25 percent or more of the total of this section.

D3 TOTAL (Must equal Section A, item 2h)

Section A - Continued

A2i Provision for loan losses (Must equal Section B, item 5)

Section B - Allowance for Possible Loan Losses

SECTION B - ALLOWANCE FOR POSSIBLE LOAN LOSSES (Year-to-Date)	Mil.	Thou.	
1. Balance end of previous year			1
2. Losses charged to allowance			2
3. Recoveries credited to allowance			3
4. Net loan and lease losses (recoveries)			4
5. Provision for possible loan losses (Must equal Section A, item 2i)			5
6. Other increases (decreases)			6
7. Balance at end of current period			7

Section B is to reflect transactions in the valuation portion of allowance set up for possible loan losses. This section must be completed by every bank, whether on an actual or accrual basis for provision for possible loan losses.

This section has been provided as a reconciliation of entries affecting only the valuation portion. Losses and recoveries when debited and credited to allowance for possible loan losses should be reported in this section.

- *Do not include* in this section reserves carried in equity capital accounts, such as reserves for contingencies.

B1 Balance end of previous year

The amount representing the valuation portion of allowance for possible loan losses at the prior year-end.

- This amount must be the same as the balance reported at the prior year-end in the Report of Income.

B2 Losses charged to allowance

Actual gross charge-offs on loans during the period

- Banks not on a reserve basis must enter gross charge-offs on loans during the current report period.

B3 Recoveries credited to allowance

Banks on an allowance basis should enter recoveries of amounts previously charged off against allowances for possible loan losses.

Banks not on an allowance basis for financial reporting must enter gross recoveries of loans previously charged-off.

B4 Net loan and lease losses (recoveries)

Deduct line B3 from line B2.

B5 Provision for possible loan losses

Banks not on an allowance basis must report gross recoveries at item B3, gross charge-offs at item B2, actual net loan losses at item B2, and in Section A, item 2i. With a zero balance at the beginning of the period, these entries must result in a zero balance at the end of the period.

- If actual net loan losses are used and the recoveries exceed charge-offs the appropriate entry here and in Section A, item 2i will be negative and should be so indicated by enclosure within parentheses.
- Must equal the amount reported in Section a, item 2i.

Banks on a loan loss allowance basis must report an amount sufficient to bring the balance of the allowance for possible loan losses to an adequate level based on management's appraisal of the condition of the current loan portfolio.

- Management's judgement as to the adequacy of the loan loss provision and allowance balance will be subject to review by bank examiners during the course of their examinations. Management is, therefore, required to maintain a reviewable record of the basis for its determination of the loan loss provision. Management's best judgement of the adequacy for

loan losses necessary for the year-to-date should be entered in this item and in Section A, item 2i.

B6 Other increases (decreases), net

Include valuation portion of reserves carried over from the books of a bank or other business that has been merged, consolidated, purchased, or absorbed by the bank during the calendar year-to-date (only such allowance as were carried on the books of the absorbed bank or business at the time the accounts were consolidated with the accounts of the continuing bank)

B7 Balance end of period:

Sum of item B1 plus or minus B2 through B5

- A negative balance may not be reported in this item. The amount expensed in "provision for possible loan losses" must be increased to make item B6 zero.
- Banks not on a reserve basis will report zero at both item b1 and item b6 since items B2, B4, and B5 will be offsetting.

Allocated Reserves

In some foreign banking corporations, loan classifications are being reduced by what is described as "specific" reserves. While the reduction of a classification is appropriate for a true "allocated" reserve, classified loans should not be reduced by any portion of the Allowance for Loan and Lease Losses (ALLL).

While this may seem obvious, we are finding that there is confusion over what is considered to be an "allocated" reserve, especially since management of the foreign branch or agency may use the terms "allocated" reserve and "specific" reserves interchangeably. The proper treatment of these reserves has been further obfuscated by the fact that "FFIEC Instructions for Preparation of the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks" call for reporting branches and agencies to report the aggregate book value of all loans and leases to nonrelated institutions net of any "specific" reserves. However, because there is no definition of what constitutes a "specific" reserve, some foreign branches and agencies are reflecting loans net of these "specific" reserves. Because the treatment of these reserves has a significant impact on classification totals in reports of examination, it is important that there be an understanding of what constitutes a true "allocated" reserve.

As we are all aware, an ALLL should be maintained in an amount which is adequate to absorb estimated credit losses associated with the loan and lease portfolio. Estimated credit losses are provided to the ALLL by periodic assessments of the loan portfolio by bank management. Although the bank may provide an estimation of loss based upon a variety of factors such as historical charge-off rates, the estimate may also include amounts based upon an analysis of "specific" loans, which generally include significant classified loans. In such cases, there is no intention for management to charge-off any portion of these significant loans. Moreover, the ALLL is available to absorb all credit losses that arise from the loan and lease portfolio and is not segregated for, or allocated to, any particular loan or group of loans. That portion of the ALLL relating to an analysis of a "specific" loan is not to be used to reduce the balance of the loan in a report of examination. In contrast to the ALLL, an "allocated" reserve is established as the general equivalent of a charge-off.

In lieu of charging off a loan, a bank may set up an "allocated" reserve for a particular loan. This may be done for a variety of reasons, including while awaiting approval from head office, or from the home country regulator (e.g. Ministry of Finance in Japan) to charge off the loan. In any event, since foreign branches and agencies licensed in California are subject to reporting requirements as dictated by GAAP, the proper treatment of an "allocated" reserve is to follow the accepted method of accounting for credit losses as prescribed by GAAP, which entails a charge to the ALLL for the amount of the "allocated" reserve. By establishing the reserve in this manner, the foreign branch or agency is, in effect, charging off the loan.

As noted previously, the FFIEC instructions require that foreign branches and agencies report loans and leases net of "specific" reserves. While the FFIEC instructions do not provide a definition of what constitutes a "specific" reserve, we have determined from discussions with the Federal Reserve Bank of San Francisco that a "specific" reserve, as utilized in the instructions, is intended to be the equivalent of an "allocated" reserve as described above, rather just being a portion of the ALLL attributable to an analysis of a specific loan. The Federal Reserve Bank of San Francisco is in concurrence with the fact that establishing a "specific" reserve is the equivalent of a charge-off.

The appropriate accounting entries for setting up a true "allocated" reserve include:

1. Debit - Provision For Loan Losses
Credit - Allowance For Loan and Lease Losses
2. Debit - Allowance For Loan and Lease Losses*
Credit - Allocated Reserve

* The amount charged against the ALLL in establishing the allocated reserve in the current calendar year should be shown in Section B, item 2.

During the course of an examination of a foreign branch or agency, one may find what is referred to as an "allocated" or "specific" reserve. In many cases, such reserves are established merely by making a Loan Loss Provision, with no **intent** by management to charge-off the loan. Examiners are instructed to review any "allocated" or "specific" reserves and make a determination as to whether a true "allocated" reserve exists and if has been properly established. It is necessary to ascertain the **intent** of the agency or branch with respect to:

1. whether the specific loan, or portion thereof, is determined to be a "loss" and if a true charge-off is intended. If so, then the accounting entries described for an "allocated" reserve above must be followed

Or

2. whether branch or agency management is merely making a decision as to the risk in a particular loan and attributing a portion of the ALLL to the loss estimation of that individual loan. If this is the case, the reserve should be treated as a portion of the ALLL and reported (according to FFIEC instructions) as part of the "due to head office" accounts.

The net P&L effect of the charged-off amount associated with the "allocated" reserve does not differ from a branch or agency merely making a Loan Loss Provision. However, by passing the second part of the above accounting entries, there is now an audit trail whereby a loan loss reserve transcript accurately reflects the branch's loan loss history, namely that the loan has been charged-off. Income should also be reduced by the amount of accrued interest associated with the charged-off amount.

For reporting purposes, a true "allocated" reserve is to be netted against the loan balance, thereby effectively treating the allocation as a charge-off on the report. As a result, such amount would be eliminated from any calculation of "classified assets." If, on the other hand, there is no intent by the bank to charge-off the loan and/or proper entries are not made as described above, the "specific" reserve should not be netted against the loan balance and no reserve would be deducted in the loan classification.

SECTION E - MEMORANDA

E1 Provision for income taxes for period

This item is intended to cumulate all income taxes applicable to operating income, securities transactions, and extraordinary items.

- If the appropriate figure results in a tax credit, enclose it in parentheses.

E1a Provision for U.S. Federal income taxes

An estimate of the Federal income tax represented in Section A, item 6.

E1b Provision for U.S. State and local income taxes

An estimate of the State and local income tax represented in Section A, item 6.

E1c Total: Sum of items E1a, and E1b.

E2 Number of employees on payroll at end of period

The number of officers and employees employed as of the reporting date whose salaries and benefits were reported at item A2a which convert the number of part-time employees to full-time equivalents. For example, the bank would report 32 full-time equivalent employees if it had 32 full-time equivalent employees if it had 30 full-time employees and 4 part-time employees working half the full-time hours.

- Report exact number: do not round to thousands.

E3 Fees on loans