

Board of Governors of the Federal Reserve System

Supplemental Instructions

December 2006

Editing of Data by Respondents

The Federal Reserve requires validation checks to be performed by respondents as part of the electronic submission process for the FR Y-9 series of reports. This process requires bank holding companies (BHCs) to perform published validity and quality checks on data (so-called edits) by the filing deadline. Respondents are encouraged to file reports electronically as soon as possible, rather than waiting until the submission deadline. Validity and quality edits are provided at the end of the reporting instructions for the FR Y-9C, FR Y-9LP, FR Y-9SP and FR Y-9ES. Additional information regarding this submission process may be found on the web site: www.reportingandreserves.org under the heading BHC Modernization project. For example, see this website for information on guidelines for resolving edits and a document addressing frequently asked questions (FAQ).

FASB Statement No. 158 on Defined Benefit Postretirement Plans

FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158), issued in September 2006, requires a bank holding company that sponsors a single-employer defined benefit postretirement plan, such as a pension plan or health care plan, to recognize the funded status of each such plan on its balance sheet. An overfunded plan is recognized as an asset while an underfunded plan is recognized as a liability. As of the end of the fiscal year when a bank holding company initially applies FAS 158, the postretirement plan amounts recognized on the bank holding company's balance sheet before applying FAS 158 must be adjusted to recognize gains or losses, prior service costs or credits, and transition assets or obligations that have not yet been included in the net periodic benefit cost of its plans. These adjustment amounts are recognized directly in equity capital as components of the ending balance of accumulated other comprehensive income (AOCI), net of tax. Thereafter, a bank holding company must recognize certain gains and losses and prior service costs or credits that arise during each reporting period, net of tax, as a component of other comprehensive income (OCI) and, hence, AOCI. Postretirement plan amounts carried in AOCI are adjusted as they are subsequently recognized in earnings as components of the plans' net periodic benefit cost.

Bank holding companies that sponsor single-employer defined benefit postretirement plans must adopt FAS 158 for regulatory reporting purposes in accordance with the standard's effective date and transition provisions. Accordingly, bank holding companies that have "publicly traded equity securities," as defined in FAS 158, must initially recognize the funded status of these plans as of the end of the fiscal year ending after December 15, 2006. All other bank holding companies must initially recognize the funded status of these plans as of the end of the fiscal year ending after June 15, 2007. Thus, bank holding companies that have a calendar year fiscal year must adopt FAS 158 as of December 31, 2006, if they have "publicly traded equity securities" and as of December 31, 2007, if they do not. Early adoption of FAS 158 is permitted, but must be for all of an institution's benefit plans. For FR Y-9C reporting purposes, bank holding companies should report the adjustments to the ending balance of AOCI from initially

applying FAS 158 as of the end of their fiscal year, net of tax, in item 12, “Other comprehensive income,” of Schedule HI-A, Changes in Equity Capital.

In addition, according to an interim decision announced by the banking agencies on December 14, 2006, bank holding companies should exclude from regulatory capital any amounts recorded in AOCI resulting from the adoption and application of FAS 158. For FR Y-9C purposes, these excluded amounts should be reported in item 4 of Schedule HC-R, Regulatory Capital, together with the accumulated net gains (losses) on cash flow hedges. If the sum of the amounts included in AOCI (Schedule HC, item 26.b) for defined benefit postretirement plans under FAS 158 and for cash flow hedges represents a net gain (i.e., a net increase) in reported equity capital, this sum should be reported as a positive value in item 4 of Schedule HC-R. If the sum represents a net loss (i.e., a decrease) in reported equity capital, it should be reported as a negative number in item 4 of Schedule HC-R.

Quantifying FR Y-9 Report Misstatements

The staff of the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), in September 2006 (<http://www.sec.gov/interps/account/sab108.pdf>). This guidance has been codified as Topic 1.N. in the Codification of Staff Accounting Bulletins. According to SAB 108, the effects of prior year misstatements should be considered when quantifying misstatements in current year financial statements.

SAB 108 describes two approaches, generally referred to as “rollover” and “iron curtain,” that have been commonly used to accumulate and quantify misstatements. The rollover approach “quantifies a misstatement based on the amount of the error originating in the current year income statement,” which “ignores the ‘carryover effects’ of prior year misstatements.” In contrast, the “iron curtain approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement’s year(s) of origination.” Because each of these approaches has its weaknesses, SAB 108 advises that the impact of correcting all misstatements on current year financial statements should be accomplished by quantifying an error under both the rollover and iron curtain approaches and by evaluating the error measured under each approach. When either approach results in a misstatement that is material, after considering all relevant quantitative and qualitative factors, an adjustment to the financial statements would be required. Guidance on the consideration of all relevant factors when assessing the materiality of misstatements is provided in the SEC’s Staff Accounting Bulletin No. 99, *Materiality* (SAB 99), which has been codified as Topic 1.M. in the Codification of Staff Accounting Bulletins (<http://www.sec.gov/interps/account/sab99.htm>).

Because of prior year misstatements, SAB 108 observes that when the correction of an error in the current year would materially misstate the current year’s financial statements, the prior year financial statements should be corrected. However, SAB 108 provides transition guidance under which financial statements for fiscal years ending on or before November 15, 2006, need not be restated “if management properly applied its previous approach, either iron curtain or rollover,”

and considered all relevant qualitative factors when assessing materiality. In this situation, the effects of initially applying SAB 108 should be reported in the annual financial statements covering the first fiscal year ending after November 15, 2006. This would be accomplished by reporting the cumulative effect of the initial application of SAB 108 in the carrying amounts of assets and liabilities as of the beginning of the fiscal year, and making an offsetting adjustment to the opening balance of retained earnings for that year.

For regulatory reporting purposes, bank holding companies should apply the guidance from SAB 108 and SAB 99 when quantifying the impact of correcting misstatements, including both the carryover and reversing effects of prior year misstatements, on their current year regulatory reports. In this regard, bank holding companies may also apply the transition guidance in SAB 108 for regulatory reporting purposes. Accordingly, bank holding companies with calendar year fiscal years (and with November 30 fiscal years) should first apply the SAB 108 error quantification guidance in their regulatory reports for December 31, 2006. Bank holding companies with other fiscal years should first apply SAB 108 in their regulatory reports for the calendar quarter in 2007 that includes their fiscal year-end date, but such bank holding companies may adopt the SAB 108 guidance in their December 31, 2006, regulatory reports. For FR Y-9C reports, the cumulative effect of the initial application of SAB 108 on the opening balance of retained earnings as of the beginning of the fiscal year of initial application (i.e., as of the beginning of 2006 for bank holding companies with calendar year fiscal years) should be reported in Schedule HI-A, item 2, "Restatements due to corrections of material accounting errors and changes in accounting principles," and each error correction may be separately described in the Notes to the Income Statement—Other.

FASB Interpretation No. 48 on Uncertain Tax Positions

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), was issued in June 2006 as an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*. Under FIN 48, the term "tax position" refers to "a position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities." FIN 48 further states that a "tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets."

According to FIN 48, a bank holding company should initially recognize the effects of a tax position in its financial statements when, based on the technical merits, it is more likely than not (i.e., a likelihood of more than 50 percent) that the position will be sustained upon examination by the taxing authority, including the resolution of any related appeals or litigation. The more-likely-than-not evaluation must consider the facts, circumstances, and information available at the report date. When a tax position meets the more-likely-than-not recognition threshold, it should initially and subsequently be measured as the largest amount of tax benefit greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. FIN 48 also provides guidance on subsequent recognition, derecognition, and measurement of tax positions, including the effect of changes in judgment, and on the recognition of interest and penalties.

Bank holding companies must adopt FIN 48 for regulatory reporting purposes for fiscal years beginning after December 15, 2006. FIN 48 permits earlier adoption as of the beginning of an earlier fiscal year, provided the bank holding company has not yet issued a financial statement or filed a regulatory report for any period of that fiscal year. Because FIN 48 was issued in June 2006, i.e., after the filing of the March 31, 2006, FR Y-9C or FR Y-9LP reports, a bank holding company with a calendar year fiscal year may not adopt FIN 48 early and must begin to apply this interpretation as of January 1, 2007.

FASB Statement No. 156 on Servicing

FASB Statement No. 156, *Accounting for Servicing of Financial Assets* (FAS 156), issued in March 2006, requires all separately recognized servicing assets and liabilities to be initially measured at fair value. It then permits an entity to choose to subsequently measure each class of servicing assets and liabilities at fair value with changes in fair value recognized in earnings. If fair value is not elected, each class of servicing is subsequently accounted for using the amortization method that applied to all servicing assets and liabilities prior to the issuance of FAS 156. An entity identifies its classes of servicing assets and liabilities based on the availability of market inputs for estimating their fair value, its method for managing the risks of its servicing assets and liabilities, or both. An entity's election of the fair value option for a class of servicing is irreversible. The election can be made for an individual class of servicing assets and liabilities upon adoption of FAS 156 or at the beginning of any subsequent fiscal year.

Bank holding companies must adopt FAS 156 for FR Y-9 series reporting purposes as of the beginning of their first fiscal year that begins after September 15, 2006. Earlier adoption of FAS 156 is permitted as of the beginning of an earlier fiscal year, provided the bank holding company has not yet issued a financial statement or filed a FR Y-9 report for any period of that fiscal year. Thus, a bank holding company with a calendar year fiscal year must adopt FAS 156 as of January 1, 2007, unless it elected earlier adoption and applied FAS 156 in its originally filed March 31, 2006, FR Y-9C/FR Y-9LP, or its June 30, 2006, FR Y-9SP.

When reporting the carrying amount of mortgage servicing assets (FR Y-9C: Schedule HC-M, item 12.a; FR Y-9LP: Schedule PC, item 7.b; FR Y-9SP: included in Schedule SC, item 7) and nonmortgage servicing assets in FR Y-9C Schedule HC-M, item 12.b, bank holding companies should include all classes of servicing accounted for under the amortization method as well as all classes of servicing accounted for at fair value. The fair value of all recognized mortgage servicing assets should be reported in FR Y-9C Schedule HC-M, item 12.a.(1), regardless of the measurement method applied to these assets. The servicing asset carrying amounts reported in Schedule HC-M, items 12.a and 12.b, even if these amounts include fair values, should be used when determining the lesser of 90 percent of the fair value of these assets and 100 percent of their carrying amount for regulatory capital calculation purposes in Schedule HC-R. Changes in the fair value of any class of servicing assets to which the fair value option is applied should be included in earnings in Schedule HI, item 5.f, "Net servicing fees."

FASB Statement No. 155 on Hybrid Financial Instruments

FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments* (FAS 155),

issued in February 2006, requires bifurcation of certain derivatives embedded in interests in securitized financial assets and permits fair value measurement (i.e., a fair value option) for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation under paragraphs 12 and 13 of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133). Bifurcation is required when the economic characteristics and risks of the embedded derivative are not clearly and closely related economically to the economic characteristics and risks of the host contract and certain other conditions are met. Under the fair value option in FAS 155, a bank holding company may irrevocably elect to initially and subsequently measure an eligible hybrid financial instrument in its entirety at fair value, with changes in fair value recognized in earnings, rather than bifurcating the instrument and accounting for the embedded derivative separately from the host contract. The election can be made on an instrument-by-instrument basis, but must be supported by appropriate documentation. In addition, FAS 155 clarifies which interest-only and principal-only strips are not subject to FAS 133. For further information on embedded derivatives and FAS 133, refer to the Glossary entry for “Derivative Contracts” in the Y-9C Instructions.

For FR Y-9 series reporting purposes, FAS 155 must be applied to all financial instruments acquired, issued, or subject to a remeasurement event (as defined in the standard) occurring after the beginning of a bank holding company’s first fiscal year that begins after September 15, 2006. The fair value option may also be applied upon adoption of FAS 155 to a bank holding company’s existing hybrid financial instruments that had been bifurcated prior to adoption. Earlier adoption of FAS 155 is permitted as of the beginning of an earlier fiscal year, provided the bank holding company has not yet issued a financial statement or filed a FR Y-9 series report for any period of that fiscal year. Thus, a bank holding company with a calendar year fiscal year must adopt FAS 155 as of January 1, 2007, unless it elected earlier adoption and applied FAS 155 in its originally filed March 31, 2006, FR Y-9C/FR Y-9LP report, or in its originally filed June 30, 2006, FR Y-9SP report.

Following a bank holding company’s adoption of FAS 155, hybrid financial instruments to which the fair value option has been applied should not be reclassified as trading assets or trading liabilities for FR Y-9 reporting purposes solely due to the election of this option. Such hybrid financial instruments should continue to be reported in the asset or liability category appropriate to the instrument. If a hybrid financial instrument to which the fair value option has been applied is an available-for-sale security, it should be included in available-for-sale securities on the balance sheet (FR Y-9C: Schedule HC, item 2.b; FR Y-9LP: Schedule PC, item 2; FR Y-9SP: Schedule SC, item 2) and the security’s fair value should be reported in (FR Y-9C: columns C and D of Schedule HC-B, Securities; FR Y-9LP: Schedule PC-B, item 11.a; FR Y-9SP: Schedule SC-M, item 7.a.). Changes in the fair value of hybrid financial instruments to which the fair value option is applied should be aggregated and reported consistently in the income statement either as “Other noninterest income” (FR Y-9C: Schedule HI, item 5.i; FR Y-9LP: Schedule PI, item 1.e; FR Y-9SP: Schedule SI, item 4) or “Other noninterest expense” (FR Y-9C: Schedule HI, item 7.d; FR Y-9LP: Schedule PI, item 2.d; FR Y-9SP: Schedule SI, item 7).

The Federal Reserve is considering the regulatory capital implications of FAS 155, and more broadly, the use of the fair value option. Except as discussed below, changes in the fair value of

hybrid instruments that are recognized in earnings should be reflected in Tier 1 capital, pending further guidance from the Federal Reserve. In the interim, for a hybrid financial instrument **to which the fair value option is applied** that is an asset, the embedded derivative should not be bifurcated from the host contract for risk-based capital purposes in Schedule HC-R. For a hybrid financial instrument for which the embedded derivative is bifurcated, a bank holding company should treat the host contract and the embedded derivative separately for risk-based capital purposes. For a hybrid financial instrument to which the fair value option is applied that is a liability, a bank holding company should exclude the portion of the change in the fair value of the instrument that is attributable to a change in the bank's own creditworthiness from Tier 1 capital. For regulatory capital purposes, this excluded portion of the change in fair value is, in essence, an adjustment to the bank holding company's reported retained earnings and should be taken into account in determining the Tier 1 capital subtotal (reported in Schedule HC-R, item 8) that is used to determine the regulatory capital limits on such items as servicing assets, deferred tax assets, and credit-enhancing interest-only strips. However, as an interim measure until the Federal Reserve revises Schedule HC-R, the excluded portion of the change in fair value should be reported in item 10 of the schedule.

FASB Statement No. 123 (Revised 2004) and Share-Based Payments

FASB Statement No. 123 (Revised 2004), *Share-Based Payment* (FAS 123(R)), requires all entities to recognize compensation expense in an amount equal to the fair value of share-based payments, e.g., stock options and restricted stock, granted to employees. Bank holding companies must adopt FAS 123(R) for regulatory reporting purposes in accordance with the standard's effective date and transition provisions. Public companies other than small business issuers, including bank holding companies that are subsidiaries of such public companies, were required to adopt FAS 123(R) as of the beginning of their first fiscal year beginning after June 15, 2005. All other companies, including small business issuers and bank holding companies that are not subsidiaries of public companies, were required to adopt FAS 123(R) as of the beginning of their first fiscal year beginning after December 15, 2005. Thus, all bank holding companies with a calendar year fiscal year were required to implement FAS 123(R) as of January 1, 2006.

Under FAS 123(R), the "compensation cost for an award of share-based employee compensation classified as equity shall be recognized over the requisite service period," which is typically the same as the vesting period, "with a corresponding credit to equity (generally, paid-in capital)." The recording of the compensation cost also gives rise to deferred tax consequences, i.e., a deferred tax asset, that must be recognized (and evaluated for realizability). For FR Y-9C purposes, the compensation expense should be included in Schedule HI, item 7.a., "Salaries and employee benefits," and reported in Schedule HI, memoranda item 15, "Stock-based employee compensation expense (net of tax effects) calculated for all awards under the fair value method," with the corresponding credit included in Schedule HC, item 25, "Surplus." In Schedule HI-A, Changes in Equity Capital, this credit should be included in item 5, "Sale of perpetual preferred stock," or in item 6, "Sale of common stock." This reporting treatment applies regardless of whether the shares awarded to the employee are shares of bank stock or shares of the bank's parent holding company.

Tobacco Transition Payment Program

Bank holding companies should continue to follow guidance on the tobacco buyout program included in the FR Y-9C Supplemental Instructions for June 30, 2006, which can be accessed via the Federal Reserve's Web site
(www.federalreserve.gov/boarddocs/reportforms/supplemental/SI.FRY9.200606.pdf).

FASB Interpretation No. 46 (Revised), *Consolidation of Variable Interest Entities*

Bank holding companies should continue to follow the guidance provided on this subject in the FR Y-9C Supplemental Instructions provided for December 31, 2005. These Supplemental Instructions can be accessed via the Federal Reserve's Web site
(www.federalreserve.gov/boarddocs/reportforms/supplemental.cfm?WhichFormID=FR_Y-9C).

Reporting of Trust Preferred Securities

Bank holding companies should continue to follow the guidance provided on this subject in the FR Y-9C Supplemental Instructions provided for December 31, 2005. These Supplemental Instructions can be accessed via the Federal Reserve's Web site
(www.federalreserve.gov/boarddocs/reportforms/supplemental.cfm?WhichFormID=FR_Y-9C).

Commitments to Originate and Sell Mortgage Loans

Bank holding companies should continue to follow the guidance provided on this subject in the FR Y-9C Supplemental Instructions provided for December 31, 2005. These Supplemental Instructions can be accessed via the Federal Reserve's Web site
(www.federalreserve.gov/boarddocs/reportforms/supplemental.cfm?WhichFormID=FR_Y-9C).

Listing of Revisions

Revisions to the FR Y-9C for December 2006:

Report Form and Corresponding Instructions

- (1) *Cover page*. Updated reporting date to December 31, 2006.
- (2) *Schedule HI, item 14*. Deleted item for “Stock-based employee compensation expense (net of tax effects).”

Instructions

- (1) *Schedule HC-R, Memoranda item 2.g*. Clarified reporting treatment of credit derivative contracts.

Revisions to the FR Y-9LP for December 2006:

Report Form

Cover page. Updated reporting date to December 31, 2006.

Instructions

- (1) *Schedule PC, item 20(c)*. Clarified reporting of stock-based employee compensation expense.
- (2) *Schedule PC-A, item 1(a)(1)*. Clarified reporting of stock-based employee compensation expense.
- (3) *Schedule PC-A, item 2(a)(1)*. Clarified reporting of stock-based employee compensation expense.
- (4) *Schedule PC-A, item 3(a)(1)*. Clarified reporting of stock-based employee compensation expense.
- (5) *Schedule PC-B, item 16*. Clarified portion of notes payable that does not directly relate to the amount of trust preferred securities issued.

Revisions to the FR Y-9SP for December 2006:

Report Form

Cover page. Updated reporting date to December 31, 2006. Revised attestation language and designated the Certified Financial Officer (or individual performing this equivalent function) as the signer of the BHCs report.

Instructions

- (1) *General Instructions, Verification and Signatures*. Clarified that the report must be signed by the Chief Financial Officer (or equivalent).
- (2) *Schedule SC, item 3(a)*. Corrected cross-reference.
- (3) *Schedule SC, item 4(a)*. Clarified reporting of stock-based employee compensation expense.
- (4) *Schedule SC, item 5(a)*. Clarified reporting of stock-based employee compensation expense.
- (5) *Schedule SC, item 6(a)*. Clarified reporting of stock-based employee compensation expense.
- (6) *Schedule SC, item 11*. Clarified reporting of guaranteed long-term debt of Employee Stock Ownership Plan.
- (7) *Schedule SC, item 16(b)*. Clarified reporting of stock-based employee compensation expense.
- (8) *Schedule SC-M, Memoranda item 13*. Clarified portion of notes payable that does not directly relate to the amount of trust preferred securities issued.

Revisions to the FR Y-11/S for December 2006

Report Form

Cover page. Revised the reporting date to December 31, 2006.

**SUMMARY OF EDIT CHANGES EFFECTIVE
FOR December 31, 2006, FR Y-9C, FR Y-9LP and FR Y-9SP CHECKLISTS**

FR Y-9C

(Validity - V, Quality - Q, Intraserries - I)

Revised Edits

Quality: 6778, 7590

Deleted Edits:

Quality: 9205 (HI-Mem14)

FR Y-9LP

(Validity - V, Quality - Q, Intraserries - I, Interseries - R)

Revised Edits

Quality: 0990

FR Y-9SP

(Validity - V, Quality - Q, Intraserries - I)

New Edits:

Validity: 0030, 0035, 0075, 0205, 0210, 0215, 0220, 0225, 0230, 0360, 0450, 0455, 0465, 0470, 0475, 0482, 0483, 0484, 0485, 0495, 0505, 0525, 0538, 0540, 0545

Quality: 0605, 0615, 0675, 0778, 0782, 0784, 0805, 0920, 0924, 0926, 0930, 0932, 0940, 0952, 0954, 0959, 0970, 0972, 0982, 0986, 0988, 0991, 0992, 0994, 0996, 0998

Revised Edits:

Validity: 0535

Quality: 0985, 0990

Deleted Edits:

Validity: 0370, 0460, 0530

Quality: 0610, 0775, 0776, 0945, 0980

Renumbered Edits:

Quality EDCK 0960 was renumbered to 0968