Supporting Statement for
Bank Holding Company Report of
Insured Depository Institutions' Section 23A Transactions with Affiliates
(FR Y-8; OMB No. 7100-0126)

Summary

The Board of Governors of the Federal Reserve System, under delegated authority from the Office of Management and Budget (OMB), proposes to extend for three years, with revision, the Bank Holding Company Report of Insured Depository Institutions' Section 23A Transactions with Affiliates (FR Y-8; OMB No. 7100-0126) effective with the June 30, 2003, report date. This reporting form collects information on transactions between an insured depository institution (banks and savings associations) and its affiliates that are subject to section 23A of the Federal Reserve Act. All top-tier bank holding companies (BHCs), including financial holding companies (FHCs), file the FR Y-8 for each insured depository institution that they own. The FR Y-8 comprises a cover page, declaration page, and a one-page reporting form.

The primary purpose of the data is to enhance the Federal Reserve's ability to monitor bank exposures to affiliates and to ensure banks' compliance with section 23A of the Federal Reserve Act. Section 23A of the Federal Reserve Act is one of the most important statutes on limiting exposures to individual institutions and protecting against the expansion of the federal safety net. The Federal Reserve proposes to add one new item to enhance the Federal Reserve's ability to monitor compliance with section 23A and three new items on derivative transactions between insured depository institutions and their affiliates to assist the Federal Reserve in monitoring derivative transactions and establishing policy for regulating such transactions. The Federal Reserve also proposes to revise the instructions to reflect interpretations and definitions included in Regulation W, the rule that comprehensively implements sections 23A and 23B of the Federal Reserve Act. This new rule is effective April 1, 2003.

The total current annual burden for the FR Y-8 report is estimated to be 147,341 hours and is estimated to increase by 12,278 hours with these proposed revisions. A copy of the proposed reporting form is provided in the attachment.

Background and Justification

The Federal Reserve implemented the Report of Bank Holding Company Intercompany Transactions and Balances in March 1975 (FR Y-8) to monitor transactions between subsidiary depository institutions, the parent bank holding company, and other affiliates of the bank holding company. In 1981, the reporting frequency was changed to semiannually. Over the intervening years the reporting panel and several items were revised to reflect changing data needs.

Effective December 2000, the reporting form and instructions were completely revised to enhance the Federal Reserve's ability to monitor bank exposures to affiliates and to ensure banks' compliance with section 23A of the Federal Reserve Act. The report was retitled, "The Bank Holding Company Report of Insured Depository Institution's Section 23A Transactions with

Affiliates." The revised report required all bank holding companies, including financial holding companies, to report fourteen items of information on their insured depository institution's covered transactions with affiliates under section 23A. Bank holding companies were required to file the information on an individual basis for each of their insured depository institutions. In addition, foreign banking organizations that directly own U.S. subsidiary banks were added to the reporting panel. The reporting frequency was changed to quarterly and interim reporting of certain large asset transfers was eliminated.

Section 23A of the Federal Reserve Act is one of the most important statutes protecting against the expansion of the federal safety net (i.e., lower cost insured deposits, the payment system, and the discount window) by limiting exposures of insured depository institutions to affiliates. The Gramm-Leach-Bliley Act of 1999 (GLB Act) elevated the importance of section 23A and the need to collect information to monitor insured depository institution exposures to affiliates. The Federal Reserve strongly believes that the FR Y-8 data, collected on an individual basis for all insured depository institutions that are owned by the bank holding company, are necessary to monitor compliance with section 23A. The information requested should be available because insured depository institutions already should, on an ongoing basis, be continuously monitoring their section 23A covered transaction exposures to ensure compliance with the statute.

Description of Information Collection

Current FR Y-8

The FR Y-8 is filed quarterly by all top-tier BHCs, including FHCs, for all insured depository institutions that are owned by the BHC and by foreign banking organizations that directly own a U.S. subsidiary bank. The report is filed on an individual insured depository institution basis. Currently, the report comprises a cover page, declaration page, and a one-page report.

Bank holding companies that own insured depository institutions that do not have any covered transactions with affiliates and do not have any financial subsidiaries sign the declaration page attesting to these facts and submit the report each quarter with the cover page.

For their insured depository institutions with covered transactions with affiliates, BHCs report the following four items:

(1) For all covered transactions subject to section 23A's collateral requirements, holding companies report for each of their insured depository institutions (a) the outstanding amount of such transactions as of the report date and (b) the maximum amount of such transactions during the calendar quarter ending with the report date.

(2) For covered transactions <u>not</u> subject to the collateral requirements, holding companies report for each of their insured depository institutions (a) the outstanding amount of such transactions as of the report date and (b) the maximum amount of such transactions during the calendar quarter ending with the report date.

All transactions between insured depository institutions and financial subsidiaries of insured depository institutions are excluded from these four items. Therefore, all BHCs with an insured depository institution that have covered transactions with financial subsidiaries only, are not required to complete these four items.

In addition to these four items, holding companies with insured depository institutions that control financial subsidiaries must report ten additional items on covered transactions between the insured depository institution and financial subsidiaries and between the affiliates of the insured depository institution:

(1) For all covered transactions subject to section 23A's collateral requirements between the insured depository institution and financial subsidiaries, holding companies report for each of their insured depository institutions (a) the outstanding amount of such transactions as of the report date and (b) the maximum amount of such transactions during the calendar quarter ending with the report date.

(2) For all covered transactions not subject to section 23A's collateral requirements between the insured depository institution and financial subsidiaries, holding companies report for each of their insured depository institutions (a) the outstanding amount of such transactions as of the report date and (b) the maximum amount of such transactions during the calendar quarter ending with the report date.

(3) For purchase of, or investment in, securities issued by the financial subsidiaries of the insured depository institution by the insured depository institution, holding companies report the outstanding amount of (a) equity securities as of the report date and (b) debt securities as of the report date.

(4) For purchase of, or investment in, securities issued by the financial subsidiaries of the insured depository institution by the affiliates of the insured depository institution, holding companies report the outstanding amount of (a) equity securities as of the report date and (b) debt securities as of the report date.

(5) For loans and other extensions of credit by affiliates of the insured depository institution to the financial subsidiaries of the insured depository institution, holding companies report (a) the outstanding amount of such transactions as of the report date and (b) the maximum amount of such transactions during the calendar quarter ending with the report date.

The collection of these items is necessary to monitor compliance with the aggregate limits in section 23A and to identify institution-specific and industry-wide levels of changes in covered transaction activity and their effect on insured depository institution risk exposure. The Federal Reserve reviews the maximum amounts by types of covered transactions to monitor BHCs with high levels of various types of covered transactions and to measure the volume of covered transactions by type.

Proposed Reporting Requirements

The Federal Reserve proposes the following changes to the data items collected on the FR Y-8:

(1) Add a memoranda item to collect the maximum aggregate amount for all covered transactions included in Items 1 through 6 for any single day during the calendar quarter.

Currently, the report collects only maximum aggregate amounts for specific types of covered transactions. However, since the maximums currently collected may occur on different days during the quarter, it is impossible for the Federal Reserve to track whether an insured depository institution exceeded the 20 percent limit at any time during the quarter other than as of the report date. The collection of a single number representing the largest total end of the day amount of all covered transactions in the quarter would enhance the Federal Reserve's ability to monitor and ensure ongoing compliance with section 23A.

(2) Add three items on derivative transactions between insured depository institutions and their affiliates: 1) Positive fair value of derivative contracts between the insured depository institution and its affiliates; 2) amount of collateral pledged to the insured depository institution to secure contracts between the insured depository institution and its affiliates; and 3) notional amount of derivative contracts between the insured depository institution and its affiliates. Only insured depository institutions that engage in derivative transactions with their affiliates would complete the three items.

Under the GLB Act, the Federal Reserve Board was required to adopt, by May 12, 2001, a final rule to address as covered transactions under section 23A, the credit exposure arising from derivative transactions between insured depository institutions and their affiliates. Because of the complexities of the subject matter and the statutory deadline in the GLB Act, the Federal Reserve Board took a two-step approach to address the credit exposure arising from derivative transactions between insured depository institutions and their affiliates.

On May 11, 2001, the Federal Reserve Board published an interim final rule concurrently with proposed Regulation W (66 FR 24229) that subjected derivative transactions between insured depository institutions and their affiliates to the market terms requirement of section 23B. The interim rule also required, under section 23A, that an insured depository institution establish and maintain policies and procedures reasonably designed to manage the credit exposure arising from the insured depository institution's derivative transactions with affiliates. The interim final rule had a delayed effective date of January 1, 2002.

In October 2002, the Federal Reserve Board approved a final Regulation W that included the interim final rule on derivative transactions between insured depository institutions and their affiliates. In its *Federal Register* notice (67 FR 76560) adopting final Regulation W, the Federal Reserve Board stated:

> "The Board is not prepared at this time to subject credit exposure arising from bank-affiliate derivatives to all the requirements of section 23A. The Board continues to collect information regarding the derivatives practices of banks and believes that more time is needed to determine whether the general approach of the interim rule on bank-affiliate derivatives will suffice to prevent banks from incurring problematic levels of credit exposure to affiliates in these transactions."

Accordingly, the Federal Reserve proposes to collect additional information concerning derivative transactions between insured depository institutions and their affiliates to further assist in monitoring these transactions. The information necessary to report the proposed new items should be readily available from insured depository institutions' internal risk management reports. Moreover, effective April 1, 2003, insured depository institutions would be required by Regulation W (12 CFR 223.33) to maintain policies and procedures reasonably designed to manage the credit exposure arising from its derivative transactions with affiliates in a safe and sound manner. These policies and procedures required by Regulation W and the interim rule must at a minimum provide for monitoring and controlling the credit exposure arising at any one time from the insured depository institution's derivatives transactions with each affiliate and all affiliates in the aggregate (through, among other things, imposing appropriate credit limits, marked-to-market requirements, and collateral requirements).

The requested information on derivative transactions between insured depository institutions and their affiliates would enable the Federal Reserve to better monitor trends in intercompany derivative transactions on an aggregate basis. This information, coupled with enhanced on-site supervision of derivative transactions between insured depository institutions and their affiliates at large complex banking organization (LCBOs), should aid the Federal Reserve in evaluating whether it should continue the approach for regulating derivative transactions between insured depository institutions and their affiliates that was initially adopted in the Regulation W.

As of September 2002, an estimated 408 insured depository institutions reported derivative positions. In 2002, Federal Reserve examiners conducted a limited survey of a number of large banking organizations to ascertain their compliance with the Federal Reserve Board's interim rule on derivative transactions between insured depository institutions and their affiliates. In the course of selecting insured depository institutions for sampling, the Federal Reserve confirmed that not all insured depository institutions with derivative positions also engage in derivative transactions between insured depository institutions and their affiliates; accordingly, the Federal Reserve expects the number of respondents who need to supply this information would be less than 408.

(3) Modify the FR Y-8 cover page to allow the respondent to provide the email address of the person to whom questions about this report should be directed.

Instructions

The current reporting instructions and glossary would be revised and clarified to reflect interpretations and definitions in Regulation W. Interpretations and definitions included in Regulation W would modify the information reported in current line items and in some cases covered transactions would be reported in different line items of the report. The instructions for the FR Y-8 declaration page would be revised to (1) clarify that an insured depository institution is not required to complete page 2 or page 3 of the report if it only engaged in covered transactions that are exempt pursuant to sections 223.41 and 223.42 of Regulation W and (2) indicate that BHCs with derivative transactions between insured depository institutions and their affiliates must complete the report form.

Regulation W also applies 23A to transactions between U.S. branches and agencies of foreign bank and affiliates of the foreign bank engaged in the United States in new GLB Act activities. However, over 95% of the U.S. branches and agencies are uninsured and would not fall within the scope of this report. Consistent with current reporting requirements, foreign banks would not be required to submit a FR Y-8 for their insured U.S. branches and agencies.

Frequency

The Federal Reserve recommends that the reporting frequency of the FR Y-8 remain quarterly for all bank holding companies. Semiannual or less frequent reporting by small bank holding companies would hinder the Federal Reserve's ability to ensure compliance by smaller insured depository institutions; compliance issues arise almost as frequently in small insured depository institutions as large institutions. Regular and frequent reporting significantly enhances the Federal Reserve's ability to monitor transactions with affiliates and to detect liquidity and funding problems within an organization. Regular reporting permits off-site monitoring, consistent with the goals of the risk-focused examination approach. Reports facilitate pre-analysis work and conserve on-site examination resources for verifications of compliance and a review of pertinent issues. In addition, quarterly data lends itself to analysis with data collected on other bank holding company reports and the Call Report.

Time Schedule for Information Collection

The FR Y-8 is currently reported quarterly as of the last day of March, June, September, and December. The FR Y-8 must be submitted to the appropriate Reserve Bank within thirty days after the as-of-date. A fifteen-day extension may be given to BHCs that own banks with more than one foreign office. Data from these reports are not published.

Legal Status

The Board's Legal Division has determined that section 5(c) of the Bank Holding Company Act (12 U.S.C. 1844(c)) and section 225.5(b) of Regulation Y (12 CFR 225.5(b)) authorize the Board to require the report. The report is confidential pursuant to the Freedom of Information Act (5 U.S.C 552(b)(4) and (8)). Section (b)(4) exempts information deemed competitively sensitive from disclosure and Section (b)(8) exempts information "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions."

Consultation Outside the Agency

There has been no consultation outside the Federal Reserve System.

Sensitive Questions

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

Estimates of Respondent Burden

The following table shows the estimated annual reporting burden for the current and proposed FR Y-8 report. These BHCs vary greatly in size and number of insured depository institutions; although the largest holding companies have several insured depository institutions, the average is less than two insured depository institutions. Similarly, although the volume of section 23A transactions may be high for some insured depository institutions, a significant number of the insured depository institutions have no covered transactions and therefore, only complete the declaration page.

The Federal Reserve estimates that the proposed changes would likely increase the annual burden from 147,341 to 159,619 hours. Proposed memo item 1 in Part I is applicable to all respondents and the annual burden for reporting this item is estimated to be 10,232 hours. Based on a survey of large banking institutions, conducted by Federal Reserve examiners, there are an estimated 408 insured depository institutions with derivative positions. However, the Federal Reserve expects the number of respondents that may have to report the three proposed derivative items in Part II to be less than 408, since not all insured depository institutions with derivative positions engage in derivative transactions with their affiliates. The burden for reporting the three derivative items is estimated to be 2,046 hours annually. On average across all 5,116 respondents, the total burden would increase 36 minutes per respondent. The burden of both the current report and the proposed revised report are less than 3 percent of the total Federal Reserve System burden.

	Number of respondents	*Annual frequency*	*Estimated average hours per response*	*Estimated annual burden hours*
Current FR Y-8	5,116	4	7.2	147,341
Proposed FR Y-8	5,116	4	7.8	159,619
Change				12,278

Based on an hourly cost of $20, the annual cost to the public is estimated to be $3,192,380, an increase of $245,560.

Estimate of Cost to the Federal Reserve System

Current costs to the Federal Reserve System for collecting and processing the FR Y-8 are estimated to be $210,000 per year. Under the proposed revisions, the estimated costs will rise to $220,800 per year. The one-time costs to implement the revised report are estimated to be $39,000.