

Supporting Statement for the Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies (FR Y-12; OMB No. 7100-0300) and the Annual Report of Merchant Banking Investments Held for an Extended Period (FR Y-12A; OMB No. 7100-0300)

Summary

The Board of Governors of the Federal Reserve System, under delegated authority from the Office of Management and Budget (OMB), proposes to extend, with revision, the mandatory Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies (FR Y-12; OMB No. 7100-0300). This information collection also contains the mandatory Annual Report of Merchant Banking Investments Held for an Extended Period (FR Y-12A), which is being extended without revision. The FR Y-12 report was implemented as of September 30, 2001, in response to the Gramm-Leach-Bliley Act (GLB Act) of 1999, which broadened the scope of permissible investments in nonfinancial companies. The FR Y-12A was implemented as of December 31, 2006.

The FR Y-12 collects information from certain domestic bank holding companies (BHCs) on their equity investments in nonfinancial companies. Respondents report the FR Y-12 either quarterly or semi-annually based on reporting threshold criteria. The FR Y-12A is filed annually by institutions that hold merchant banking investments that are approaching the end of the holding period permissible under Regulation Y.

The Federal Reserve proposes the following revisions to the FR Y-12 reporting form and instructions effective March 31, 2010: (1) add one Memorandum item to Schedule A to collect data on the pre-tax impact of management fee income and (2) add two columns to Schedule D to collect data on direct investments in nonpublic entities. The Federal Reserve also proposes to clarify the FR Y-12 reporting instructions.

The total current annual reporting burden for this information collection is estimated to be 1,531 hours and would increase by 45 hours based on the proposed revisions. A draft copy of the revised FR Y-12 reporting form and instructions is attached.¹

Background and Justification

BHC investments in nonfinancial companies increased significantly during the late 1990s. These investments contributed significantly to earnings and capital at institutions actively involved in this business line. Equity investments also contributed to the volatility of earnings and capital and increased some institutions' risk profiles. The GLB Act permits financial holding companies (FHCs) to make investments in any amount, in any type of nonfinancial company as part of a securities underwriting, merchant banking or investment banking activity. The investments permissible under the GLB Act's merchant banking authority are substantially broader in scope than the investment activities otherwise permissible for BHCs. Thus, these

¹ A copy of the FR Y-12A reporting form and instructions can be found on the Board's public website at www.federalreserve.gov/reportforms/default.cfm

investments present the potential for additional volatility and risk in banking organizations' portfolios.

On January 31, 2001, the Federal Reserve and U.S. Department of Treasury (the agencies) published in the *Federal Register* a final rulemaking on merchant banking investments made by FHCs (66 FR 8466). In Section 225.175 of this final rulemaking, the agencies stated that reporting forms to fulfill the quarterly and annual reporting requirements would be published separately. The rule also noted that data may be submitted at such times as may be determined by the Board. The FR Y-12 data fulfill the quarterly reporting requirements and the FR Y-12A data fulfill the annual reporting requirements.²

The FR Y-12 data serve as an important risk-monitoring device for institutions active in this business line by allowing supervisory staff to monitor an institution's activity between review dates. They also serve as an early warning mechanism to identify institutions whose activities in this area are growing rapidly and therefore warrant special supervisory attention.

After the FR Y-12 reporting process was introduced in 2001, 41 BHCs reported, as of year-end 2001, \$45.7 billion in aggregate equity investments in nonfinancial companies. Recently, there has been some reduction in the number of BHCs and amounts they reported. As of year-end 2008, 26 BHCs reported an aggregate \$39.4 billion, reflecting the impact of bank mergers and portfolio devaluations primarily associated with the general economic downturn. This report will continue to collect vital information for the supervisory process with the inclusion of the former investment banks and unregulated financial companies.

Regulation Y implements a holding period restriction by permitting an FHC to own or control a merchant banking investment for no longer than 10 years. Merchant banking investments made in, or held through, a private equity fund, however, may be held for the duration of the fund, up to a maximum of 15 years. An FHC must obtain the Board's approval to own or control a merchant banking investment beyond these time periods.³ The FR Y-12A data continue to be a useful tool for examiners to monitor institutions that have merchant banking investments that are approaching holding period limitations. As of year-end 2008, 13 FHCs reported 112 investments through the FR Y-12A reporting process.

Description of Information Collection

The FR Y-12 collects information on the types of investments made by BHCs and their subsidiaries in nonfinancial companies (excluding investments held in trading accounts).

This report is filed quarterly by each top-tier domestic BHC that:

- files the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C; OMB No. 7100-0128), and
- has aggregate nonfinancial equity investments that equal or exceed the lesser of \$100 million (on an acquisition cost basis) or 10 percent of the BHC's consolidated tier 1 capital as of the report date, and

²The Board subsequently determined that the FR Y-12 could be submitted semiannually by FR Y-9SP filers.

³(See 12 C.F.R. §§ 225.172(b)(4); 225.173(c))

- has made an effective election to become a FHC *or* directly or indirectly has an Edge corporation, agreement corporation, or small business investment company (SBIC) subsidiary *or* holds equities under section 4(c)(6) or 4(c)(7) of the BHC Act.

This report is also filed semi-annually by each top-tier domestic BHC that:

- files the Company Only Financial Statements for Small Bank Holding Companies (FR Y-9SP; OMB No. 7100-0128), and
- has aggregate nonfinancial equity investments that equal or exceed (on an acquisition cost basis) 10 percent of the BHC's total capital as of the report date, and
- has made an effective election to become a FHC *or* directly or indirectly has an Edge corporation, agreement corporation, or SBIC *or* holds equities under section 4(c)(6) or 4(c)(7) of the BHC Act.

The current FR Y-12 reporting form comprises four schedules: Schedule A - Type of Investments, Schedule B - Type of Security, Schedule C - Type of Entity within the Banking Organization, and Schedule D – Nonfinancial Investment Transactions During Reporting Period. The information collected in each schedule is discussed below.

Schedule A – Type of Investments collects information on the acquisition cost, net unrealized holding gains not recognized as income, carrying value, and publicly quoted value for direct investments made in public entities, nonpublic entities, and all indirect investments. The memoranda items collect information on the number of companies in which investments are made for the entire portfolio, amount of investments made under the merchant banking authority, the impact on net income, and amount of investments managed for others.

Schedule B – Type of Security collects information on the acquisition cost and carrying value of the type of security held by the reporting institution: common stock, convertible debt and convertible preferred stock, other equity instruments, and total portfolio. The memorandum item collects information on unused equity commitments and warrant activity.

Schedule C – Type of Entity within the Banking Organization identifies the type of company within the BHC structure through which the investments reported in Schedules A and B are held (for example, broker/dealer, SBIC, or Edge subsidiary) and collects the information on the acquisition cost, net unrealized holding gains not recognized as income, and carrying value. The memoranda items collect information on the amount of foreign and domestic investments.

Schedule D - Nonfinancial Investment Transactions During the Reporting Period collects information on all PEMB activity of the BHC, on an aggregate basis, for the reporting period. Columns A and B collect acquisition cost and carrying value for all purchases, returns of capital, and net changes in valuation made for all direct investments. Columns C and D collect information on the same items for all transactions involving indirect (fund) investments. These data provide valuable insight into the scope of activity on a transaction basis and, when reviewed over time, provide critical trend data useful for industry studies as well as BHC supervisory monitoring.

The FR Y-12A reporting form collects:

- The name and location of the corporate entity within the FHC organization that holds the covered investment
- The date the FHC acquired the covered investment
- The name and location of the company held
- The primary activity of the company held (using the North American Industry Classification System (NAICS) Activity Codes for Commonly Reported Activities wherever possible). FHCs provide a text description of the primary activity of the company held only if it is unable to identify a five- or six-digit NAICS code corresponding to the activity
- The type of interest held by the FHC (for example, common stock, convertible bonds)
- The percentage of ownership held by the FHC (both voting and non-voting)
- The FHC's acquisition cost of the covered investment
- The value at which the covered investment currently is carried on the FHC's books
- A brief narrative explanation of the FHC's plan and schedule for disposition of a covered investment

Proposed Revisions to the FR Y-12 Reporting Form and Instructions

Schedule A - Type of Investments. The Federal Reserve proposes to add Memorandum item 5, Pre-tax impact of management fee income. This memorandum item would collect the earnings effect of management fees derived from managing investments for others, which is reflected in Memorandum item 4. The collection of these data would enhance the BHC supervisory monitoring process as they would give a clearer picture of the effect of this activity and when coupled with Memorandum item 3, would provide a better understanding of the overall earnings effect of the equity investment activity, both on- and off-balance sheet, on the BHC's income statement.

Schedule D - Nonfinancial Investment Transactions During Reporting Period. The Federal Reserve proposes to re-label current Columns C and D as E and F and insert new Columns C and D to collect acquisition cost and carrying value for all transactions involving all direct nonpublic investments. These data would provide valuable insight into the scope of activity on a transaction basis. These data would, when reviewed over time, provide critical trend data useful for BHC supervisory oversight as well as provide valuable information to facilitate industry studies. .

Reporting Instructions. The Federal Reserve proposes to add language to the General Instructions to clarify reporting of nonfinancial equity investments. Language would be added to clarify that BHCs should only exclude equity securities in a trading account that are short term in nature (namely, those that are managed or purchased with the intent to sell in relation to short-term movement in the price of the investment). This clarification would help ensure that all reporting organizations report their nonfinancial equity investments fully and consistently. The Federal Reserve also proposes to clarify the reporting of negative amounts by stating that paper filers should report negative amounts in parentheses or with a minus (-) sign and electronic filers should report negative amounts with a minus (-) sign.

Reporting Panel

The FR Y-12 reporting panel comprises a subset of top-tier domestic BHCs that file the FR Y-9C or the FR Y-9SP and meet the FR Y-12 reporting threshold criteria. A screening question on both FR Y-9 reports, developed from the FR Y-12 reporting threshold criteria, is used to determine whether the BHC is required to complete the FR Y-12. Financial Holding Companies generally have to submit an FR Y-12A if they hold merchant banking investments for longer than eight years (or 13 years in the case of an investment held through a qualifying private equity fund). The applicable reporting periods (eight or 13 years) for a merchant banking investment is less than the permissible holding periods (10 or 15 years) for the investment so that the Federal Reserve can monitor investments that are approaching the end of the holding periods generally permitted under Regulation Y.

Frequency

The Federal Reserve recommends that the quarterly (for FR Y-9C filers) and semi-annually (for FR Y-9SP filers) reporting frequency for the FR Y-12 and the annual reporting frequency for the FR Y-12A remain unchanged. The current reporting frequencies provide adequate timely data to meet the analytical and supervisory needs of the Federal Reserve.

Time Schedule for Information Collection

The FR Y-12 data are collected as of the end of each calendar quarter from those BHCs that file the FR Y-9C and as-of the end of June and December from those BHCs that file the FR Y-9SP. The FR Y-12 data are submitted to the appropriate Federal Reserve Bank within 45 calendar days after the as-of date for all FR Y-9C and FR Y-9SP respondents. The FR Y-12 filing deadlines would remain unchanged. The FR Y-12A report must be submitted by February 15 of the following calendar year to the appropriate Reserve Bank.

Legal Status

The Board's Legal Division has determined that Section 5(c) of the Bank Holding Company Act authorizes the Board to require data from BHCs to keep the Board informed of, among other things, their financial condition and risk management systems. Overall, the Board does not consider the data collected on the FR Y-12 to be confidential. However, a BHC may request confidential treatment pursuant to sections (b)(4) of the Freedom of Information Act [5 U.S.C. 552(b)(4)]. The Board considers the data collected on the FR Y-12A to be confidential pursuant to sections (b)(4) and (b)(8) of the Freedom of Information Act [5 U.S.C. 552(b)(4) and (b)(8)].

Consultation Outside the Agency and Discussion of Public Comment

The Federal Reserve conducted informal interviews with several Large Complex Banking Organizations, soliciting comment on the current version of the FR Y-12 and FR Y-12A and proposed revisions to the FR Y-12. This proposal reflects, to a large extent, the content of the feedback received.

On September 25, 2009, the Federal Reserve published a notice in the *Federal Register* (74 FR 48960) requesting public comment for 60 days on the extension, with revision, of the FR Y-12. The comment period for this notice expires on November 24, 2009.

Sensitive Questions

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

Estimate of Respondent Burden

The current total annual reporting burden for the FR Y-12 and FR Y-12A information collection is 1,531 hours. The current annual burden for the FR Y-12A report is estimated to be 91 hours and would remain unchanged. The current annual reporting burden for the FR Y-12 is estimated to be 1,440 hours. It is estimated that the proposed revisions to the FR Y-12 would increase the reporting burden for the FR Y-12 from 1,440 hours to 1,485, a net increase of 45 hours. The burden increase is primarily attributed to the revision to Schedule A, which would take approximately one hour to collect information not currently reported but usually tracked at the organizational level. The revisions to Schedule D, however, would reduce burden by 30 minutes because the direct investments data (public and nonpublic), which is typically tracked separately by the institutions, would no longer be required to be aggregated. The total burden for the FR Y-12 and FR Y-12 A represents less than 1 percent of total Federal Reserve System annual burden.

	<i>Estimated number of respondents</i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
<i>Current</i>				
FR Y-9C filers	19	4	16	1,216
FR Y-9SP filers	7	2	16	224
FR Y-12A	<u>13</u>	1	7	<u>91</u>
<i>Total</i>	39			1,531
<i>Proposed</i>				
FR Y-9C filers	19	4	16.5	1,254
FR Y-9SP filers	7	2	16.5	231
FR Y-12A	<u>13</u>	1	7	<u>91</u>
<i>Total</i>	39			1,576
<i>Change</i>				45

Based on the proposed revisions the total cost to the public is estimated to increase from the current level of \$94,386 to \$97,160.⁴

Estimate of Cost to the Federal Reserve System

The cost to the Federal Reserve System for collecting and processing these reports is estimated to be 29,300. The one-time cost to implement the revised report is estimated to be \$6,800.

⁴Total cost to the public was estimated using the following formula: percent of staff time, multiplied by annual burden hours, multiplied by hourly rate (30% Administrative or Junior Analyst @ \$25, 45% Managerial or Technical @ \$55, 15% Senior Management @ \$100, and 10% Legal Counsel @ \$144). Hourly rate estimates for each occupational group are averages using data from the Bureau of Labor and Statistics (BLS), Occupational Employment and Wages 2007, www.bls.gov/news.release/ocwage.nr0.htm Occupations are defined using the BLS Occupational Classification System, www.bls.gov/soc/