

**Supporting Statement for
Semiannual Report of Derivatives Activity
(FR 2436; OMB No. 7100-0286)**

Summary

The Board of Governors of the Federal Reserve System, under delegated authority from the Office of Management and Budget, proposes to extend for three years, with revision, the Semiannual Report of Derivatives Activity (FR 2436; OMB No. 7100-0286). This voluntary report collects derivatives market statistics from eight large U.S. dealers of over-the-counter (OTC) derivatives. Data are collected on notional amounts and gross market values of the volumes outstanding of broad categories of foreign exchange, interest rate, equity- and commodity-linked OTC derivatives contracts across a range of underlying currencies, interest rates, and equity markets.

This collection of information complements the ongoing triennial Survey of Foreign Exchange and Derivatives Market Activity (FR 3036; OMB No. 7100-0285). The FR 2436 collects similar data on the outstanding volume of derivatives, but not on derivatives turnover. The Federal Reserve conducts both surveys in coordination with other central banks and forwards the aggregated data furnished by U.S. reporters to the Bank for International Settlements (BIS), which publishes global market statistics that are aggregations of national data.

The Federal Reserve proposes to revise the FR 2436 by adding a table to collect data on credit default swaps, effective with the December 31, 2004, report date. Given the very rapid growth of credit derivatives in recent years, the G-10 central banks determined that data on credit default swaps should be collected semiannually. The current estimated annual burden for this report is 1,600 hours. The proposed estimated annual burden for this report is 2,400 hours, an increase of 800 hours. A draft copy of the proposed reporting form and instructions is attached.

Background and Justification

In January 1997, the Governors of the Central Banks of the Group of Ten Countries (G-10) approved a proposal by the Euro-currency Standing Committee (now called the Committee on the Global Financial System) to collect data on global derivatives activity from leading dealers, beginning at the end of June 1998. The Yoshikuni group, a working group of the Euro-currency Standing Committee, developed the reporting framework in a July 1996 report. The report outlined the derivatives market statistics that would be useful to central banks for oversight of global financial markets. They based the report design on the Common Minimum Framework that was developed and released jointly by the Basel Committee on Banking Supervision and the Technical Committee of the International Organization of Securities Commissions (IOSCO) in May 1995. The report also outlined the methodological considerations for collecting and aggregating these data. For example, the working group developed techniques to avoid double counting in the calculation of global market size statistics and fleshed out the level of detail required in data collection efforts.

The report design draws on the results of the April 1995 triennial Central Bank Survey of Foreign Exchange and Derivatives Activity. This survey was the first major coordinated effort by the G-10 central banks to collect data on global derivatives activity. The semiannual FR 2436 was designed to complement the triennial FR 3036, using the same format for reporting derivatives positions outstanding on both reports. This procedure avoids duplication of effort for institutions participating in both data collections and improves the comparability of the data collected by the two reports. Furthermore, the Federal Reserve uses the FR 3036 data to monitor the growth of the derivatives activities at dealers not participating in the FR 2436 panel and to update the FR 2436 panel as necessary to maintain coverage of the vast majority of global derivatives activities.

The purpose of the FR 2436 is to obtain comprehensive and internationally consistent information on the size and structure of the OTC derivatives markets. The statistics are useful to the Federal Reserve, other central banks, and other parties who monitor patterns of activity in financial transactions. Due to the global nature of derivatives activity, only the cooperative efforts of central banks can generate the statistics required for effective monitoring of this activity. The Federal Reserve's involvement in this international reporting program, therefore, is necessary to ensure the availability of statistics necessary for oversight of international financial markets. The FR 2436 provides comprehensive and consistent measures of global derivatives market size and participation not currently available from other sources.

Description of Information Collection

The panel of derivatives dealers provides data on outstanding positions (notional, gross positive and gross negative market values) with breakdowns by market risk category, product type, counterparty type, maturity, and underlying currency or equity market. As well, they provide data on the gross market value of the entire portfolio, before and after netting.

Notional amounts outstanding. A sum of notional amounts outstanding provides a means of approximating the scale and character of market transactions, in much the same manner as a sum of principal amounts provides for the cash market. Allocating notional amounts outstanding to market risk, currency, instrument, maturity, and counterparty categories provides greater insight into the exposures to price risks transferred between contracting parties. Additionally, regularly published data on notional amounts enhance market transparency and permit market participants to compare, over time, the size and composition of their derivatives activities with those taking place in the market as a whole.

Gross positive and negative market values. Gross market value figures show the magnitude of unsettled changes in value of derivatives contracts outstanding at the time of reporting. Semiannual reporting produces a series of changes in gross market value over time. Such a time series is a valuable source of information for researchers and market participants in developing an understanding of the role and function of derivatives markets in financial systems in various circumstances.

The 1995 global survey of derivatives markets found small net market value positions in derivatives for reporting U.S. dealers. The average net market value as a percentage of the total market value for foreign exchange and interest rate derivatives contracts with customers, foreign dealers, and non-reporting dealers was 1 percent. These positions were interpreted as showing that derivatives dealers had not taken large net exposures in meeting customer demands in derivatives. The availability of a time series of semiannual data on market values provides a means to better assess the risk intermediation services that are being offered by dealers as a group.

Furthermore, gross market values can be used as one measure of market size; they show, at a given point in time, the amount of risk that is transferred using derivatives contracts. Although, this measure requires summing the gross positive market values of *all* market participants (not just of reporters), the gross positive market value of non-reporting firms can be captured by measuring the negative market value of reporting firms' contracts with non-reporting firms. Thus, market size statistics based on gross market value can be constructed while maintaining a limited reporting population.

As indicated, the outstandings data collected on the FR 2436 are disaggregated several ways.

Market risk categories: foreign exchange and gold derivatives, single-currency interest rate derivatives, and equity-linked and commodity derivatives

Product types: forward contracts, swaps, and bought and sold OTC options

Counterparty types: reporting dealers, other financial institutions, and non-reporting financial institutions.

Remaining maturities: one year or less, over one year through five years, and over five years

Currency or equity market: Data for foreign exchange and single-currency interest rate contracts are reported by currency for each G-10 currency, as well as for any additional currency for which a material amount of contracts is outstanding. Data on equity-linked derivatives are reported in the six categories: U.S., Japanese, European (excluding emerging markets in Eastern Europe), Latin American, Other Asian, and Other.

Proposed Revisions

The Federal Reserve proposes to collect data on credit default swaps as part of an international effort by the G-10 central banks. The rapid growth and size of the credit derivatives market has increased the interest of the Federal Reserve and other central banks in comprehensive data on credit default swap activity. The credit default swaps data would be collected on new Tables 4A through 4D, while existing Table 4 and Table 5 would be re-numbered as Table 5 and Table 6, respectively.

The Federal Reserve proposes to collect data on outstanding positions (notional, gross positive and gross negative market values) of credit default swap contracts for protection bought and protection sold by instrument type and counterparty type. Distinguishing between protection bought and protection sold is of interest because it gives some indication of how credit default swaps are used to shift credit risk among market participants. Additionally, notional values of credit default swap contracts would be reported by rating category of the underlying reference entity, sector of the underlying reference entity, and remaining contract maturity.

Instrument types would be disaggregated into single-name and multiple-name instruments.

Counterparty types would be disaggregated into reporting dealers, other financial institutions, and nonreporting financial institutions. In addition, other financial institutions would be further disaggregated into:

- banks and securities firms
- insurance, reinsurance, and financial guaranty firms
- special purpose entities
- hedge funds
- other

This finer disaggregation of counterparty types, as compared to the disaggregation for other types of OTC derivatives, would enable central banks and other data users to get a clearer picture of how credit default swaps transfer credit risk within the global financial system.

Notional values would be further disaggregated by the credit rating of the underlying reference entity, by the sector of the underlying reference entity, and by remaining maturity of outstanding credit default swap contracts.

Table 4A-Credit Default Swaps by Rating Category. Data would be disaggregated into upper investment grade (AA and higher), lower investment grade (A and BBB), non investment grade (BB and lower), and not rated. Information on the credit rating of the reference entity would give central banks and other data users a clearer picture of the nature and amount of credit risk that is being transferred in the credit default swap market.

Table 4B-Credit Default Swaps by Sector of the Reference Entity. Data would be disaggregated into financial firms, nonfinancial firms, sovereigns, and multiple sectors (for multiple-name instruments). Information on the sector of the reference entity would give central banks and other data users a clearer picture of the nature of the credit risk that is being transferred in the credit default swap market.

Table 4C-Credit Default Swaps by Remaining Contract Maturity. Data would be disaggregated into one year or less, over one year through five years, and over five years.

Table 4D-Credit Default Swaps, Gross Positive and Gross Negative Market Values. Data would show the magnitude of unsettled changes in value of credit default swap contracts

outstanding at the time of reporting. Such a time series is a valuable source of information for researchers and market participants in developing an understanding of the role and function of the credit default swap market in financial systems in various circumstances.

Reporting Panel

The reporting panel, together with reporters from other reporting countries, represents approximately 90 percent of total global activity in each of the major categories of derivatives. Firms were selected as potential reporters based on the size of their derivatives positions reported in the April 1995 triennial derivatives market survey. Since then, one additional reporter has agreed to participate in the survey. Eight U.S. institutions participate in the current reporting panel: Bank of America, Bank One, Citigroup, Goldman Sachs, JP Morgan Chase, Lehman Brothers, Merrill Lynch, and Morgan Stanley Dean Witter.

Frequency

Respondents file the FR 2436 semiannually, as of the close of business each June 30 and December 31.

Time Schedule for Information Collection and Publication

Data are submitted to the Federal Reserve Bank of New York within sixty days of the as-of dates, June 30 and December 31 each year. After editing the data, the Federal Reserve Bank of New York sends the aggregated data to the BIS and to the Board. The BIS compiles the data from reporting U.S. institutions with those from the approximately seventy additional reporters from other G-10 countries and constructs and publishes global derivatives market statistics. The Securities and Exchange Commission receives copies of the reports from the reporting securities firms.

When the G-10 central banks approved this information collection, they anticipated that respondents would fully automate the preparation of the FR 2436 and that the due date could be shortened to one month. At this time, it is still difficult for some U.S. reporters to file their responses in sixty days. However, the G-10 central banks would still like to change the reporting due date to thirty days at some time in the future.

Legal Status

The Board's Legal Division has determined that this report is authorized by law [12 U.S.C. §§ 248(a)(2) and 353-359] and is voluntary. Individual respondent data are regarded as confidential under the Freedom of Information Act [5 U.S.C. §552(b)(4)].

Consultation Outside the Agency

The Federal Reserve consulted with other G-10 central banks on the details of the data to be collected.

Estimate of Respondent Burden

The current annual reporting burden for this report is estimated to be 1,600 hours, as shown in the table below. The proposed revisions would increase the estimated average hours per response from 100 hours to 150 hours. This change would increase the estimated annual burden to 2,400 hours, a net increase of 800 hours. This represents less than 1 percent of total Federal Reserve burden for all reports.

	<i>Number of respondents</i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
Current	8	2	100	1,600
Proposed	8	2	150	2,400
Change				800

Based on an hourly cost of \$20, the estimated annual reporting cost to the public would increase from \$32,000 to \$48,000.

Sensitive Questions

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

Estimate of Cost to the Federal Reserve System

The cost of collecting and processing the data is absorbed by the Regulatory Reports Division of the FRBNY. The current cost associated with the FR 2436 is \$100,000 per year. The division anticipates the proposed changes would not significantly increase the current operating cost.