

**Supporting Statement for  
Semiannual Report of Derivatives Activity  
(FR 2436; former 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; former OMB No. 7100-0286). This voluntary report collects derivatives market statistics from the five largest U.S. dealers of over-the-counter (OTC) derivatives. Data are collected on the notional amounts and gross market values of the volumes outstanding of broad categories of foreign exchange, interest rate, and 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 collecting additional data on credit default swaps (CDS). The large size of the credit derivatives market and the important role that credit derivatives play for financial institutions in managing their credit risk have increased the need for more detailed comprehensive data on CDS activity. As a result, the central banks of the Group of Ten Countries (G-10) would like to collect additional data on CDS from their important derivatives dealers and report the aggregate data to the BIS (so that more detailed global statistics can be assembled). The proposed revisions would be implemented in two phases in order to balance the need for additional information quickly against the burden associated with implementing changes relatively rapidly. Phase 1 would be effective with the June 30, 2010, report date and Phase 2 would be effective with the June 30, 2011, report date. The current estimated annual burden for this report is 1,500 hours. The annual burden for the revised report is estimated to be 2,100 hours, an increase of 600 hours.<sup>1</sup> 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 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.

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<sup>1</sup> The number of respondent for this information collection is less than 10 per year and therefore not subject to the Paperwork Reduction Act.

They based the report design on the Common Minimum Framework that was developed and released jointly by the Basle 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.

Beginning in December 2004, the Federal Reserve began collecting 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 increased the interest of the Federal Reserve and other central banks in comprehensive data on credit default swap activity.

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.

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, 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 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 nonreporting firms can be captured by measuring the negative market value of reporting firms' contracts with nonreporting firms. Thus, market size statistics based on gross market value can be constructed while maintaining a limited reporting population.

## 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 broad market risk category, product type, counterparty type, maturity, and specific underlying market risks—the currency, equity market, or reference entity that underlie the contract. In addition, reporters provide data on the gross market value of the entire portfolio, before and after netting.

**Notional amounts outstanding (Tables 1A, 2A, 3A, 4A, 4B, 4C, and 5).** Respondents should report the notional value. The notional value of the derivative contract is the underlying principal (or par) amount upon which cash flow or the exchanges of assets are settled.

**Gross positive and negative market values (Tables 1B, 1C, 2B, 2C, 3B, 3C, 4D, and 6).** Respondents report as market value the amount at which a contract could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for a contract, respondents report the number of trading units of the contract multiplied by that market price. If a quoted market price is not available, respondents report their best estimate of market value based on the quoted market price of a similar contract or on valuation techniques such as discounted cash flow.

Table 6 collects both gross and net market values. Respondents report information on credit exposures and liabilities arising from OTC derivatives contracts (excluding commodity contracts). Respondents report the gross market value of these contracts, as well as their net market value, which takes into account any legally enforceable bilateral netting agreements. By taking netting agreements into account, net market values represent the amounts that reporting dealers would owe to or be owed by their counterparties, if all contracts were to settle on the report date.

**Additional detail.** With the exception of Table 6, the tables listed above collect the following additional detail on the notional amounts and gross positive and negative market values of outstanding derivatives contracts.

*Broad market risk categories:* Foreign exchange rate, gold price, interest rate, equity, commodity, and credit.

*Product types:* Forward contracts, swaps, and bought and sold OTC options. However, credit derivatives data are collected on only one type of product, credit default swaps, which are broken out into single-name and multiple-name instruments.

*Counterparty types:* Reporting dealers, other financial institutions, and nonfinancial institutions. For credit default swaps, other financial institutions are further broken out into (1) banks and securities firms, (2) insurance, reinsurance, and financial guaranty firms, and (3) other. This finer disaggregation of counterparty types gives central banks and other data users a clearer picture of how credit default swaps transfer credit risk within the global financial system.

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

*Underlying market risks:* 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. Two currencies are reported for each foreign exchange contract. Data on equity derivatives are reported in six categories according to the region of the referenced equity market: U.S., Japanese, European (excluding emerging markets in Eastern Europe), Latin American, Other Asian, and Other. Data on the notional amounts of credit default swaps are reported by characteristics of the reference entity: whether it is a sovereign or not, and whether its credit rating is investment grade, sub-investment grade, or it is unrated.

*Protection bought and sold:* For credit default swaps, data are reported according to whether the contract buys or sells credit protection. 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.

### **Proposed Revisions**

The Federal Reserve proposes to collect additional data on CDS as part of an international effort by the G-10 central banks. The large size of the credit derivatives market and the important role that credit derivatives play for financial institutions in managing their credit risk have increased the need for more detailed, global data on CDS activity. The CDS data would be collected on Tables 4A through 4H: tables currently labeled 4A through 4D would be expanded and four new tables would be added.

The Federal Reserve proposes to collect additional detail on the product type, reference entities, counterparty type, and counterparty credit exposure of outstanding CDS contracts. The Federal Reserve is interested in greater detail on two types of credit derivative products: (1) index CDS, because this product type has reportedly grown considerably in importance, and (2) synthetic collateralized debt obligations, because of the complexity of the product (which has caused problems for investors during the current financial crisis) and because comprehensive data are not available on this product. The Federal Reserve is interested in more detail on reference entities because it would provide a clearer picture of the nature of the credit risk that is

being transferred in this very large market.<sup>2</sup> The Federal Reserve's interest in obtaining more detail on counterparty type and counterparty credit exposure arises because of the role that counterparty credit risk played in the recent financial crisis. In addition, counterparty type informs about the redistribution of credit risk using CDS and counterparty credit exposure illuminates the credit risk that directly stemming from using CDS.

The Federal Reserve proposes to implement the revisions to the report in two phases in order to balance the Federal Reserve's interest (and that of staff of other G-10 central banks) in having additional information as soon as possible against the burden associated with implementing changes with a relatively short lead time. The data items selected for reporting in Phase 1 were viewed as easiest to implement by U.S. reporters. In Phase 1, effective with the June 2010 report date, the existing four tables (4A through 4D) would be expanded to include additional detail on types of counterparties to CDS contracts. In addition, a new table on index CDS (a type of multi-name CDS) would be added. In Phase 2, effective with the June 2011 report date, two of the existing tables would be further expanded to include the additional detail on reference entities and three new tables would be added to collect information on the location of the head office of the counterparty, counterparty credit exposure, and synthetic collateralized debt obligations. Details of each phase are provided below.

#### *Phase 1 Revisions*

**Table 4A: Credit Default Swaps by Remaining Maturity, Table 4B: Single-Name Credit Default Swaps by Rating Category, and Table 4C: Single-Name Credit Default Swaps by Sector of the Reference Entity.** Central counterparties and the additional detail on the counterparty type of other nonreporting financial institutions would be added to the tables. Counterparty types would be expanded by adding central counterparties and by further disaggregating other nonreporting financial institutions into hedge funds, special purpose entities, and other.<sup>3</sup>

**Table 4D: Multi-Name Credit Default Swaps, of which Contracts that are Index Products.** Index CDS bought and sold, disaggregated by the expanded counterparty type, would be included as a new table. Product types would be consistent with the other tables by disaggregating the notional amounts of multiple-name CDS into index CDS.

**Table 4E: Credit Default Swaps, Gross Positive and Gross Negative Market Values.** Current Table 4D would be re-numbered 4E and central counterparties and the additional detail on the counterparty type of other nonreporting financial institutions would be added to the table consistent with the Tables 4A through 4C.

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<sup>2</sup> At year-end 2008, the notional amount of credits on which protection was purchased through CDS was \$41.9 trillion, globally. The gross market value of this credit protection was \$5.7 trillion. Source: BIS OTC derivatives statistics, which can be found at <http://www.bis.org/statistics/otcder/dt1920a.pdf>.

<sup>3</sup> A list of central counterparties would be provided to reporters.

*Phase 2 Revisions*

**Table 4B: Single-Name Credit Default Swaps by Rating Category.** The finer disaggregation of the rating of the reference entity would be added to the table and this disaggregation would be reported for all CDS, single-name CDS, and multi-name CDS. Specifically, the investment-grade rating category would be disaggregated into two categories: “AAA and AA” and “A and BBB.” The table would be renamed Credit Default Swaps by Rating Category.

**Table 4C: Single-Name Credit Default Swaps by Sector of the Reference Entity.** The finer disaggregation of the sector of the reference entity would be added to the table and this disaggregation would be reported for all CDS, single-name CDS, and multi-name CDS. The table would be renamed Credit Default Swaps by Sector of the Reference Entity. The non-sovereign sector would be disaggregated into financial firms, nonfinancial firms, asset-backed securities (ABS), and multiple sectors (to be reported when the sector of the reference entity is too difficult to identify because it is a multi-name instrument covering multiple sectors).

**Table 4E: Credit Default Swaps by Location of Counterparty Credit.** This new table would collect the notional amount of CDS bought and sold by the location of the head office of the counterparty, which would be disaggregated into the United States, Japan, Western Europe, Latin America, other Asian countries excluding Japan, all other countries, and reporting dealers in the United States.<sup>4</sup>

**Table 4F: Credit Default Swaps, Gross Positive and Gross Negative Market Values.** Phase 1 Table 4E would be relabeled Table 4F.

**Table 4G: Counterparty Credit Exposure from Credit Default Swaps.** This new table would collect, by the expanded counterparty type, the net positive and net negative fair values of CDS contracts—where CDS contracts are netted against other CDS contracts with which the reporter has a legally enforceable netting agreement. Specifically, the net positive fair value of CDS contracts (which is the reporter’s credit exposure to counterparties) and net negative fair value of CDS contracts (which is counterparties’ credit exposure to the reporter)—where CDS contracts are netted against other CDS contracts with counterparties which the reporter has a legally enforceable netting agreement—would be collected by counterparty type.

**Table 4H: Synthetic Tranched Structured Finance Instruments.** In Phase 2, this new table would collect the notional amounts of outstanding synthetic tranched structured finance instruments bought and sold.

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<sup>4</sup> Western Europe would be defined to consist of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

## **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. Originally, firms were selected as potential reporters based on the size of their derivatives positions reported in the June 1995 triennial derivatives market survey. The appropriateness and coverage of the reporting panel is periodically re-evaluated, using data from the most recent FR 3036. Currently, five U.S. institutions participate in the reporting panel.

## **Frequency**

Respondents file the FR 2436 semiannually, as of the close of business each June 30 and December 31. The current reporting frequency provides adequate timely data.

## **Time Schedule for Information Collection and Publication**

Data are submitted to the Federal Reserve Bank of New York (FRBNY) within 75 days of the as-of dates, June 30 and December 31 each year. After editing the data, FRBNY staff sends the aggregated data to the BIS and sends reporter-level and aggregated data to the Board. The Federal Reserve uses the reporter-level data to compute aggregated concentration statistics, which it sends to the BIS. The BIS compiles the aggregated data and the concentration statistics from U.S. institutions with those from the approximately 50 additional reporters from other G-10 countries and constructs and publishes global derivatives market statistics. Data from the reporting securities firms can be shared with the Securities and Exchange Commission.

The Board follows the retention requirements for reports set forth by an agreement with the National Archives and Records Administration on March 28, 2001. Accordingly, Reserve Bank staff should retain reports for the current year plus three years.

## **Legal Status**

The Board's Legal Division has determined that this report is authorized by law (12 U.S.C. §§ 225a, 248(a), 348(a), 263, 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**

For the renewal of this information collection, the Federal Reserve consulted with other G-10 central banks on the details of the data to be collected. The Federal Reserve also consulted with each reporting institution about the feasibility and reporting burden of the proposed additional data items.

## Estimate of Respondent Burden

The current annual reporting burden for this information collection is estimated to be 1,500 hours, as shown in the table below. The proposed revisions in Phases 1 and 2 combined would increase the estimated annual burden to 2,100 hours, a net increase of 600 hours.<sup>5</sup> The burden increase is attributed to the proposed additional data items, which would increase the estimated average hours per response from 150 hours to 210 hours. The total burden represents less than 1 percent of total Federal Reserve paperwork burden for all reports.

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	<i>Number of respondents</i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
Current	5	2	150	1,500
Proposed	5	2	210	<u>2,100</u>
<i>Change</i>				600

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The total cost to the public is estimated to be \$84,750 and would increase to \$118,650.<sup>6</sup>

## 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.

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<sup>5</sup> The bulk of this increase is attributed to the proposed revisions in Phase 2.

<sup>6</sup> Total cost to the public was estimated using the following formula. Percent of staff time, multiplied by annual burden hours, multiplied by hourly rate: 10% Clerical @ \$25, 80% Managerial or Technical @ \$55, and 10% Senior Management @ \$100. Hourly rate estimates for each occupational group are averages using data from the Bureau of Labor and Statistics (BLS), Occupational Employment and Wages 2007, <http://www.bls.gov/news.release/ocwage.nr0.htm> Occupations are defined using the BLS Occupational Classification System, <http://www.bls.gov/soc/>