

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 for three years, without revision, the mandatory Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies (FR Y-12; OMB No. 7100-0300). In addition, the Federal Reserve proposes to implement a companion reporting form, the mandatory Annual Report of Merchant Banking Investments Held for an Extended Period (FR Y-12A), effective December 31, 2006. Finally, the Federal Reserve proposes to clarify the FR Y-12 instructions.

These collections of information are designed to collect data that will help the Federal Reserve monitor the equity investment activities of top-tier domestic bank holding companies (BHCs), including the merchant banking investments of financial holding companies (FHCs), and to monitor holding periods of merchant banking investments. The proposed FR Y-12A would provide the Federal Reserve with data concerning merchant banking investments that are approaching the end of the holding period permissible under Regulation Y. The FR Y-12A reporting panel would ordinarily be a subset of FR Y-12 filers. An FHC that meets the reporting criteria would complete a separate FR Y-12A for each covered investment that it owns, controls, or holds as of December 31 of the relevant calendar year. The current total annual burden is estimated to be 1,824 hours and would increase to 1,929 hours with the new report. A copy of the proposed reporting form and instructions is attached.

Background and Justification

BHC investments in nonfinancial companies increased significantly in the years preceding and immediately after the passage of the Gramm-Leach-Bliley Act of 1999 (GLB Act), but have stabilized over the past few years. These investments contributed significantly to earnings and capital at certain 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 expanded the scope of permissible nonfinancial investments by BHCs that have made an effective election to become an FHC. The investments permissible under the GLB Act's merchant banking authority are substantially broader in scope than the investment activities otherwise permissible for BHCs. These investments may be illiquid or have other characteristics that make their disposition problematic, thereby posing potentially increased risk to the FHC and its depository institution affiliates. Thus, these investments present the potential for additional volatility and risk in banking organizations' portfolios. The Bank Holding Company Act (BHC Act) and the Federal Reserve's implementing regulations generally allow FHCs to hold their merchant banking investments for up to ten years, although investments held through certain qualifying private equity funds may be held up to fifteen years. On January 31, 2001, the Federal Reserve Board and U.S. Department of Treasury

(the agencies) published in the *Federal Register* a final rulemaking and promulgated regulations that took effect February 12, 2001, on merchant banking investments made by FHCs.¹

The FR Y-12 collects data from certain domestic BHCs on their equity investments in nonfinancial companies on four schedules: Type of Investments, Type of Security, Type of Entity within the Banking Organization, and Nonfinancial Investment Transactions during Reporting Period. The FR Y-12 data serve as an important risk-monitoring device for institutions active in this business line by allowing the Federal Reserve to monitor an institution's activity between review dates. It also serves as an early warning mechanism to identify institutions whose activities in this area are growing rapidly and therefore warrant special supervisory attention.

The data collected on the proposed FR Y-12A would allow the Federal Reserve to monitor merchant banking investments made by FHCs that are approaching the end of the relevant ten-year or fifteen-year holding period. These investments may be illiquid or have other characteristics that make it difficult for the FHC to dispose of the investments on a reasonable basis. The data collected on the proposed FR Y-12A would provide the Federal Reserve with information concerning these aging investments and the FHC's plan for disposing of the investments.

Description of Information Collection

The FR Y-12 collects data on the types and amounts of investments made by BHCs and their subsidiaries in nonfinancial companies (excluding investments held in trading accounts) through a variety of investment authorities. The FR Y-12 collects data concerning investments in nonfinancial companies held by: (i) BHCs under section 4(c)(6) of the BHC Act (which allows BHCs to acquire up to 5 percent of the voting securities of any type of company), (ii) FHCs under the merchant banking authority, and (iii) BHCs and their bank subsidiaries through small business investment companies (SBICs).

The 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 the Reporting Period. The data collected in each schedule is discussed below.

Schedule A – Type of Investments collects data 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 only, nonpublic entities, and all indirect investments (i.e. investments held through pooled investment vehicles). The memoranda items collect data on the number of companies in which investments are made, investments made under the merchant banking authority, the impact on net income, and investments managed for others.

Schedule B – Type of Security collects data 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 memoranda items

¹ 66 FR 8,466; 12 CFR 225.170-.176.

collect data on unused equity commitments and whether the BHC holds any warrants received in connection with equity investment 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). Columns A, B, and C collect the acquisition cost, the net unrealized holding gains not recognized as income, and the carrying value of these investments, respectively. The memoranda items collect data on foreign and domestic investments.

Schedule D - Nonfinancial Investment Transactions during the Reporting Period collects data on all nonfinancial equity investment 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 the same data items for all transactions involving indirect (fund) investments.

The FR Y-12 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

The FR Y-12 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.

Data are collected from a BHC that meets the above requirements and has made either an effective election to become an FHC *or* directly or indirectly has an Edge corporation, agreement corporation, SBIC, or that holds equities under section 4(c)(6) or 4(c)(7) of the BHC Act, or holds equities in a nonfinancial company under section 24 of the Federal Deposit Insurance Act. A screening question on both of these FR Y-9 reporting forms, developed from the FR Y-12 reporting threshold criteria, is used to determine whether the BHC is required to complete the FR Y-12.

Proposed Implementation of FR Y-12A

The Federal Reserve proposes to implement the Annual Report of Merchant Banking Investments Held for an Extended Period (FR Y-12A). As noted above, the reporting form is intended to provide the Federal Reserve with data concerning merchant banking investments that are approaching the end of the holding period permissible under Regulation Y. An FHC generally would have to submit a FR Y-12A if it holds a merchant banking investment for longer

than eight years (or thirteen years in the case of an investment held through a qualifying private equity fund).

The proposed FR Y-12A would comprise a cover page and a one-page reporting form. The cover page would collect the reporter's name, street, and mailing addresses as well as a contact name and mailing address. In addition, an executive officer would be required to sign and date the cover page to indicate that the data have been reviewed for accuracy.

The FR Y-12A would collect:

- 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 would 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 (e.g., 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 that the covered investment currently is carried at on the FHC's books
- A brief narrative explanation of the FHC's plan and schedule for disposition of a covered investment

The FR Y-12A reporting panel would ordinarily be a subset of FR Y-12 filers. It is possible that a BHC that no longer meets the FR Y-12 reporting threshold criteria would still hold older private equity investments approaching the end of the holding period permissible under Regulation Y. Although FR Y-12A reporting would be triggered two years prior to expiration of the regulatory holding period, it is envisioned that filings should be relatively rare because regulatory holding periods exceed those that are customary for participants conducting merchant banking activities.

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 semiannually from those BHCs that file the FR Y-9SP. The FR Y-12 data are submitted to the appropriate Federal Reserve Bank within forty-five 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-12 data are not routinely published.

An FHC that meets the reporting criteria would complete a separate FR Y-12A for each covered investment that it owns, controls, or holds as of December 31 of the relevant calendar year. An FHC, however, may complete one FR Y-12A cover page when reporting multiple covered investments. In a multi-tiered organization with one or more FHCs, only the top-tier FHC would complete the FR Y-12A, which would be prepared on a consolidated basis. The

report must be submitted by February 15 of the subsequent calendar year to the appropriate Federal Reserve Bank. The FR Y-12A data would not be published.

Consultation Outside the Agency

On August 31, 2006, the Federal Reserve published a notice in the *Federal Register* (71 FR 51828) requesting public comment for sixty days on the extension, without revision, of the Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies and the implementation of the Annual Report of Merchant Banking Investments Held for an Extended Period. The comment period for this notice expired on October 30, 2006, and the Federal Reserve received two comment letters. An FHC commented on the Federal Reserve Board and U.S. Department of Treasury regulations concerning Merchant Banking Holding Periods that went into effect February 12, 2001; however, the comment was outside the scope of the proposal. An FHC requested two modifications to the FR Y-12 instructions concerning warrants, their acquisition cost, and the potential difficulty in determining their fair value. As a result, the Federal Reserve clarified definition of warrants in the Glossary. This same FHC suggested re-titling FR Y-12 Schedule D, data item 1; however, the Federal Reserve did not accept this suggestion. On December 22, 2006, the Federal Reserve published a final notice in the *Federal Register* (71 FR 77022).

Sensitive Questions

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

Legal Status

The Board's Legal Division has determined that Section 5(c) of the BHC Act authorizes the Federal Reserve to require the FR Y-12 from BHCs to keep the Federal Reserve informed of, among other things, their financial condition and risk management systems. The Federal Reserve also may require the filing of the proposed FR Y-12A in order to help the Federal Reserve monitor compliance by FHCs with the restrictions on merchant banking investments.

Overall, the Federal Reserve does not consider the data in the four schedules in the FR Y-12 to be confidential. However, a BHC may request confidential treatment pursuant to sections (b)(4) and (b)(8) of the Freedom of Information Act.² Section (b)(4) provides exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." Section (b)(8) exempts matters that are "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."

The Federal Reserve, however, generally considers that data that would be collected on the FR Y-12A would be confidential on the basis that disclosure of specific commercial or financial data relating to investments held for extended periods of time could result in substantial harm to the competitive position of the FHC. If, for any reason, the Federal Reserve believes

² 5 U.S.C. §§552(b)(4) and (b)(8).

that particular FR Y-12A data cannot be withheld from disclosure, the Federal Reserve would inform the respondent of its views and give the respondent an opportunity to object as required under the Board’s Rules Regarding Availability of Information.³

Estimate of Respondent Burden

The current annual reporting burden for the FR Y-12 is estimated to be 1,824 hours, as shown in the table below. The Federal Reserve anticipates that only 50 percent of holding companies with merchant banking investments would hold the investments for an extended period, requiring the submission of the FR Y-12A. In recognition of the possibility that data for the proposed FR Y-12A would not be centralized, the Federal Reserve estimates the time required to collect, assemble, and disclose the FR Y-12A data would average seven hours per respondent. The total burden for the FR Y-12 and proposed FR Y-12A 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>
Current				
FR Y-9C filers	27	4	16	1,728
FR Y-9SP filers	3	2	16	<u>96</u>
<i>Current Total</i>				1,824
Proposed				—
FR Y-9C filers	27	4	16	1,728
FR Y-9SP filers	3	2	16	96
FR Y-12A	15	1	7	<u>105</u>
<i>Proposed Total</i>				1,929
<i>Change</i>				105

The proposed total cost to the public is estimated to be \$110,435.⁴

Estimate of Cost to the Federal Reserve System

Current cost to the Federal Reserve System for collecting and processing the FR Y-12 data is estimated to be \$36,741 per year. The one-time cost to implement and the ongoing cost to process the proposed FR Y-12A report are estimated to be immaterial; therefore, the cost estimate would remain unchanged.

³ 12 CFR 261.15.

⁴ Total cost to the public was estimated using the following formula. Percent of staff time, multiplied by annual burden hours, multiplied by hourly rate: 95% Managerial or Technical @ \$55.00 and 5% Senior Management @ \$100.00. Hourly rate estimates for each occupational group are averages using data from the Bureau of Labor and Statistics, *Occupational Employment and Wages*, news release.